

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Criteria for Reassertion of Jurisdiction Over the Gathering Services of Natural Gas Company Affiliates Docket No. PL05-10-000

ORDER TERMINATING PROCEEDING AND CLARIFYING POLICY

(Issued February 15, 2007)

1. In September 2005, the Commission issued a Notice of Inquiry (NOI)¹ to evaluate possible changes in the criteria set forth in *Arkla Gathering Service Co.*² for determining when the Commission may assert Natural Gas Act (NGA) jurisdiction over the gathering activities of a gathering affiliate of a natural gas pipeline to guard against abusive practices by the affiliated companies. In *Arkla*, the Commission held that gathering affiliates of interstate pipelines are generally exempt from the Commission's NGA jurisdiction. However, the Commission also held that “if an affiliated gatherer acts in concert with its pipeline affiliate in connection with the transportation of gas in interstate commerce and in a manner that frustrates the Commission's effective regulation of the interstate pipeline, then the Commission may look through, or disregard, the separate corporate structures and treat the pipeline and gatherer as a single entity.”³
2. In *Williams Gas Processing – Gulf Coast Company, L.P. v. FERC*,⁴ the United States Court of Appeals for the District of Columbia Circuit vacated and remanded

¹ 112 FERC ¶ 61,292 (2005).

² *Arkla Gathering Service Co.*, 67 FERC ¶ 61,257, at 61,871 (1994), *order on reh'g*, 69 FERC ¶ 61,280 (1994), *reh'g denied*, 70 FERC ¶ 61,079 (1995), *reconsideration denied*, 71 FERC ¶ 61,297 (1995) (collectively, *Arkla*), *aff'd in part and reversed in part*, *Conoco Inc. v. FERC*, 90 F.3d 536 (D.C. Cir. 1996) (*Conoco*).

³ *Arkla*, 67 FERC at 61,871.

⁴ *Williams Gas Processing-Gulf Coast Co., L.P. v. FERC*, 373 F.3d 1335 (D.C. Cir. 2004) (*Williams Gas Processing*).

Commission orders, in which the Commission had sought to reassert jurisdiction over certain affiliated gathering activities under the criteria set forth in *Arkla*. The court held that the Commission had not met its own test under *Arkla* for reassertion of jurisdiction. In light of the court's holding that the circumstances presented by the *Williams Gas Processing* case did not satisfy the *Arkla* test, the Commission determined to explore whether that test should be modified. To assist this reevaluation of the *Arkla* test, the Commission issued the NOI, asking parties to submit comments and respond to a number of specific questions. After carefully reviewing the comments, the Commission has determined not to change its current policies with respect to affiliated gatherers, although we do clarify the existing *Arkla* test.

I. Statutory and Regulatory Backdrop

3. Section 1(b) of the NGA gives the Commission jurisdiction over (1) transportation of natural gas in interstate commerce, (2) sales in interstate commerce of natural gas for resale,⁵ and “natural gas companies”⁶ engaged in such transportation or sales. However, section 1(b) exempts “gathering of natural gas” from Commission jurisdiction. The Commission uses the “primary function” test to determine whether a facility is devoted to jurisdictional interstate transportation or non-jurisdictional gathering of natural gas.⁷ Under that test, the Commission relies on various physical characteristics of the facilities to determine their jurisdictional status.

4. Before Order No. 436,⁸ interstate natural gas pipelines generally did not perform transportation-only or gathering-only services. Rather, they used all their facilities,

⁵ The Wellhead Decontrol Act of 1989 removed all first sales from Commission jurisdiction.

⁶ Section 2(6) of the NGA defines “natural-gas company” as “a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale.”

⁷ The Commission first articulated the primary function test in *Farmland Industries, Inc.*, 23 FERC ¶ 61,063 (1983). The Commission subsequently modified the test in *Amerada Hess Corp.*, 52 FERC ¶ 61,268 (1990).

⁸ *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 436, 50 Fed. Reg. 42,408 (Oct. 18, 1985), FERC Stats. & Regs. ¶ 30,665 at 31,554 (1985), *vacated and remanded*, *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988), *readopted on an interim basis*, Order No. 500, 52 Fed. Reg. 30,334 (Aug. 14, 1987), FERC Stats. & Regs. ¶ 30,761

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including any gathering facilities they owned, to provide a bundled transportation and sale for resale service, for which they charged a single bundled rate. The United States Supreme Court held that the gathering exemption did not foreclose the Commission from reflecting “the production and gathering facilities of a natural gas company in the rate base and determining the expenses incident thereto for the purpose of determining the reasonableness of the [bundled] rates subject to its jurisdiction.” *Colorado Interstate Natural Gas Co. v. FPC*, 324 U.S. 581, 603 (1954). See *Conoco, Inc. v. FERC*, 90 F.3d 536, 545 (D.C. Cir. 1996).

A. Order Nos. 436 and 636

5. In Order No. 436, the Commission initiated its open access transportation program, under which shippers can obtain a transportation-only service from the pipeline, and purchase their gas from third parties. As part of Order No. 436, the Commission adopted a regulation requiring that the rates for open access transportation service “separately identify cost components attributable to transportation, storage, and gathering costs.”⁹ In *Northern Natural Gas Co.*,¹⁰ a pipeline seeking authorization to perform open access transportation service stated that it intended to charge its customers separate rates for any gathering services it provided in connection with open access transportation

service. However, the pipeline contended that NGA section 1(b) prevented the Commission from requiring those rates to be set forth in its tariff or determining the lawfulness of those rates. The Commission rejected this contention.

6. The Commission pointed out that NGA section 4(a) provides:

(1987), *remanded*, *American Gas Ass’n v. FERC*, 888 F.2d 136 (D.C. Cir. 1989), *readopted*, Order No. 500-H, 54 Fed. Reg. 52,344 (Dec. 21, 1989), FERC Stats. & Regs. ¶ 30,867 (1989), *reh’g granted in part and denied in part*, Order No. 500-I, 55 Fed. Reg. 6,605 (Feb. 26, 1990), FERC Stats. & Regs. ¶ 30,880 (1990), *aff’d in part and remanded in part*, *American Gas Ass’n v. FERC*, 912 F.2d 1496 (D.C. Cir. 1990), *cert. denied*, 498 U.S. 1084 (1991).

⁹ 18 C.F.R. § 284.8 (d)(1) (1986). That regulation is now found at 18 C.F.R. § 284.10(c)(1) (2006).

¹⁰ 43 FERC ¶ 61,473 (1988), *order on reh’g*, 44 FERC ¶ 61,384 (1988).

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 the Commission, and all rules and regulations *affecting or pertaining to* such rates or charges, shall be just and reasonable [emphasis added].

7. In addition, section 5(a) similarly provides that when the Commission finds that any rate charged by a natural gas company “in connection with” jurisdictional transportation or sales is unjust and unreasonable, or finds that any rule, regulation, or practice affecting such rate is unjust and unreasonable, the Commission may modify it. The Commission concluded that these provisions “require the Commission to determine the rates, rules, and regulations not only for the actual transportation or sales subject to the Commission's jurisdiction, but also for other services performed in connection with or ancillary to such transportation and sales,”¹¹ including gathering. The United States Court of Appeals for the Eighth Circuit affirmed this decision.¹²

8. When pipelines first implemented Order No. 436, they generally continued to bundle gathering service within their stand-alone open access transportation service. Thus, even though the pipelines separately identified their gathering costs in their rates for open access transportation service, shippers still had to purchase a bundled gathering/transportation service. However, in the 1989 Rate Design Policy Statement,¹³ the Commission stated its preference for a full unbundling of gathering services from transportation, so that shippers would only pay for the services they actually used.¹⁴ While Order No. 636¹⁵ only mandated pipelines to unbundle their sales service from their

¹¹ *Northern Natural Gas Co.*, 43 FERC at 62,160.

¹² *Northern Natural Gas Co. v. FERC*, 929 F.2d 1261 (8th Cir. 1991).

¹³ *Interstate Natural Gas Pipeline Rate Design*, 47 FERC ¶ 61,295, at 62,059 (1989).

¹⁴ See also *Panhandle Eastern Pipeline Co.*, 57 FERC ¶ 61,264, at 61,840 (1991) (Opinion No. 369), *order on reh'g*, 59 FERC ¶ 61,244, at 61,853 (1992) (Opinion No. 369-A).

¹⁵ *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation, and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636, 57 Fed. Reg. 13,267 (Apr. 16, 1992), FERC Stats. and Regs. Regulations Preambles (January 1991 - June 1996) ¶ 30,939 (Apr. 8, 1992),
(continued...)

transportation service, Order No. 636-A restated the Commission's strong preference for fully unbundled gathering services with separately charged rates, consistent with the Rate Design Policy Statement.¹⁶ Ultimately, most pipelines with gathering facilities did unbundle their gathering services, either in their Order No. 636 restructuring proceedings or in rate cases.¹⁷

9. In the Order No. 636 restructuring proceedings, the Commission continued to require pipelines performing gathering services to include a statement of their gathering rates in their tariff. The Commission also required that the pipeline's tariff include a statement that its gathering service is non-discriminatory, not unduly preferential, and not inconsistent with the terms and conditions applicable to its Part 284 open access service. However, the Commission did not further exercise its authority over the terms and conditions of gathering services by requiring such pipelines to include a full gathering rate schedule in their tariffs, similar to the separate rate schedules required for jurisdictional service such as firm and interruptible transportation service.¹⁸

B. The Arkla Policy and Conoco Inc. v. FERC

10. In the aftermath of Order No. 636, a number of pipelines determined that it would be advantageous in the new regulatory environment either to “spin down” their gathering

order on reh'g, Order No. 636-A., 57 Fed. Reg. 36,128 (Aug. 12, 1992), FERC Stats. and Regs. Regulations Preambles (January 1991 - June 1996) ¶ 30,950 (Aug. 3, 1992), *order on reh'g*, Order No. 636-B, 57 Fed. Reg. 57,911 (Dec. 8, 1992), 61 FERC ¶ 61,272 (1992), *notice of denial of reh'g*, 62 FERC ¶ 61,007 (1993), *aff'd in part, vacated and remanded in part*, *United Dist. Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *order on remand*, Order No. 636-C, 78 FERC ¶ 61,186 (1997).

¹⁶ Order No. 636-A, at 30,609. *See also El Paso Natural Gas Co.*, 60 FERC ¶ 61,109, at 61,353, 61,355 (1992), *order on reh'g*, 61 FERC ¶ 61,173, at 61,633-5 (1992).

¹⁷ *See, e.g.*, Opinion No. 369, 57 FERC at 61,841; Opinion No. 369-A, 59 FERC at 61,853; *Columbia Gas Transmission Corp.*, 64 FERC ¶ 61,060, at 61,517 (1993); *National Fuel Gas Supply Corp.*, 62 FERC ¶ 61,200, at 62,445 (1993).

¹⁸ *Natural Gas Gathering Services Performed by Interstate Pipelines and Interstate Pipeline Affiliates – Issues Related to Rates and Terms and Conditions of Service*, 65 FERC ¶ 61,136, at 61,689 (1993); *Williams Natural Gas Co.*, 64 FERC ¶ 61,165, at 62,432 (1993).

facilities to corporate affiliates or “spin off” the facilities to unrelated third parties. In February 1994, the Commission held a public conference to explore the issues raised by these filings.¹⁹ After receiving written comments following the conference, the Commission determined to establish its policy concerning the spin down of gathering facilities to an affiliate of a natural gas company in the individual pending cases, including *Arkla*²⁰ and several companion orders issued the same day.

11. First, the Commission addressed the issue of the extent of its jurisdiction to regulate the rates, terms, and conditions of gathering services performed by affiliates of natural gas companies. The Commission held that it generally lacks jurisdiction over affiliates that perform only a gathering service. The Commission recognized that the Eighth Circuit had confirmed in *Northern Natural v. FERC*, that under NGA sections 4 and 5 the Commission may regulate gathering services provided by “natural gas companies” “in connection with” their jurisdictional transportation services. However, the Commission pointed out that NGA section 2(6) defines a jurisdictional “natural gas company” as a person engaged in the transportation or natural gas in interstate commerce or the sales of such gas in interstate commerce for resale. Interstate pipelines are, of course, such natural gas companies. The Commission then held:

However, companies that perform only a gathering function, whether they are independent or affiliated with an interstate pipeline, are not natural gas companies because they neither transport natural gas in interstate commerce, nor sell such gas in interstate commerce for resale. Therefore, the Commission does not have jurisdiction over such companies whether they are independent or affiliated with an interstate pipeline.²¹

¹⁹ *Natural Gas Gathering Services Performed by Interstate Pipelines and Interstate Pipeline Affiliates – Issues Related to Rates and Terms and Conditions of Service*, 65 FERC ¶ 61,136 (1993).

²⁰ 67 FERC ¶ 61,257, *order on reh’g*, 69 FERC ¶ 61,280, *reh’g denied*, 70 FERC ¶ 61,079, *reconsideration denied*, 71 FERC ¶ 61,297, *aff’d in part and reversed in part*, *Conoco*, 90 F.3d 536.

²¹ 67 FERC at 61,871. The Commission also observed that, “although the Eighth Circuit’s decision contained a footnote that might be construed to the contrary, the issue of whether the Commission has similar jurisdiction over pipeline-affiliated gatherers was not before that Court. We do not believe that that sections 4 and 5 of the NGA nor the holding in *Northern* support the view that the Commission has jurisdiction over rates for gathering services that are ‘in connection with’ interstate gas transportation if those

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12. Despite concluding that it generally lacked jurisdiction over affiliates performing only a gathering function, the Commission stated that it “can exert control over the gathering activities of affiliated gatherers in particular circumstances where such action is necessary to accomplish the Commission's policies for the transportation of natural gas in interstate commerce.” The Commission then set forth the following standard for asserting jurisdiction over an affiliated gatherer:

If an affiliated gatherer acts in concert with its pipeline affiliate in connection with the transportation of gas in interstate commerce and in a manner that frustrates the Commission's effective regulation of the interstate pipeline, then the Commission may look through, or disregard, the separate corporate structures and treat the pipeline and gatherer as a single entity, *i.e.*, a single natural gas company. In so doing, the Commission would regulate the gathering activities as it would if the gathering facilities were owned directly by an interstate pipeline.²²

13. The Commission then further explained its standard for asserting jurisdiction as follows:

The types of affiliate abuses which would trigger the Commission's authority to disregard the corporate form would be limited to abuses arising specifically from the interrelationship between the pipeline and its affiliate. That is, a complainant would have to allege that the pipeline would benefit by certain actions taken by the affiliate in conjunction with its affiliated pipeline. Such actions might include the affiliate's giving preferences to market affiliate gas or tying gathering service to the pipeline's jurisdictional transmission service; the pipeline's giving transportation discounts only to those utilizing the affiliate's gathering service; and actions resulting in cross-subsidization between the affiliate's gathering rates and the pipeline's transportation rates. Although an affiliate could undertake other types of anti-competitive activities, the Commission's jurisdiction would be implicated only where the abuse is directly related to the affiliate's unique relationship with an interstate pipeline. Except where the Commission finds that a pipeline and its gathering affiliate should be treated together as a single “natural gas company,” the affiliated gatherer would be subject to

services are not provided by a natural gas company.” *Id.*

²² *Id.*

state, not Federal jurisdiction.²³

14. In *Arkla*, the Commission held that, in order to implement a proposal to spin down gathering facilities to an affiliate, the pipeline must file an application under NGA section 7(b) to abandon any of the gathering facilities for which it had received a certificate. In addition, the Commission held that, because the pipeline's termination of its gathering services was a change of service subject to the Commission's jurisdiction under NGA section 4, the pipeline must make a section 4 filing to terminate its gathering services for both the certificated and uncertificated facilities.²⁴ The Commission held that these filings would give it an opportunity to take several actions to protect shippers, in addition to its reservation of the right to assert jurisdiction over an affiliated gatherer in the circumstances discussed above.

15. First, the Commission stated it would require the pipeline to include non-discriminatory and equal access provisions in its tariff.²⁵ Second, as clarified on rehearing, the Commission required the pipeline to file a default gathering contract continuing existing rates for two years, which its affiliate had to offer to the pipeline's existing gathering customers. The Commission held that such a default contract was necessary to ensure continuity of service for the existing customers who had a reasonable expectation of a continuation of regulated service. Accordingly, without the default contract, the Commission could not find any section 7 abandonment or section 4 termination of service to be in the public interest and just and reasonable.²⁶

16. In addition to the pipeline's filings to implement the spin-down, the entity acquiring the assets typically files a request for a declaratory order declaring that the facilities are non-jurisdictional gathering facilities. The Commission evaluates both those

²³ *Id.*

²⁴ *Arkla*, 69 FERC at 62,082-3.

²⁵ The required tariff provisions state that the pipeline: (1) will provide nondiscriminatory access to all sources of supply, (2) will not give shippers of its gathering affiliate undue preferences over shippers of non affiliated gatherers, and (3) will not condition or tie its agreement to provide transportation service to an agreement by the producer, customer, end-use or shipper relating to any service in which its gathering affiliate is involved.

²⁶ *Arkla*, 69 FERC at 62,081-5.

requests for declaratory orders and pipeline requests to abandon certificated gathering facilities pursuant to its primary function test.

17. In one of the companion orders to *Arkla*, the Commission held that, in determining whether to approve a spin down proposal, it would not consider whether the customers of spun down facilities would have competitive alternatives.²⁷ Rather, the Commission would approve spin down proposals, where application of the primary function test showed that the facilities were gathering, and the pipeline complied with the tariff language and default contract conditions. The Commission stated that, because the NGA does not give it jurisdiction to regulate affiliated gatherers, the existence or absence of competition is irrelevant to whether or not the Commission will regulate affiliated gatherers. The Commission pointed out that the comments filed in response to its notice revealed that “a significant part of the gathering industry, perhaps as much as 70 percent, is performed by unregulated independent gatherers,” and “many customers of such gatherers are captive to a single gatherer, *i.e.*, there is no competition for gathering services.”²⁸ Nevertheless, the NGA only authorizes the Commission to regulate gathering performed by natural gas companies, *i.e.* pipelines, in connection with jurisdictional transportation service. The Commission also found that the comments suggested that abuse of market power was not a significant problem, because customers of unregulated independent gatherers had found ways to prevent excessive rates²⁹ and there are various state and federal antitrust laws that could be invoked. The Commission concluded that the existence of competition is not particularly relevant to a decision to allow a pipeline to abandon its gathering facilities and, to the extent it was relevant, the excessive effort to assess it would be unwarranted where customers have recourse to other remedies.

18. The United States Court of Appeals for the District of Columbia Circuit reviewed the Commission’s *Arkla* orders in *Conoco, Inc. v. FERC*, 90 F.3d 536 (D.C. Cir. 1996). The court affirmed the Commission's holding that it generally lacks jurisdiction over affiliates that perform only a gathering service and thus are not natural gas companies as defined in NGA section 2(6). The court stated, “Section 1(b) contemplates that some measure of authority over gathering should be reserved to the states, and jurisdiction over

²⁷ *Mid Louisiana Gas Co.*, 67 FERC ¶ 61,255, at 61,850-1 (1994), *order on reh’g*, 69 FERC ¶ 61,303, at 62,168-9 (1994).

²⁸ *Id.* at 61,851.

²⁹ The Commission gave the example of gathering customers threatening to build bypass facilities.

companies whose sole business is gathering is a permissible place to start.”³⁰ With regard to the Commission’s reservation of the right to reassert jurisdiction in certain circumstances, the court stated:

As an abstract matter, we have no reason to doubt the Commission's conclusion that a non-jurisdictional entity could act in a manner that would change its status by enabling an affiliated interstate pipeline to manipulate access and costs of gathering.³¹

19. However, the court stated that, because the Commission had not yet sought to exercise such authority, it could not speculate as the specific circumstances under which such a reassertion of authority would be justified.

20. The court reversed the Commission’s requirement that the pipeline file a default contract as a condition for approval of a spin-down, finding that the Commission had not identified any source of authority to impose that condition. The court explained,

Where an activity or entity falls within NGA § 1(b)’s exemption for gathering, the provisions of NGA §§ 4, 5, and 7, including the “in connection with” language of §§ 4 and 5, neither expand the Commission's jurisdiction nor override § 1(b)’s gathering exemption. . . . Because the Commission concluded that the facilities to be transferred by NorAm Gas were exempt under § 1(b) as gathering facilities, and that NorAm Gas’ independently operated affiliate gatherer was not a “natural gas company” subject to the NGA, the Commission cannot simply assert authority over the facilities and the affiliate by invoking other sections of the Act.³²

C. OCSLA

21. Section 5(e) of the Outer Continental Shelf Lands Act (OCSLA) authorizes the Secretary of Interior to grant rights of way through submerged lands on the Outer Continental Shelf (OCS) for purposes of transporting natural gas, upon the condition that the pipeline will transport natural gas produced in the vicinity of the pipelines in such proportionate amounts as the Commission, in consultation with the Secretary of Energy,

³⁰ *Conoco*, 90 F.3d at 547.

³¹ *Id.* at 549.

³² *Id.* at 553.

may determine to be reasonable. Section 6(e)(1) provides that every permit, right-of-way, or other grant of transportation authority must require that the pipeline be operated in accordance with various competitive principles. These include that the pipeline must provide open and nondiscriminatory access to both owner and non-owner shippers. Section 6(e)(2) provides that the Commission may exempt pipelines that feed into a facility where gas is first collected from the required competitive principles of subparagraph 1.

22. In 2002, the Commission issued Order No. 639,³³ adopting regulations requiring companies providing natural gas transportation services, including gathering, on the OCS to periodically file information with the Commission concerning their pricing and service structures. The Commission relied on the OCSLA as providing the necessary authority for these regulations, and stated that the required information would assist it in determining whether OCS transportation services conform to the open access requirements of the OCSLA. In Order No. 639-A, the Commission recognized that it had generally relied only on the NGA to regulate offshore natural gas facilities and services. However, the Commission stated that, as offshore exploration and development had evolved, it had grown beyond our ability to regulate by relying exclusively on the NGA. The Commission further stated that approximately half of offshore gas infrastructure was now considered gathering and thus excluded from its NGA jurisdiction. In these circumstances, the new OCSLA reporting requirements were needed to ensure compliance with the OCSLA's competitive principles.

23. In *Williams Companies v. FERC*, 345 F.3d 910 (D.C. Cir. 2003)(*Williams Companies*), the D.C. Circuit affirmed a District Court decision vacating the rules adopted by Order No. 639 as exceeding the Commission's authority under the OCSLA. The court held that the OCSLA does not provide the Commission a general power to enforce the OCSLA open access provisions, but only assigns the Commission a few well-defined tasks. When the Commission issues certificates pursuant to NGA section 7, it

must include the open access conditions required by OCSLA section 6(f)(1). However, the court held that the OCSLA provided for the Secretary of Interior to enforce those conditions, not the Commission.

³³ *Regulations under the Outer Continental Shelf Lands Act Governing the Movement of Natural Gas on Facilities on the Outer Continental Shelf*, Order No. 639, 65 Fed. Reg. 20,354 (Apr. 17, 2000), III FERC Stats. & Regs. ¶ 31,097 (2000), *order on reh'g*, Order No. 639-A, 65 Fed. Reg. 47,294 (Aug. 2, 2000), III FERC Stats. & Regs. ¶ 31,103 (2000), *order denying clarification*, 93 FERC ¶ 61,274 (2000).

D. Shell Offshore Inc. v. Transco and the Williams Gas Processing Remand

24. Transco filed an application for abandonment in which it proposed to spin-down roughly 22 miles of its North Padre Island pipeline facilities on the OCS, which were originally functionalized as transmission, to its affiliate, Williams Field Services (WFS). The application was accompanied by WFS's petition to declare the facilities gathering upon their acquisition by WFS. Over protests, the Commission approved the abandonment and granted the petition, declaring the facilities to be gathering upon completion of the sale, which occurred on December 1, 2001.³⁴

25. Prior to the spin-down Transco had charged Shell Offshore Inc. (Shell) \$0.08/Dth to transport Shell's gas the 230-mile distance from the interconnect with Shell's production facilities to one of Transco's mainline pooling points. After the spin-down, Shell not only paid Transco the \$0.08 transportation rate, WFS also demanded that it pay WFS an additional \$0.08/Dth for transporting Shell's gas 3.08 miles from the connection with Shell's production facilities on what had become WFS's facilities to the interconnection with Transco's transmission facilities. Shell chose to shut in its production rather than pay double the rate it had been paying Transco alone for the same transportation service.

26. Shell filed a complaint against Transco and its affiliates, and the Commission set the complaint for hearing before an ALJ. In affirming the ALJ's Initial Decision, the Commission adopted the ALJ's finding that Transco and WFS, in effectuating the spin-down, met the *Arkla* test. Treating Transco and WFS as a single entity because of their concerted actions, the Commission found that their behavior frustrated the Commission's regulation of Transco by requiring Shell to execute a gathering agreement that included an exorbitant gathering rate and anticompetitive conditions, such as a life-of-reserves commitment tying Shell's production to the Transco facilities for the life of the reserves. The Commission also found that WFS's actions violated the OCSLA. The Commission then imposed a just and reasonable rate of \$0.0169/Dth for gathering services on the spun-down North Padre facilities.

27. On rehearing, in attempting to rebuff arguments that the Commission did not properly apply the *Arkla* test, the Commission clarified that it viewed the *Arkla* test as being simply a circumvention test. That is, the Commission could reassert jurisdiction based on its finding that Transco created the "illusion of a separate gathering entity to evade the Commission's regulations," thus permitting "WFS to extract money that

³⁴ *Transcontinental Gas Pipe Line Corp.*, 96 FERC ¶ 61,115 (2001), *reh'g denied*, 103 FERC ¶ 61,177 (2003).

Transco, as a natural gas company, providing both services alone, could not.”³⁵ The Commission denied requests for rehearing, describing the spin-down as “a sham ... designed to circumvent the Commission’s regulation.”³⁶

28. WFS filed a petition for review of the Commission’s orders³⁷ with the U.S. Court of Appeals for the District of Columbia. On July 13, 2004, the court vacated and remanded the Commission’s orders in *Williams Gas Processing – Gulf Coast Company, L.P. v. FERC*.³⁸ The court rejected both of the Commission’s statutory bases for reasserting jurisdiction – the NGA and the OCSLA. At the heart of the court’s findings with respect to the Commission’s NGA jurisdiction is its determination that the Commission misapplied the *Arkla* test. First, the court found that the Commission failed to show that the narrow kinds of abuses that would trigger a reassertion of jurisdiction had occurred. The court stated that *Arkla* permits a reassertion of jurisdiction in circumstances “limited to” abuses “directly related to the affiliate’s unique relationship with an interstate pipeline,” such as “tying gathering service to the pipeline’s jurisdictional transmission service,” or “cross-subsidization between the affiliate’s gathering rates and the pipeline’s transmission rates.”³⁹ Thus, under *Arkla*, the court found that “[o]nly those types of activities – where the affiliate is leveraging its relationship with the pipeline to enhance its market power – would ‘trigger the Commission’s authority to disregard the corporate form and treat the pipeline and its affiliate as a single entity.’”⁴⁰ The court found that WFS’s actions fell outside this category. The court found that the gathering affiliate’s affiliation with the pipeline was “utterly irrelevant to its ability to charge high rates, or to impose onerous conditions for gathering service.”⁴¹ Instead, the affiliate “could do these things for one reason only – because it was a recently deregulated monopolist in the North Padre gathering market.”⁴²

³⁵ *Id.* at P 7.

³⁶ 103 FERC ¶ 61,177 at P 7.

³⁷ 100 FERC ¶ 61,254 (2002), *reh’g denied*, 103 FERC ¶ 61,177 (2003).

³⁸ *Williams Gas Processing*, 373 F.3d 1335.

³⁹ *Id.* at 1342.

⁴⁰ *Id.* (citing *Arkla*, 67 FERC at 61,871).

⁴¹ *Id.* at 1342.

⁴² *Id.*

It observed that WFS was charging the same rates and service conditions that any non-affiliate gatherer could demand in the OCS and, thus, was not “leveraging” its unique relationship with Transco.

29. Second, the court found that the Commission, in piercing the corporate veil to treat WFS and Transco as a single entity in a “sham” transaction (the spin-down), analyzed the elements of the *Arkla* test out of sequence: “it adopts as its first premise (WFS is Transco) the *Arkla Gathering* test’s ultimate conclusion – that corporate form may be set aside.”⁴³ Under *Arkla*, the rationale for reasserting “in connection with” jurisdiction is that the concerted behavior between the two entities (*i.e.*, the regulated pipeline and the affiliated non-jurisdictional gathering affiliate) has frustrated the Commission’s ability to regulate the *pipeline* (not the gatherer). By treating WFS and Transco as a single entity, the Commission “could thus attribute the gatherer’s alleged malfeasance to the pipeline, and apply the pipeline’s regulatory requirements to the gatherer.”⁴⁴ The court found error, because “Only when the Commission finds both concerted action between a jurisdictional pipeline and its gathering affiliate and that the concerted action frustrates the Commission’s effective regulation of the pipeline, may it then pierce the corporate veil and treat the legally distinct entities as one.”⁴⁵

30. The court also rejected the Commission’s finding that WFS’ actions warranted application of the OCSLA’s open access and nondiscrimination prohibitions to set a just and reasonable gathering rate. Describing an argument made on appeal that the Commission simply was enforcing the open access and non-discrimination conditions in Transco’s tariff as *post hoc* rationalization, the court observed that the Commission’s assertion of OCSLA jurisdiction over WFS based on the *Arkla* test “is nowhere present in either the Order or the Order on Rehearing.”⁴⁶ It left open for another day the broader question of whether the Commission may ever assert jurisdiction over gas gatherers, whether affiliated with a pipeline or not.

31. On remand, the Commission found that, based on the record in the proceeding and the court’s interpretation of the Commission’s precedent, the Commission lacked

⁴³ *Id.* at 1343.

⁴⁴ *Id.*

⁴⁵ *Id.* (citing *Arkla*, 67 FERC at 61,871).

⁴⁶ *Id.* at 1345.

sufficient basis to reassert NGA jurisdiction or to assert OCSLA jurisdiction over the gathering rates and services of WFS's North Padre Island gathering facilities.⁴⁷ On rehearing, Shell contended that the Commission should modify the *Arkla* test, and grant relief based on the revised test. The Commission denied rehearing on the ground that the case had been fully litigated based on the existing test. However, the Commission concurrently issued a notice of inquiry to evaluate possible changes in the *Arkla* test. Thirteen comments have been filed. The commenters include (1) producers,⁴⁸ (2) providers of gathering services, and (3) interstate pipelines.⁴⁹ No local distribution companies, state regulatory Commissions, or other representatives of natural gas consumers filed comments.

II. Comments

32. Several of the producer commenters⁵⁰ contend that the Commission should modify the *Arkla* test so that the Commission can reassert jurisdiction when: (a) the gatherer's facilities are connected to an affiliate's transportation facilities, and (b) the gatherer frustrates the Commission's effective regulation of interstate transportation. They

⁴⁷ *Shell Offshore Inc. v. Transcontinental Gas Pipe Line Corp.*, 110 FERC ¶ 61,254, *order on reh'g*, 112 FERC ¶ 61,293 (2005).

⁴⁸ The following producers submitted comments: Natural Gas Supply Association (NGSA); Independent Petroleum Association of America (IPAA); Producer Coalition (Producer Coalition); Shell Offshore, Inc. (Shell Offshore); and Indicated Shippers (Indicated Shippers). Indicated Shippers include: BPAmerica Production Company, BP Energy Company, ExxonMobil Gas & Power Marketing Company, Chevron U.S.A. Inc., Marathon Oil Company and Shell Offshore Inc).

⁴⁹ The following gathering providers and/or pipelines submitted comments: Williams Midstream Gas and Liquids (Williams); ONEOK Field Services Company (ONEOK); Western Gas Resources, Inc. (Western); Duke Energy Field Services, Inc. (Duke); Enterprise Products Partners, L.P. (Enterprise); Enbridge Energy Partners, L.P. and Enbridge, Inc. (Enbridge); Williston Basin Interstate Pipeline Company (Williston); and Interstate Natural Gas Association of America (INGAA).

⁵⁰ Shell Offshore and Indicated Shippers.

contend that such frustration may occur when the gathering affiliate charges an excessive price for gathering, since that effectively allows the corporate family to charge excessive rates for the entire transportation path, including over the pipeline itself. These producers further contend that there is a problem with offshore gathering notwithstanding the limited number of complaints to date. They assert that pipelines are waiting for final resolution of the Commission's jurisdiction. Spin-downs and spin-offs create the potential for abuse because they involve existing facilities; the customer does not have meaningful alternatives.

33. Other producer commenters recognize that the Commission has limited legal authority to reassert jurisdiction over gathering facilities that have been spun down to an affiliate or spun off to an independent company.⁵¹ These commenters accordingly request that the Commission should review the potential for an abuse of market power when it considers a pipeline's request for abandonment of gathering facilities, rather than only considering whether the facilities are gathering facilities. These commenters also request that the Commission should redefine gathering so that fewer facilities qualify for the gathering exemption from Commission regulation.

34. Gathering providers and pipelines contend that the Commission should retain the current *Arkla* test for reasserting jurisdiction. They argue that, as a legal matter, the Commission lacks jurisdiction to assert jurisdiction over gathering performed by non-natural gas companies except in the situation allowed by the current *Arkla* test. These commenters also state that there is no regulatory gap with respect to gathering. The states regulate gathering onshore and in state waters. OCS gathering is governed by the OCSLA and antitrust laws. In any event, they state that there is no industry-wide problem requiring a solution, since only a few complaints have been filed with the Commission. Moreover, they argue the current policy appropriately permits affiliated and non-affiliated gatherers to compete under the same regulatory structure. Also current commercial arrangements have been entered into based on the *Arkla* policy as it now stands. Re-regulation by the Commission would introduce regulatory risk and adversely affect investment in new infrastructure. The potential chilling of long-term commitments in gathering is not warranted given the relatively small number of spin-downs and the effectiveness of current regulation.

III. Discussion

⁵¹ Producer Coalition comments at 2-3, 10-11; IPAA comments at 2-3.

35. After carefully reviewing the comments, the Commission has determined to clarify the existing *Arkla* test in certain respects. However, consistent with the court's decision in *Williams Gas Processing*, an assertion that the gathering affiliate has charged too high a rate, by itself, would be insufficient to justify a reassertion of jurisdiction over the affiliate's gathering activities.

A. The *Arkla* test for reasserting jurisdiction

36. As the Commission held in *Arkla*, and the court affirmed in *Conoco*, the Commission generally lacks jurisdiction over affiliates of interstate pipelines that perform only a gathering service. However, the Commission has reserved the right to "exert jurisdiction over the [affiliate's] gathering service to the extent needed to preserve the Commission's statutory mandates under the NGA."⁵² The Commission has no doubt as to its authority to disregard corporate structures, including those created when a pipeline spins down its gathering facilities to a corporate affiliate, where necessary to prevent frustration of the statutory purpose of the NGA.⁵³ For example, in *Transcontinental Gas Pipe Line Corp. v. FERC (Transco)*,⁵⁴ the court upheld the Commission's order that found Transco had used affiliates to engage in a complicated scheme to (1) make jurisdictional sales to non-captive customers at less than its filed rate, while (2) passing through losses in those sales to its jurisdictional captive customers: "For the Commission not to have investigated further would frustrate a statutory purpose by allowing Transco to set up subsidiaries to sell gas at prices at which the company could not legally sell."⁵⁵

37. The issue here is what circumstances would require the Commission to exert jurisdiction over an affiliate's gathering activities in order to avoid frustration of the purposes of the NGA. In order to answer that question, it is first necessary to understand the relevant statutory purposes of the NGA, particularly what activities the Congress intended the Commission to regulate when it enacted the NGA. Therefore, the first section below discusses the extent to which the regulation of gathering may be

⁵² *Arkla*, 69 FERC at 62,087.

⁵³ *Capital Tel. Co. v. FCC*, 498 F.2d 734, 738, n.10 (D.C. Cir. 1974) ("[w]here the statutory purpose could be easily frustrated through the use of separate corporate entities a regulatory commission is entitled to look through the corporate entities and treat the separate entities as one for purposes of regulation.").

⁵⁴ 998 F.2d 1313 (5th Cir. 1993).

⁵⁵ *Id.* at 1321.

considered to be within the statutory purposes of the NGA. We then clarify, in the next section, the type of conduct that would frustrate the NGA's statutory purposes, and thus justify a reassertion of jurisdiction. Finally, we consider the issues whether a finding of "concerted action" between the affiliate and the pipeline is necessary to justify a reassertion of jurisdiction, and whether the affiliate's gathering activities must be conducted by separate personnel.

1. Statutory Purpose of the NGA

38. The statutory purpose of the NGA is, of course, "to protect consumers against exploitation at the hands of natural gas companies."⁵⁶ In order to carry out that purpose, NGA section 1(b) gives the Commission jurisdiction to regulate: (1) transportation of natural gas in interstate commerce, (2) sales for resale of natural gas in interstate commerce,⁵⁷ and (3) "natural gas companies" engaged in such transportation and sales. This gives the Commission full authority to regulate the rates, terms, and conditions of jurisdictional transportation service performed by natural gas companies, *i.e.* interstate pipelines. If a natural gas company provides gathering service in addition to jurisdictional transportation service, the Commission's regulation of the jurisdictional transportation service "may necessarily impinge on" the gathering service if "gathering is intertwined with jurisdictional activities."⁵⁸ For example, the Supreme Court has held that the Commission may consider a natural gas company's gathering costs "for the purpose of determining the reasonableness of rates subject to its jurisdiction."⁵⁹

39. However, the statutory purpose of the NGA does not include the regulation of gathering service, particularly by companies who are not natural gas companies. This follows from the fact that NGA section 1(b) expressly exempts "gathering of natural gas" from the Commission's jurisdiction. As the Supreme Court stated in *Northwest Central Pipeline v. State Corp. Commission*, 489 U.S. 493, 509-14 (1989), Congress in the NGA "carefully divided up regulatory power over the natural gas industry" so as to "expressly reserve to the States the power to regulate . . . gathering."

⁵⁶ *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944).

⁵⁷ Excluding "first sales" deregulated by the Wellhead Decontrol Act of 1989.

⁵⁸ *Conoco*, 90 F.3d at 549.

⁵⁹ *Colorado Interstate Gas Co.*, 324 U.S. 581, 603 (1945).

40. Several of the producer commenters nevertheless argue that the provisions of NGA sections 4 and 5 permitting the Commission to determine rates for a natural gas company's services performed "in connection with" jurisdictional transportation and sales support a holding that the statutory purpose of the NGA includes ensuring that natural gas companies and their affiliates do not charge excessive rates for gathering. These commenters rely on the Eighth Circuit's holding in *Northern Natural* that the Commission "may . . . under the NGA's §§ 4 and 5 regulate rates charged for gathering on the pipeline's own gathering facilities in connection with jurisdictional interstate transportation, notwithstanding the explicit § 1(b) exclusion of gathering from the act." 929 F.2d at 1269. In addition, they point out that the court defined the phrase "gathering facilities owned by the pipeline" and all subsequently similar expressions [used in its opinion] . . . to include such facilities owned or operated directly or indirectly by a pipeline or its parent, affiliate, subsidiary or lessors." *Id.*, at 1263 n. 2.

41. However, in both *Arkla* and *Conoco*, the Commission and the D.C. Circuit rejected similar contentions that the Eighth Circuit's decision should be relied upon to find that the Commission has NGA sections 4 and 5 "in connection with" jurisdiction over gathering affiliates. For example, in *Conoco*, the D.C. Circuit pointed out that the gathering service at issue in *Northern Natural* was provided by the pipeline itself, not an affiliate, and thus the Eighth Circuit "did not have to consider the full ramifications of its footnote. It did not discuss the issue of the jurisdictional status of affiliate-run gathering services, and it thus provides little persuasive authority on that issue." 90 F.3d, at 546.

42. While the Commission's regulation of a natural gas company's jurisdictional transportation services may necessarily impinge on any gathering services that company performs which are intertwined with its jurisdictional activities, the "in connection with" language of sections 4 and 5 does not constitute a grant of authority to the Commission to regulate gathering independent of its effect on jurisdictional transportation. The D.C. Circuit made this clear in *Conoco*, when it reversed *Arkla's* default contract condition. *Arkla* had required a pipeline spinning down gathering facilities to an affiliate to file a default contract offering the existing gathering customers service at existing rates for two years. The court rejected the Commission's argument that it could impose this condition pursuant to its section 4 authority to regulate non-jurisdictional activities performed "in connection with" jurisdictional service. The Commission had argued that permitting a pipeline to terminate its gathering services without adequate protection for its existing gathering customers would frustrate the Commission's policy, in its regulation of jurisdictional transportation service, to promote a competitive market. The court held that the statute forecloses interpreting the phrase "in connection with" in section 4 as permitting the Commission to regulate facilities which the Commission has expressly found to be outside its section 1(b) jurisdiction.

43. The court explained its decision as follows:

Where an activity or entity falls within NGA section 1(b)'s exemption for gathering, the provisions of NGA §§ 4, 5, and 7, including the "in connection with" language of §§ 4 and 5, neither expand the Commission's jurisdiction nor override § 1(b)'s gathering exemption. In language no less applicable here, the Supreme Court held in *Panhandle III*, 337 U.S. at 508-09, that "sections 4, 5, and 7 do not concern the production 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. . . . Nothing in the sections indicates that the power given to the Commission over natural-gas companies by § 1(b) could have been intended to swallow all the exemptions of the same section, and thus extend the power of the Commission to the constitutional limit of congressional authority over commerce." Because the Commission concluded that the facilities to be transferred by NorAm Gas were exempt under § 1(b) as gathering facilities, and that NorAm Gas' independently operated affiliated gatherer was not a "natural gas company" subject to the NGA, the Commission cannot simply assert authority over the facilities and the affiliate by invoking other sections of the act.

44. We recognize that Congress intended the NGA to be a comprehensive regulatory scheme, without any "attractive gaps."⁶⁰ Given this purpose of the NGA, the Supreme Court has held that, in borderline cases, Commission jurisdiction may be found where necessary to avoid a regulatory gap.⁶¹ In light of this rule of statutory construction, the Commission included in the NOI several questions designed to enable it to further review the extent to which regulation of gatherers affiliated with interstate pipelines may be justified as necessary to prevent a regulatory gap.⁶² Upon review of those comments, we

⁶⁰ *FPC v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 28 (1961).

⁶¹ *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 631 (1972). In *Conoco*, 90 F.3d at 553, the court found that the Commission had not supported its contention that a default contract was necessary to avoid a regulatory gap, finding that the Commission had not explained why the states would be unable to protect NorAm Gas Transmission Company's customers.

⁶² Question 11 asked, "Is there a gap between state regulation of gathering services and the Commission's regulation of natural gas companies, and, if so, what is the nature of that gap?" Question 12 asked, "Should the Commission view the conduct of offshore

(continued...)

continue to find that the regulatory gap argument does not justify a finding that a purpose of the NGA is to enable the Commission to regulate gathering, particularly by non-natural gas companies, whether onshore or on the OCS.

45. Onshore and in state waters, there is no regulatory gap, because the states have full authority to regulate gathering within their borders, including the rates charged by non-natural gas company gathering providers. As the court stated in *Conoco*, “Section 1(b) contemplates that some measure of authority over gathering should be reserved to the States, and jurisdiction over companies whose sole business is gathering is a permissible place to start.”⁶³ And, while states have not imposed across-the-board cost-based rate regulations on local gatherers, they have imposed anti-discrimination requirements and permitted the filing of complaints by producers.⁶⁴

46. We recognize that states cannot regulate gathering on the OCS, since only the federal government has regulatory authority with respect to the OCS.⁶⁵ However, this does not justify a finding that a purpose of the NGA is to fill any regulatory gap with respect to the regulation of gathering on the OCS. NGA section 1(b) makes no distinction between the Commission's jurisdiction onshore and its jurisdiction on the OCS. Thus, given our holding that the purposes of the NGA do not include the regulation of gathering

affiliated gatherers differently from onshore affiliated gatherers due to this lack of state regulation offshore?”

⁶³ 90 F.3d at 547.

⁶⁴ See Enbridge comments at 26-30, summarizing how Texas, Louisiana, New Mexico, Wyoming, and Oklahoma regulate gathering. See also Enterprise comments at 16, and Williams comments at 24-25.

⁶⁵ Under the OCSLA, 43 U.S.C. § 1331 *et seq.* (2000), it is “the policy of the United States that . . . the subsoil and seabed of the outer Continental Shelf appertain to the United States and are subject to its jurisdiction, control, and power of disposition . . .” 43 U.S.C. § 1332 (2000). However, while “[a]ll law applicable to the Outer Continental Shelf is federal law, [] to fill the substantial ‘gaps’ in the coverage of federal law, OCSLA borrows the ‘applicable and not inconsistent’ laws of the adjacent States as surrogate federal law.” *Ten Taxpayer Citizens Group v. Cape Wind Associates*, 373 F.3d 183, 192 (1st Cir. 2004) (quoting *Gulf Offshore Co. v. Mobil Oil Corp.*, 453 U.S. 473, 480 (1981)).

by non-natural gas companies onshore, there is no basis in the language of the NGA to make a different finding with respect to gathering by non-natural gas companies offshore.

47. We find that Congress determined how to address any regulatory gap with respect to gathering on the OCS in the OCSLA. When Congress first enacted the OCSLA in 1953, it recognized that there was no federal law applicable to the recovery of natural resources from the OCS.⁶⁶ At that time, Congress enacted only a “‘bare bones’ leasing authority with essentially no statutory standards or guidelines,” because there was a “relative lack of basic knowledge concerning, and interest in, development of the resources of the Shelf at that time.”⁶⁷ However, by the late 1970s, it was recognized that “the OCS represents such a large and promising area for oil and gas exploration,” that “Congress must update the [OCSLA] . . . to provide adequate authority and guidelines for the kind of development activity that probably will take place in the next few years.”⁶⁸ Accordingly, Congress amended the OCSLA in 1978 for this purpose.

48. The OCSLA, unlike the NGA, contains no exemption for gathering, but applies to the full range of gas exploration, development, production, gathering, and transportation activities. One purpose of the 1978 OCSLA amendments was to assure that resources on the OCS are developed “in a manner which is consistent with the maintenance of competition.”⁶⁹ To that end, section 5(e) of the OCSLA authorizes the Secretary of Interior to grant rights of way through submerged lands on the OCS for purposes of transporting natural gas, upon the condition that the pipeline will transport natural gas produced in the vicinity of the pipelines in such proportionate amounts as the Commission, in consultation with the Secretary of Energy, may determine to be reasonable. Section 5(f)(1) provides that every permit, right-of-way, or other grant of transportation authority must require that the pipeline be operated in accordance with

⁶⁶ For example, the House Committee on the Judiciary, which reported on H.R. 5134, the bill which was enacted in 1953 as the OCSLA, found that “no law [] exists whereby the Federal Government can lease those submerged lands [in the Outer Continental Shelf], . . . [] [T]herefore, [it is] the duty of the Congress to enact promptly a leasing policy for the purpose of encouraging the discovery and development of the oil potential of the Continental Shelf.” H.R. Rep. No. 413 (1953).

⁶⁷ S. Rep. No. 95-284, at 48 (1977).

⁶⁸ *Id.*

⁶⁹ OCSLA section 3(3).

various competitive principles. These include that the pipeline must provide open and nondiscriminatory access to both owner and non-owner shippers.

49. However, the D.C Circuit held in *Williams Companies v. FERC*⁷⁰ that these sections do not give the Commission any general power to create and enforce open access on the OCS. Rather, Congress intended that the Secretary of Interior have the general power to enforce these provisions,⁷¹ with the Commission assigned only a few well-defined roles. One of those roles is to include in any certificates issued to an OCS pipeline pursuant to NGA section 7 the condition required by OCSLA section 5(f)(1). However, since our NGA section 7 certificate authority does not extend to gathering facilities, this provision cannot give us any jurisdiction with respect to OCS gathering.⁷²

50. In this order, we express no opinion on the extent of the Secretary of the Interior's authority under these provisions of the OCSLA to address assertions that a gatherer has abused its market power to charge unreasonably high prices. We hold only that Congress recognized in both 1953 when it first enacted the OCSLA and in 1978 when it amended that Act, that there was a regulatory gap on the OCS, and adopted the current provisions of the OCSLA for the express purpose of addressing that gap. In so doing, Congress did not amend the NGA to give this Commission any additional authority under that Act with

respect to the OCS. We therefore conclude that the regulation of gathering on the OCS is no more within the purposes of the NGA than is the regulation of gathering onshore or in state waters.⁷³

⁷⁰ 345 F.3d 910 (D.C. Cir. 2003).

⁷¹ In addition, OCSLA section 23 authorizes citizens to commence civil actions to enforce any provision of the OCSLA.

⁷² In addition, OCSLA section 5(f)(2) permits the Commission to exempt from the section (f)(1) competitive principles "any pipeline or class of pipelines which feeds into a facility where oil and gas are first collected, separated, dehydrated, or otherwise processed." However, the court held in *Williams Companies* that "a provision allowing FERC to exempt a subset of facilities from section (f)(1)'s competitive principles is plainly not an authorization for it to adopt and enforce principles over all facilities." 345 F.3d at 914.

⁷³ In addition to the state and OCSLA regulation described above, gathering
(continued...)

2. Conduct Frustrating the Statutory Purpose

51. We now turn to the issue of the type of conduct that would frustrate the NGA's statutory purpose, and thus justify the Commission's disregarding the corporate form in order to exert jurisdiction over an affiliate's gathering service. For the reasons discussed below, the Commission finds that it may assert NGA sections 4 and 5 "in connection with" jurisdiction over the activities of an affiliated gatherer, when (1) the gatherer has used its market power over gathering to benefit the pipeline in its performance of jurisdictional transportation or sales service and (2) that benefit is contrary to the Commission's policies concerning jurisdictional services adopted pursuant to the NGA. However, the fact that an affiliated gatherer has abused its market power over gathering to benefit its own gathering service would not, by itself, justify an assertion of jurisdiction.

52. Examples of the types of conduct by an affiliated gatherer which could justify an assertion of jurisdiction include the following. An affiliated gatherer could refuse to provide gathering service or charge higher rates, unless the shipper also entered into a contract with the affiliated pipeline for long-term firm service, rather than short-term firm or interruptible transportation service. This could enable the pipeline to obtain more profitable contracts for its jurisdictional transportation service, than it otherwise could. That is because the Commission requires pipelines to accept a maximum rate bid for a short-term service, absent a higher net present value bid for a longer-term service.⁷⁴ Or, in situations where an affiliated, long-haul pipeline is interconnected with other interstate pipelines in the production area, the affiliated gatherer could refuse service or charge higher rates, unless the shipper also entered into a long-haul transportation contract with the affiliated pipeline for the entire haul to the market area, rather than using an unaffiliated interconnecting pipeline to reach the market area. This would similarly enable the pipeline to obtain a more profitable contract than it otherwise could, because, under the Commission's open access requirements, pipelines must accept maximum rate bids for short-haul service, absent a higher net present value bid for long-haul service. Such circumvention would frustrate the Commission's regulation of the pipeline's jurisdictional transportation service pursuant to the NGA.

affiliates are also subject to federal and state anti-trust laws. For example, the Clayton Act, 15 U.S.C. §§ 12-17 (2000), prohibits various anti-competitive activities.

⁷⁴ *Northern Border Pipeline Co.*, 107 FERC ¶ 61,027, at P 11 (2004).

53. The above two examples of conduct justifying assertion of jurisdiction are both anti-competitive tying arrangements,⁷⁵ which, in the words of *Arkla*, are “directly related to the affiliate’s unique relationship with an interstate pipeline.”⁷⁶ That is because the actions benefit the pipeline by enabling the pipeline to obtain more profitable contracts for its jurisdictional transportation service. The actions do not provide any direct benefit to the gathering affiliate’s own business. Thus, absent the affiliation, a gatherer with market power would not appear to have an incentive to exercise its market power in such a manner. Such conduct would not increase the profitability of an independent gatherer’s business.

54. By contrast, a gathering affiliate’s charging an unreasonably high rate for its gathering service, without more, does not frustrate the statutory purpose of the NGA and thus would not justify an assertion of jurisdiction.⁷⁷ This is true, even where the gathering affiliate owns gathering facilities that provide the sole link between a production field and the interstate pipeline. As already discussed, the statutory purpose of the NGA does not include the regulation of gathering service, particularly by companies who are not natural gas companies. Rather, the NGA only permits the Commission to affect gathering service to the extent necessary to carry out its responsibilities under the NGA to regulate jurisdictional services. A gathering affiliate’s exercise of market power to charge high gathering prices may increase its own profits. But such an exercise of market power does not affect the Commission’s regulation of jurisdictional transportation service. It does not permit the pipeline to circumvent any of the Commission’s policies concerning jurisdictional transportation service or otherwise benefit the affiliated pipeline in its performance of jurisdictional transportation service.

55. Thus, unlike the examples of conduct justifying an assertion of jurisdiction described above, there is simply no relationship between the gathering affiliate’s relationship with the pipeline and its charging of high prices for gathering service. As

⁷⁵ As the court found in *Williams Gas Processing*, 373 F.3d at 1342, a tying arrangement is “conditioning the sale of a good or service on the purchase of another different (or tied) good or service.” In the above examples, the gathering affiliate would be conditioning sale of its gathering service on the purchase of a particular type of transportation service from the pipeline.

⁷⁶ 67 FERC at 61,871.

⁷⁷ *Contrast Transco*, 998 F.2d 1313, in which the court affirmed the Commission’s assertion of jurisdiction where the use of corporate affiliates had enabled the pipeline to make *jurisdictional sales* at unduly discriminatory prices.

now Chief Justice Roberts wrote in *Williams Gas Processing*, “The fact that WFS is an affiliate of Transco is utterly irrelevant to its ability to charge high rates, or to impose onerous conditions for gathering service. This irrelevance is demonstrated by the fact that WFS, as a deregulated monopolist, could have (and likely would have) undertaken the same course of conduct had Transco been owned by someone else entirely. The fact that WFS had an affiliate relationship with Transco neither enhanced nor detracted from its ability to charge high rates or impose onerous conditions.”⁷⁸

56. When the Commission determined in *Arkla* that it lacks jurisdiction over non-natural gas companies performing gathering service including affiliates of pipelines, the Commission recognized that many customers of such gatherers are “captive . . . *i.e.*, there is no competition for gathering services.”⁷⁹ The Commission nevertheless held that the NGA only authorizes it to regulate gathering performed by natural gas companies in connection with jurisdictional services. Therefore, the Commission stated that “the absence of competition by itself is not sufficient to confer upon the Commission jurisdiction to regulate gathering by non-pipelines.”⁸⁰ It follows that a gathering affiliate’s exercise of market power solely to charge high gathering prices does not violate the NGA’s statutory purpose.

57. Producer commenters generally recognize that, in order to assert jurisdiction over an affiliated gatherer, the Commission must find that the gatherer has engaged in conduct that frustrates the statutory purpose of the NGA. For example, Shell Offshore proposes that the Commission modify the *Arkla* test “to provide that the Commission may assert jurisdiction over the gathering services on an affiliate of an interstate pipeline whenever the affiliate abuses its market power *and the abuses frustrate the effective regulation of the pipeline* as a consequence of any of the factors underlying the ‘in connection with’ relationship between the interstate transportation service and the gathering services.”⁸¹ The producers argue that any abuse of market power by an affiliated gatherer, including simply charging excessive rates frustrates our regulation of the pipeline. That is because, as Shell Offshore argues, those excessive gathering rates “effectively exact monopolistic

⁷⁸ *Williams Gas Processing*, 373 F.3d at 1342.

⁷⁹ *Mid Louisiana Gas Co.*, 67 FERC at 61,851.

⁸⁰ *Id.*

⁸¹ Shell Offshore comments at 41 (emphasis supplied).

rents . . . over the entire combined service [of both the gatherer and the pipeline] nominally applying them solely to the gathering component.”⁸²

58. In order to find a frustration of statutory purpose in the manner suggested by the producer commenters, the Commission would have to treat a gathering affiliate’s charges in excess of a reasonable gathering rate as being additional charges for the pipeline affiliate’s jurisdictional transportation service, rather than additional charges for the gathering affiliate’s own service. However, this would effectively nullify the Commission’s holding in *Arkla*, affirmed by the D.C. Circuit in *Conoco*, that the Commission lacks jurisdiction to regulate the rates charged by a gathering affiliate that performs only a gathering service. That is because whenever the gathering affiliate charged more than we determined was a reasonable rate for gathering service, we would treat the excess charge as a charge for jurisdictional transportation service and disallow it. This would have essentially the same effect as our directly regulating the rates charged for gathering by all affiliated gatherers.

59. Above, we have held that Congress reserved to the states jurisdiction to regulate gathering within their boundaries (*i.e.*, onshore and in state waters) by non-natural gas companies, including affiliates of natural gas companies. Therefore, it is consistent with the statutory purpose of the NGA to allow the states to address any assertions that a non-natural gas company, whether or not affiliated with a pipeline, has charged excessive rates for gathering service within their boundaries. Similarly, we have held that Congress gave us no greater NGA authority with respect to OCS gathering, than over gathering onshore and in state waters, and has only provided for regulation of OCS gathering by non-natural gas companies under the OCSLA. The court has interpreted the OCSLA as giving the Department of the Interior, and not this Commission, the authority to enforce the non-discrimination and other requirements of the OCSLA. Therefore, we find it consistent with the purposes of the NGA and the OCSLA that a remedy, if any, for excess charges by non-natural gas companies for OCS gathering be provided by the Department of Interior, not us.

60. Finally, we emphasize that, if an interstate pipeline itself engages in anti-competitive conduct that favors its gathering affiliate, the Commission has full authority under the NGA to provide a remedy, without the need to assert jurisdiction over the affiliate. For example, if a pipeline seeks to subsidize its gathering affiliate by including costs properly allocated to the gathering affiliate in its interstate transportation rates, the Commission could order the removal of those costs.⁸³ Similarly, as described above, the

⁸² *Id.* at 43.

⁸³ *Colorado Interstate Gas Co.*, 324 U.S. 581, 603 (1945).

Commission has required pipelines spinning down gathering service to an affiliate to include in their tariffs provisions stating that the pipeline (1) will provide nondiscriminatory access to all sources of supply, (2) will not give shippers of its gathering affiliate undue preferences over shippers of non affiliated gatherers, and (3) will not condition or tie its agreement to provide transportation service to an agreement by the producer, customer, end-user or shipper relating to any service in which its gathering affiliate is involved. No pipeline has questioned our authority to impose these requirements.

61. Thus, it is only when the gathering affiliate engages in anti-competitive conduct benefiting the pipeline, that the Commission must assert jurisdiction over the affiliate's activities in order to provide a remedy. In this regard, we note that in *Arkla* one of the examples we gave of activity that could justify a reassertion of jurisdiction was: "the pipeline's giving transportation discounts only to those utilizing the affiliate's gathering service." We clarify that there would be no need to assert jurisdiction over the affiliate in this situation, since the Commission has authority under the NGA to remedy any undue discrimination in the pipeline's offering of discounts to its customers, without regard to its jurisdiction with respect to other companies who may benefit from those discounts. The appropriate example of activity that could justify exerting jurisdiction over the gathering affiliate in this context would be the reverse situation: where, as described above, the *gathering affiliate* gives gathering discounts only to those entering into particular types of contracts for the *pipeline's transportation service* that are beneficial to the pipeline. Similarly, any improper shifting of costs between a natural gas company and its gathering affiliate could be remedied in a proceeding to set the former's rates.

3. Whether Concerted Action is Necessary

62. In *Arkla*, the Commission stated that it would reassert jurisdiction "if an affiliated gatherer acts in concert with its pipeline affiliate in connection with the transportation of gas in interstate commerce and in a manner that frustrates the Commission's effective regulation of the interstate pipeline." This language has been interpreted as creating a two-pronged test under which the Commission must make separate findings that: (1) the jurisdictional pipeline and its gathering affiliate have engaged in "concerted action" and (2) the concerted action frustrates the Commission's ability to regulate the pipeline.⁸⁴ In the NOI, the Commission requested the parties' views on the need for the "concerted action" prong of the *Arkla* test.⁸⁵

⁸⁴ *Williams Gas Processing*, 373 F.3d at 1343.

63. After evaluating the parties' comments on this issue, the Commission concludes that, in determining whether to assert jurisdiction over the activities of a gathering affiliate, the focus should be on whether the gathering affiliate has engaged in the type of conduct described in the previous section as justifying such an assertion of jurisdiction. While a finding that the pipeline also participated in the conduct may buttress the need for an assertion of jurisdiction over the activities of the gathering affiliate, we find, for the reasons discussed below, that a finding of such "concerted action" is not a necessary prerequisite to an assertion of jurisdiction.

64. The D.C. Circuit has held that "[w]here the statutory purpose could be easily frustrated through the use of separate corporate entities, the Commission is entitled to look through the corporate form and treat the separate entities as one and the same for purposes of regulation."⁸⁶ Thus, the fundamental test for asserting jurisdiction over the activities of an affiliate is whether such jurisdiction is necessary to avoid frustration of the statutory purpose. When this test is met, the Commission may look through the corporate form, even though the separate corporations were formed in good faith, and there has been no showing that the corporate form was adopted for the purpose of evading the statute.⁸⁷

65. In the preceding section, the Commission has explained that, in order to justify an assertion of jurisdiction over the activities an affiliated gatherer, there must be a showing that the gatherer has engaged in conduct that frustrates the purpose of the NGA. This requires a showing that the gathering affiliate has abused its market power over gathering in order to benefit the pipeline in the pipeline's performance of jurisdictional transportation or sales service in a manner contrary to the Commission's policies concerning jurisdictional services. We believe that a showing of such conduct by the

⁸⁵ Question 8 asked, "Should a showing of 'concerted action' by the gathering affiliate and the pipeline be required, or should it be sufficient for the gathering affiliate alone to have engaged in anticompetitive or otherwise objectionable behavior to trigger the Commission's reassertion of jurisdiction?" Question 9 asked, "What kind of activities would constitute 'concerted action' between the gathering affiliate and its affiliated pipeline for purposes of circumventing the Commission's effective regulation of the pipeline?"

⁸⁶ *Transco*, 998 F.2d at 1321 (quoting *Capital Tel. Co. v. United States*, 449 F.2d 846, 855 (5th Cir. 1971)).

⁸⁷ *Anderson v. Abbott*, 321 U.S. 349 (1944); *Kavanaugh v. Ford Motor Co.*, 353 F.2d 710 (7th Cir. 1965).

gathering affiliate is sufficient to show that Commission jurisdiction over the affiliate is necessary to avoid frustration of the NGA's purpose, regardless of whether there is also evidence of "concerted action" in the form of pipeline participation in the affiliate's conduct.

66. This conclusion may be illustrated by the examples the Commission gave in the previous section of conduct that would frustrate the purpose of the NGA. In those examples, the affiliated gatherer refuses to provide gathering service or charges higher rates, unless the shipper also enters into long-term or long-haul firm transportation contracts with the affiliated pipeline. Commission policy prohibits pipelines from demanding that their customers enter into such contracts. The "concerted action" prong of the existing *Arkla* test would prevent the Commission from asserting jurisdiction in this situation, unless there was evidence not only that the gathering affiliate had engaged in this activity, but also that the pipeline had participated in the activity sufficiently to justify a finding of "concerted action." This would suggest that the Commission would have to find that the pipeline had requested the gathering affiliate to engage in the activity, or at least that the two affiliates had in some manner discussed or jointly planned the gathering affiliate's actions.

67. However, as discussed in the previous section, the gathering affiliate's actions would not provide any direct benefit to the gathering affiliate's own business. Rather, their sole purpose would appear to be to benefit the pipeline by enabling the pipeline to obtain more profitable contracts for its jurisdictional transportation service. If a gathering affiliate realizes on its own, without any consultation with the pipeline, that it can benefit the overall corporate family by requiring its customers to enter into contracts with the pipeline which the pipeline could not legally require, the purposes of the NGA have been frustrated just as much as if the two entities jointly planned the gathering affiliate's actions. Therefore, while every case must be decided based on the actual facts of that case, we will not exclude the possibility that situations could arise in which the Commission may assert jurisdiction over a gathering affiliate without a finding of "concerted action."

68. By the same token, consistent with the court's decision in *Williams Gas Processing*,⁸⁸ a finding that the gathering affiliate and the pipeline have engaged in some form of "concerted action" would not, by itself, justify asserting jurisdiction over the activities of the gathering affiliate. There must be a finding of activity by the gathering affiliate that frustrates the Commission's ability to regulate the pipeline's jurisdictional service. Thus, concerted action between the two affiliates on matters that do not frustrate

⁸⁸ 373 F.3d at 1343.

the purposes of the NGA, such as increasing the gathering affiliate's rates simply to make its gathering business more profitable, would not justify an assertion of jurisdiction.

4. Separate Operating Personnel

69. In the NOI, the Commission requested the parties' views on the extent to which a gathering affiliate must be separately staffed and otherwise independent of its pipeline affiliate in order to be considered exempt from the Commission's NGA jurisdiction.⁸⁹ Several gathering providers and pipelines assert that a requirement of separate staffing would increase the costs of providing gathering services.⁹⁰ Enbridge states that its OCS gathering and pipeline facilities were developed as coordinated projects, and must be operated in close coordination in order to deliver natural gas that meets the gas quality provisions of the pipeline and downstream markets. Enbridge states that it currently continues to realize economies of scale by using a single group of contract administrators and operations, scheduling, and gas control staff to operate its OCS pipelines and affiliated gatherers.

70. Some producers assert that the Commission should require that the gathering affiliate be separately staffed.⁹¹ However, other producers also state that the relative degree of independence of the gathering affiliate from the pipeline should not be the issue when considering whether to assert jurisdiction over a gathering affiliate because of its abuse of market power; rather the focus should be whether there has been market power abuse, regardless of the extent to which the gathering affiliate operates independently.⁹²

71. In Order No. 2004,⁹³ the Commission amended its standards of conduct in 18 C.F.R. Part 358 in order to apply them not only to marketing affiliates, but also to

⁸⁹ Question 3 asked, "What factors are relevant in determining whether a gathering affiliate is separate from its pipeline affiliate and independent from its pipeline affiliate in performing its gathering functions?" Question 4 asked, "Must a gathering affiliate be physically separate and separately staffed in order to be independent of its pipeline affiliate?"

⁹⁰ Enbridge comments at 24-25; Enterprise comments at 13.

⁹¹ See, e.g., Producer Coalition comments at 2.

⁹² Indicated Shippers comments at 32; Shell Offshore comments at 57.

⁹³ *Standards of Conduct for Transmission Providers*, Order No. 2004, 68 Fed.

certain other “energy affiliates.” Order No. 2004 generally required natural gas pipeline transmission providers and their energy affiliates to function independently.⁹⁴ Order No. 2004 defined “energy affiliates” to include affiliates which are involved in transmission transactions in U.S. energy and transmission markets or which manage or control transmission capacity of the affiliated pipeline.⁹⁵ However, the Commission excluded gathering affiliates from the definition of energy affiliate if the gatherers only made incidental purchases or sales of *de minimus* volumes of natural gas to remain in balance under applicable pipeline tariff requirements and otherwise did not engage in energy affiliate activities such as managing the affiliated pipeline’s transmission capacity.⁹⁶

72. However, in *National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831 (D.C. Cir. 2006), the D.C. Circuit vacated Order No. 2004 as applied to natural gas pipelines and remanded the order to the Commission. The court stated that vertical integration between a pipeline and its affiliates should create efficiencies which benefit consumers, and therefore the Commission cannot impede such vertical integration without adequate justification. The court concluded that Order No. 2004 had failed to provide such a justification with respect to its application of the Standards of Conduct to the relationship between natural gas pipeline transmission providers and their the non-marketing affiliates, *i.e.*, energy affiliates.

73. In response to the court’s decision, the Commission issued an interim rule on January 9, 2007,⁹⁷ which among other things, provides that the standards of conduct will

Reg. 69,134 (Dec. 11, 2003), FERC Stats. & Regs., Regulations Preambles ¶ 31,155 (2003), *order on reh’g*, Order No. 2004-A, 69 Fed. Reg. 23,562 (Apr. 29, 2004), FERC Stats. & Regs., Regulations Preambles ¶ 31,161 (2004), *order on reh’g*, Order No. 2004-B, 69 Fed. Reg. 48,371 (Aug. 10, 2004), FERC Stats. & Regs., Regulations Preambles ¶ 31,118 (2004), *order on reh’g*, Order No. 2004-C, 70 Fed. Reg. 284 (Jan. 4, 2005), FERC Stats. & Regs., Regulations Preambles ¶ 31,325 (2004), *order on reh’g*, Order No. 2004-D, 110 FERC ¶ 61,320 (2005), *vacated and remanded as it applies to natural gas pipelines, National Fuel Gas Supply Corporation v. FERC*, 468 F.3d 831 (D.C. Cir. 2006).

⁹⁴ 18 C.F.R. § 358.4 (2006).

⁹⁵ *See* 18 C.F.R. § 358.3(d)(1), (2) and (6)(vi) (2006).

⁹⁶ 18 C.F.R. § 358.4(d)(6)(vi) (2006).

⁹⁷ *Standards of Conduct for Transmission Providers*, Order No. 690, 72 Fed. Reg. (continued...)

not govern the relationship between natural gas pipeline transmission providers and their energy affiliates.⁹⁸ Subsequently, on January 18, 2007, the Commission issued a Notice of Proposed Rulemaking, proposing to make this interim rule permanent.⁹⁹ Consistent with the interim rule, the Commission will not require that a gathering affiliate function independently of its natural gas pipeline affiliate in order to be considered exempt from the Commission's NGA jurisdiction. Any assertion of jurisdiction over the gathering affiliate will turn on whether the affiliate has engaged in the types of conduct described above as justifying such an assertion of jurisdiction, without regard to the relative independence of its employees. This finding is, of course, subject to the outcome of the Notice of Proposed Rulemaking concerning the Commission's Standards of Conduct.

B. The Primary Function Test

74. Although the NOI did not request comments on the Commission's primary function test, which is applied to determine whether facilities perform primarily a gathering or a transmission function, or on the extent to which the Commission may utilize its abandonment authority under NGA section 7(b) to find that reclassifying facilities from transmission to gathering is not consistent with the public interest based on economic grounds, some producer commenters offered their views on these subjects. We will briefly respond to these comments.

75. Regarding the primary function test, the commenters note that they expressed the same views in conjunction with the September 23, 2003 public conference in Docket No. AD03-13-000, convened to address whether the primary function test should be reformulated in light of perceived uncertainty in the application of the test to offshore facilities.¹⁰⁰ They note that although the Commission compiled a substantial record in

2427 (Jan. 19, 2007), III FERC Stats. & Regs. ¶ 31,237 (2007).

⁹⁸ See revised 18 C.F.R. § 358.1(e) (to be codified).

⁹⁹ *Standards of Conduct for Transmission Providers, Notice of Proposed Rulemaking*, 72 Fed. Reg. 3,958 (Jan. 29, 2007), IV FERC Stats. & Regs. ¶ 32,611 (2007).

¹⁰⁰ See *Notice of Public Conference, Application of the Primary Function Test for Gathering on the Outer Continental Shelf* (Aug. 14, 2003) (NOI). This notice provides a comprehensive history of the development of the Commission's primary function test, particularly as it applied to offshore facilities. See also, *ExxonMobil Gas Marketing Co. v. FERC*, 297 F.3d 1071 (D.C. Cir. 2002), cert. denied, 540 U.S. 937 (2003) (*ExxonMobil*) (providing a thorough history of the primary function test).

that proceeding, it has not taken any further action, and urge that the Commission use the instant proceeding to address this issue.

76. The commenters contend that the Commission should redefine gathering so that fewer facilities will qualify for the gathering exemption under the NGA. Although most commenters conclude that the Commission should continue to employ a physical-factor test to determine the primary function of facilities, they urge the Commission to give more emphasis to non-physical factors. Such factors would include the purpose, location, operation and ownership of a facility, as well as whether the jurisdictional determination is consistent with the objectives of the NGA and with the changing technical and geographic nature of offshore exploration and production. For example, one commenter suggests that an assessment of operational function would reveal whether the subject pipeline facility will continue to provide essentially the same service of moving gas from the wellhead or platform to the same downstream pipeline after it is reclassified. If so, a change in the jurisdictional classification would not be warranted.

77. Other commenters criticize what they perceive as the Commission's emphasis on the central point of aggregation prong of its physical test, arguing that the Commission should consider all factors in an individual case.¹⁰¹ Another commenter suggests that when a pipeline seeks to reclassify a facility from transmission to gathering, there should be a presumption that the facility will continue to perform a transmission function unless the pipeline can demonstrate that the criteria of gathering are satisfied and that a change in jurisdictional status will not be economically detrimental to existing shippers on the facility who committed to service with the expectation that they could rely on Commission oversight. Under this view, the commenter opines, the Commission would not have to rely on its abandonment authority under section 7(b) of the NGA to find that a reclassification of a facility is inconsistent with the public interest, because the effect of the requested reclassification on shippers would be part of the test to determine jurisdiction. The commenters also point out that the courts have found that the Commission has great latitude or discretion when it determines what constitutes gathering and what constitutes transmission.¹⁰²

¹⁰¹ See *Sea Robin Pipeline Co.*, 87 FERC ¶ 61,384 (1999) (*Sea Robin*), order on reh'g, 92 FERC ¶ 61,072 (2000), *aff'd*, *ExxonMobil*, 297 F.3d 1071 (D.C. Cir. 2002) (the Commission reformulated its primary function test to include a central point of aggregation prong for the primary function test when applied offshore, which was intended to be an analogue for the central-point-in-the field prong of the test which is applicable onshore, but is not dispositive offshore).

¹⁰² Citing, *ExxonMobil*, 297 F.3d 1071 (D.C. Cir. 2002) and *Williams Gas*
(continued...)

78. Another commenter offers an alternative to the primary function test which it calls the “platform test.” This approach would involve redefining “gathering” as the preparation of natural gas for the first stages of distribution, consistent with the Supreme Court’s view in *Northern Natural Gas Co. v. State Corporate Commission*,¹⁰³ that gathering is “narrowly confined to the physical acts of drawing the gas from the earth and preparing it for the first stages of distribution.”¹⁰⁴ This commenter suggests that for offshore production, gathering would cease at, or just downstream of, the platform where the natural gas is first treated or prepared and made ready for delivery into a pipeline for transportation to shore.

79. In the NOI for the conference in Docket No. AD03-13-000, we acknowledged that [a]s with onshore facilities, the use of the primary function test, as modified by the policy statement for deepwater facilities, seems to be workable, and there has been relatively little controversy concerning its application in recent years. Efforts to apply the primary function test to offshore facilities in the shallow OCS, however, have been contentious.¹⁰⁵

80. We solicited responses to specific questions from interested parties as well as any ideas for a new or further modified primary function test. We stated:

[a] new test should ensure that similar facilities are subject to similar regulatory treatment. It should also provide incentives for investment in production, gathering, and transportation infrastructure offshore, without subjecting producers to the unregulated market power of third party transporters. Persons who appear at the conference should be prepared to indicate how the Commission’s definition of gathering can be changed to achieve these goals.¹⁰⁶

Processing – Gulf Coast Co. v. FERC, 331 F.3d 1011 (D.C. Cir. 2003).

¹⁰³ 372 U.S. 84 (1963).

¹⁰⁴ *Id.* at 90.

¹⁰⁵ *See NOI* at 4.

¹⁰⁶ *Id.* at 7.

81. Admittedly, that is a high standard for any new test to meet. Nevertheless, we see no point in disturbing the current regulatory regime unless doing so would result in a significant decrease in any inconsistent or uncertain results. In other words, replacing one test, which can be difficult to apply in many instances, with another test which would be equally, or perhaps more difficult to apply, would not achieve the desired goals that prompted us to issue the NOI in the first place.

82. We have not been persuaded by the comments and proposals submitted in Docket No. AD03-13-000, or by the comments proffered in this proceeding, that any new test would meet the above-described goals better than the current primary function test does. Nor are we convinced that we should depart from our practice of making jurisdictional findings on a case-by-case basis and relying, instead, on a more generic or “bright line” test, as some commenters propose. Moreover, as noted above, generally the current primary function test as applied to facilities located onshore and in deep water offshore has satisfied most interested parties. Thus, it may well be that similar results will be achieved as the Commission continues to make jurisdictional determinations for facilities located in shallow water by applying the current test on a case-by-case basis, making minor adjustments to the test or emphasizing different factors as circumstances evolve. Despite the fact that this approach may be more difficult and may sometimes produce uneven results, it is consistent with the guidance given to the Commission by the several courts that have reviewed the Commission's jurisdictional determinations under NGA section 1(b).¹⁰⁷

83. Further, some commenters offer suggestions for a new approach to the primary function test that would run afoul of the courts' various admonishments regarding the Commission's responsibilities in making jurisdictional determinations. In addition, aspects of the Commission's current test which some commenters criticize have been upheld as reasonable by the courts. For example, with regard to the Commission's reliance on the central point of aggregation as a place where gathering ended and transportation began on some offshore facilities, the court in *ExxonMobil* stated that

the central aggregation test is not a new, bright-line test, but rather is an amalgamation of physical factors, and in any event, is wholly consistent with past FERC precedent. It has long been the Commission's view, upheld by this Court, among others, that when gas from separate wells is collected by several lines which converge at a single location in the

¹⁰⁷ See, e.g., *ExxonMobil*, 297 F.3d at 1087; *Sea Robin Pipeline Co. v. FERC*, 127 F.3d 365, 370 (5th Cir. 1997); *Conoco*, 90 F.3d at 543.

producing field for delivery into a single line for transportation, the separate lateral lines behind the central point are classified as non-jurisdictional gathering facilities.¹⁰⁸

84. Obviously, where there is no such point on facilities, this prong of the primary function test would not apply, and other factors of the test would dictate the jurisdictional outcome. Thus, the “platform test” suggestion would establish a bright line test that would limit our ability to look at the other factors that may be relevant.¹⁰⁹

85. Further, the courts have stated that the Commission may not make the jurisdictional distinctions required under NGA section 1(b) simply to assure a desirable policy result.¹¹⁰ Thus we cannot adopt the commenter’s notion that we can simply create a test to distinguish gathering from jurisdictional transmission that is geared to the preordained result that more offshore pipelines will be found to perform a jurisdictional transportation rather than a gathering one. The courts have also held that as long as the NGA contemplates a distinction between gathering and jurisdictional transportation, the Commission is required to make those distinctions even when doing so is difficult.¹¹¹ In other words, we may not devise a newly conceived test just because it is easier to apply.

For all of these reasons, at this time the Commission is not adopting a new primary function test applicable to offshore pipelines and will continue to apply its current test in making jurisdictional determinations on a case-by-case basis.

86. Producer commenters also contend that the Commission should modify the way it considers whether it is in the public interest under NGA section 7(b) to permit a natural

¹⁰⁸ *ExxonMobil*, 297 F.3d at 1085.

¹⁰⁹ “The Fifth Circuit concluded that FERC had ‘reverted to its single factor, bright-line approach that it had previously rejected as unworkable for offshore pipelines,’” (*ExxonMobil*, 297 F.3d at 1079, quoting *Sea Robin Pipeline Co.*, 127 F.3d at 370 (citations omitted)).

¹¹⁰ See *ExxonMobil*, 297 F.3d at 1088 (citing *Sea Robin Pipeline Co.*, 127 F.3d at 371).

¹¹¹ See *Id.* at 1080 (“Congress did not intend to extend the FERC’s jurisdiction to all natural gas pipelines; . . . it demands the drawing of jurisdictional lines, even when the end of gathering is not easily located.” (citing *Sea Robin Pipeline Co.*, 127 F.3d 365, 371 (5th Cir. 1997))).

gas pipeline to reclassify or abandon certificated facilities or services, regardless of whether they could be considered to be primarily gathering or production.¹¹²

Commenters argue that because a natural gas company receives benefits by obtaining a certificate, the company should not be able to avoid corresponding obligations by removing facilities or services from the Commission's jurisdiction. They assert that the D.C. Circuit erroneously held that section 7(b) does not apply to a pipeline's reclassification of certificated facilities or services to gathering or production.¹¹³

87. The commenters suggest that when the Commission has permitted such reclassifications or transfers, it has only paid lip service to the public interest standard that must be met before services or facilities may be abandoned under NGA section 7(b). They propose that the Commission carefully consider and require mitigation of any potential for abuse of market power when it reviews a proposed abandonment of certificated facilities or services. Among the factors the Commission should consider are the impact on existing customers, the market power of the company that is acquiring the facilities or services, the commercial considerations underlying the contracts entered into by the interstate pipeline and its customers, and the ongoing useful life of the facility. They urge that, if it is found that an acquiring company will be able to exercise market power or will provide service over facilities transferred or sold by a natural gas company in a spin-down or spin-off, the acquiring company would be engaged in interstate transportation and, therefore, would fall within the Commission's jurisdiction. As noted, some commenters also proposed changing the test to determine whether facilities perform a gathering or production function by introducing economic or historical factors.

88. As some commenters assert, it is true that the U.S. Court of Appeals for the 5th Circuit and the U.S. Court of Appeals for the District of Columbia Circuit hold different views regarding the extent to which the NGA's abandonment authority under section 7(b) should be applied to certificated facilities and services that a natural gas company seeks to reclassify as non-jurisdictional gathering facilities and continue to operate.¹¹⁴ In any

¹¹² See, e.g., *United Gas Pipeline Co. v. McCombs*, 442 U.S. 529, 538-539 (1978).

¹¹³ See *ExxonMobil*, 297 F.3d at 1088.

¹¹⁴ The 5th Circuit held in *Pacific Gas & Electric Co. v. FERC*, 106 F.3d 1190 (5th Cir. 1997) that the Commission has discretion under section 7(b) to examine, to some extent, whether it is in the public interest for a natural gas pipeline to abandon facilities that have been classified as gathering. In contrast, the D.C. Circuit in *Williams Gas Processing-Gulf Coast Co., L.P. v. FERC*, 331 F.3d 1011 (D.C. Cir. 2003), held that once the Commission determines that a facility is not dedicated to a jurisdictional function, it does not have authority under section 7(b) to determine whether a reclassification or

(continued...)

event, those who suggest that the Commission should first determine, based on market power issues and other public interest concerns, whether it is consistent with the public convenience or necessity to permit a pipeline to reclassify or transfer facilities or services before the Commission actually determines their proper function are putting the proverbial cart before the horse.

89. When a jurisdictional natural gas company comes before the Commission to request that the function of certificated facilities it owns and operates be deemed non-jurisdictional gathering or production, the starting point for determining whether the subject facilities are performing primarily a gathering or production function under NGA section 1(b) is to consider the physical characteristics of the subject facilities. While the courts have sanctioned giving some weight to non-physical factors when applying the primary function test, non-physical factors are secondary, and generally only come into play if application of the physical factors results in a close call.¹¹⁵ The market power, economic, and historical considerations that some commenters advocate are not physical tests, and therefore cannot be given substantial weight.

The Commission orders:

(A) Commission policy concerning the assertion of jurisdiction over the gathering services of natural gas company affiliates is clarified as discussed above.

(B) Docket No. PL05-10-000 is terminated.

By the commission.

(S E A L)

transfer of the facilities is in the public interest.

¹¹⁵See, e.g., *Sea Robin Pipeline Co. v. FERC*, 127 F.3d 365, 370 (5th Cir. 1997) and *Lomak Petroleum, Inc. v. FERC*, 206 F.3d 1193 (D.C. Cir. 2000).

Magalie R. Salas,
Secretary.