Chapter 28
CONSTRUCTION OF NEW MIDSTREAM INFRASTRUCTURE: PERILS AND PITFALLS OF FEDERAL REGULATORY JURISDICTION

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§ 28.01 Introduction*

Wellhead natural gas deregulation under the Natural Gas Policy Act of 1978\(^1\) (NGPA) and the Wellhead Natural Gas Decontrol Act of 1989\(^2\) (Decontrol Act), coupled with restructuring of the interstate natural gas pipeline industry under Order No. 636,\(^3\) have led to a significant realignment of cost responsibility for development of oil and natural gas infrastructure. Historically, interstate natural gas pipelines often built “to the wellhead.”

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Financing of major interstate transportation systems was underwritten by the traditional bundled supply customers’ minimum commodity bills, guaranteeing the pipeline a secure revenue stream. In today’s restructured and deregulated climate, responsibility for underwriting infrastructure downstream from the wellhead has shifted largely to the producer sector. For example, Kinder Morgan’s highly successful Rockies Express Pipeline was constructed through project financing in which the revenue stream supporting the financing of the multi-billion dollar project was secured by commitments from producers and marketers to pay demand charges under long-term firm transportation service agreements. This trend is especially noticeable in the midstream, where producers and independent gatherers, processors, and marketers have increasingly taken the lead on connecting new gas resources to the existing interstate pipeline grid. Similar trends have also been noted respecting construction of new pipeline facilities for transportation of oil from new producing areas to new and existing markets.5

One thing all these projects have in common is the general desire of the project developer (who we will assume for purposes of this chapter to be an otherwise unregulated producer, marketer, or other entrepreneur) that the pipeline, gathering line, processing plant, etc., be exempt from federal economic regulation.6 This chapter is intended to address some common misperceptions respecting the scope of federal jurisdiction for economic

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4 In the contractual relationships between pipelines and LDCs, “minimum commodity bills” were analogous to the take-or-pay clauses in contractual relationships between producers and pipelines. Minimum bills were prohibited by FERC Order No. 380. Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions, Order No. 380, 27 FERC ¶ 61,318 (1984); Order No. 380-A, 28 FERC ¶ 61,175 (1984); Order No. 380-C, 29 FERC ¶ 61,077 (1984); Order No. 380-D, 29 FERC ¶ 61,332 (1984); see Wisconsin Gas Co. v. F.E.R.C., 770 F.2d 1144 (D.C. Cir. 1985).


6 An inescapable fact of life in the energy industry in the twenty-first century is that aspects of virtually every project will be subject to substantial federal regulation on environmental, health, safety, and other grounds. This chapter is concerned solely with federal economic regulation—regulation of the price(s) that may be charged for a service—and the terms and conditions under which the service may be provided, including such utility regulatory concepts as certification, abandonment, and tariff-based regulated terms and conditions of service.

7 This chapter is limited to domestic regulation by the U.S. Federal Energy Regulatory Commission (FERC or Commission) and does not address jurisdictional considerations applicable to national and provincial regulation in Canada, or state public utility regulation of oil and gas pipelines including, in a handful of states, regulation of gas gathering lines. Finally, it should be noted that the jurisdictional status of a pipeline for purposes of FERC regulation may be different from the status of that same pipeline for other purposes. For example, while a pipeline may be a nonjurisdictional gathering line under NGA, it may...
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regulatory purposes. The chapter will outline the major jurisdictional parameters of economic regulation under the Natural Gas Act (NGA), the Natural Gas Policy Act (NGPA), and the Interstate Commerce Act (ICA). In doing so, the chapter will focus particularly on factors that may cause facilities, which might mistakenly be assumed to be nonjurisdictional and exempt from federal economic regulation, to be subject to the Federal Energy Regulatory Commission’s (FERC or Commission) regulatory jurisdiction. Recent changes in FERC’s enforcement powers, particularly the ability to impose civil penalties of up to $1 million per violation per day for violations of the NGA or NGPA, have sharpened the focus of project developers on avoiding mistakes that could subject them to multi-million-dollar civil penalties.

§ 28.02 Overview of Jurisdictional Considerations

[1] Scope of Congressional Power to Regulate Commerce

It is commonly understood throughout most sectors of the energy industry that federal economic regulation is limited to certain activities in or affecting interstate commerce. What is often little understood (or completely misunderstood) is the potential reach of the federal regulatory power of Congress under the Commerce Clause. Whether Congress chooses to exercise that power to its fullest extent in particular circumstances will govern the extent to which federal regulation may be authorized and, to

or may not be a gathering line for other purposes, such as pipeline safety regulation or transportation allowances under MMS’ gas valuation regulations.


9 49 U.S.C. Apps. §§ 1 et seq. (1988). In 1977, regulation of oil pipelines was transferred from ICC to FERC. In 1978, ICA was revised and recodified (Revised Act) and the preexisting version of part I applicable to railroads was repealed. However, the portion of part I of ICA applicable to oil pipelines, as it existed on October 1, 1977, was not repealed and this is the law that FERC must apply in its regulation of oil pipelines. This law cannot be found by referring to Title 49 in the U.S. Code as it is published today. The last publication of the October 1, 1977, version of part I of ICA was in the 1988 publication of the U.S. Code. A pdf version of Title 49 from the 1988 U.S. Code can be found on FERC’s website available at http://www.ferc.gov/legal/fed-sta.asp?new=sc4.

10 This is not the first time this topic has been addressed by the Rocky Mountain Mineral Law Foundation. In 1995, the Foundation held a Special Institute, Oil and Natural Gas Pipelines: Wellhead to End User, and in 2005, the Foundation held a Special Institute, Oil and Gas Agreements: The Production and Marketing Phase. Both of these programs included chapters on the topic of oil and gas pipeline infrastructure.


13 U.S. Const. art. I, § 8, cl. 3.
some degree, the extent to which state regulation may or may not apply (in lieu of, or as a complement to, federal regulation). 14

As previously suggested, federal regulatory power is not limited to transactions in interstate commerce. Rather, it is well established that Congress may authorize regulation of local activities if they affect interstate commerce. 15

Although in enacting NGA Congress did not delegate to FERC the fullest extent of constitutional power to regulate interstate commerce, 16 it is important never to assume that an activity is too local to not be potentially subject to federal economic regulation. Failing to do so can sometimes lead to unfortunate consequences that are almost always expensive.


It is equally important to understand that interstate commerce itself has a different meaning under NGA, applicable to regulation of transportation of natural gas, from that under ICA, applicable to regulation of transportation of oil. While this is not the only jurisdictional difference between regulation under NGA and regulation under ICA, it is a fundamental distinction warranting careful attention.

[a] Interstate Commerce Under the Natural Gas Act (NGA)

Interstate Commerce is defined in NGA as “commerce between any point in a State and any point outside thereof, or between points within the same State but through any place outside thereof, but only insofar as such commerce takes place within the United States.” 17 Thus, commerce involving transportation of natural gas from one state to another state through a foreign country, e.g., from Michigan to New York through Canada, does not

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14 A comprehensive discussion of preemption principles under the Commerce and Supremacy Clauses of the U.S. Constitution is beyond the scope of this chapter. It is sufficient for these purposes to note that the existence of federal regulatory jurisdiction, whether fully exercised or not, is a key factor in applying preemption principles.

15 Wickard v. Filburn, 317 U.S. 111 (1942) (growing wheat in excess of amount permitted by federally authorized allotment held to affect interstate commerce).


It is equally settled that the boundary line between state and federal regulation which Congress intended to draw by enacting Section 1(b) of the Natural Gas Act was the identical line the Supreme Court had at that time placed as marking the outer limit of state authority. Section 1(b) is thus to be construed in the light of what the extent of state constitutional power was thought to be in 1938. . . .

involve interstate commerce.\textsuperscript{18} To be sure, the import and export aspects of the transaction may be subject to federal regulation, but the transportation activity is not regulated as involving interstate commerce.

On the other hand, activities that may at first blush appear intrastate in character may nevertheless be regulated as in interstate commerce. An example of this arose in connection with the transportation of natural gas wholly within the state of Ohio by a pipeline affiliate of a local distribution company (LDC) engaged in distribution of the gas to local retail customers. Gas produced outside Ohio was transported by the pipeline affiliate from an interconnect in Ohio with an interstate pipeline to the city gate of the LDC for redelivery to the LDC’s retail customers. The Supreme Court held that even though the gas was transported by the pipeline affiliate of the LDC wholly within a single state, the gas was flowing in interstate commerce.\textsuperscript{19}

Another context in which the question arises whether an activity involves interstate commerce under NGA is transportation of gas from the Outer Continental Shelf (OCS) to onshore facilities for processing and further transportation. Transportation across the OCS itself is not interstate transportation subject to regulation by FERC under NGA.\textsuperscript{20} On the other hand, the boundary (in common parlance, the three-mile limit) between state and federal waters is a state border for purposes of applying the NGA definition of jurisdictional activities. Transportation of natural gas from offshore federal leases to the adjoining state thus involves transportation in interstate commerce subject to federal regulation, whether the gas is consumed within that state or flows onward to other states.\textsuperscript{21}

Thus, we have examples of an activity that in common understanding might be considered as interstate in character, but does not involve interstate commerce under NGA, and another activity that in common understanding might be considered as not in interstate commerce, but is in fact subject to regulation under NGA.

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\textsuperscript{18} Compania de Gas de Nuevo Laredo v. F.E.R.C., 606 F.2d 1024, 1029 n.6 (D.C. Cir. 1979); Border Pipe Line Co. v. F.P.C., 171 F.2d 149, 150-52 (D.C. Cir. 1948); see also Distrigas Corp. v. F.P.C., 495 F.2d 1057, 1063 (D.C. Cir. 1974).
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\textsuperscript{20} Aspects of this activity may be regulated by the U.S. Department of the Interior under the Mineral Leasing Act of 1920, 30 U.S.C. §§ 181–263 (elec. 2010).
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\textsuperscript{21} Cont'l Oil Co. v. F.P.C., 370 F.2d 57, 66 (5th Cir. 1966).
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[b] Interstate Commerce Under the Interstate Commerce Act (ICA)

Under ICA, FERC has regulatory jurisdiction, including ratemaking authority, over the flow of oil in interstate commerce. Significantly, the definition of interstate commerce under ICA is fundamentally different from that employed under NGA, with which many producers and other midstream developers tend to be more familiar. NGA’s focus is on whether natural gas has crossed a state line at any point in its journey, the intent of shipper or transporter is irrelevant, and transportation of natural gas has been found to be jurisdictional despite the parties intent to the contrary. In contrast, ICA focuses on the essential character of the transportation to determine whether it is interstate in character. The primary factor used to determine the essential character of the commerce is the “fixed and persisting transportation intent of the shipper at the time of shipment.” The essential character test is discussed in more detail in § 28.04[2] of this chapter.

For example, as previously indicated, under NGA, movement of natural gas from the OCS to state waters constitutes interstate commerce and, if the facilities are transportation rather than gathering facilities, the transportation is subject to FERC jurisdiction. On the other hand, if transportation of oil begins on the OCS, crosses into state waters, and continues to onshore facilities, crossing from the OCS to state waters does not constitute movement in interstate commerce for purposes of ICA, and such transportation is not automatically subject to FERC regulation.

[3] Transportation

The meaning of “transportation” is another important area in which significant definitional differences exist between NGA and ICA. Both NGA and ICA are limited to transportation—of natural gas in the case of NGA and of oil in the case of ICA. However, the activities which qualify as transportation differ significantly. Moreover, applying the wrong definition, e.g., applying the NGA definition of transportation to an activity involving oil, can lead to serious (and costly) regulatory consequences.

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26 Bonito Pipeline Co., 61 FERC ¶ 61,050 (1992), aff’d sub nom. Shell Oil Co. v. F.E.R.C., 47 F.3d 1186 (D.C. Cir. 1995). As discussed below, this transportation may be subject to regulation under ICA depending on the subsequent disposition of the oil.
[a] Transportation Subject to Regulation Under NGA

NGA endeavors, through a series of exemptions, to define the transportation activities subject to economic regulation under the Act. The difficulty is that aspects of jurisdictional and nonjurisdictional facilities may be physically indistinguishable from one another. The flow of gas through jurisdictional and nonjurisdictional facilities is governed by the same physical laws, flowing from an area of high pressure to an area of low pressure. The length, diameter, and even the composition of the pipe through which the gas flows, may be identical. Yet one activity may be classified as transportation regulated under NGA (if in interstate commerce) while the other is gathering, and they are statutorily exempt from regulation.\(^{27}\) The distinction between jurisdictional transportation and nonjurisdictional gathering of natural gas is discussed in detail in § 28.03 of this chapter.

Similarly, local distribution of natural gas, which the Supreme Court has described as involving low pressure distribution through local mains,\(^ {28}\) is likewise exempt from federal regulation by FERC, even though the gas is undeniably flowing in commerce.

Finally, transportation does not always take the form of physical carriage of a particular supply of gas from a pipeline receipt point to a delivery point. Pipelines may also transport natural gas by backhaul (the process of receiving gas at a point in the pipeline’s physical flow and delivering equivalent quantities at a destination upstream from the receipt point), exchange (the process by which one party delivers gas to another party at one point in exchange for receiving gas from that party at another place), and displacement (the process by which, because of the pipeline’s configuration, it is not clear whether gas moves forward or backward from the point of receipt). All are transportation subject to FERC’s jurisdiction under NGA if interstate in character.\(^ {29}\)

[b] Transportation Subject to Regulation Under ICA

An important distinction between FERC’s jurisdiction under ICA and its jurisdiction under NGA is that, while jurisdiction under NGA makes the foregoing distinction between transportation and gathering, ICA makes no such distinction. While displacement has been proposed as a form of transportation on oil pipelines for which pipelines have sought to charge fees, displacement is in practice effected through exchanges of oil between shippers in the commodity market place and has been held not to be sub-

\(^{27}\) 15 U.S.C. § 717(b) (elec. 2010).


\(^{29}\) Associated Gas Distrib. v. F.E.R.C., 899 F.2d 1250, 1254 n.1 (D.C. Cir. 1990).
ject to FERC’s jurisdiction under ICA. The FERC test for jurisdictional transportation of oil is discussed in detail in § 28.04 of this chapter.

[4] Transportation of Natural Gas and Oil—Which Statute Applies to Which Product?

In overly simplistic terms, NGA applies to transportation of natural gas, while ICA applies to the transportation of oil. In light of what we have already seen, however, it should come as no surprise that the distinction between natural gas and oil is not as clear as might be assumed.

[a] Natural Gas

Natural gas includes casinghead gas produced from oil wells, and liquified natural gas (LNG). Natural gas includes both naturally occurring methane, and mixtures of methane, and other gaseous hydrocarbons, such as ethane. In addition, natural gas includes methane produced from biomass, and manufactured or synthetic gas, as long as it is mixed with natural gas.

The gaseous substance we commonly think of as natural gas often contains liquefiable hydrocarbons in a gaseous state. Those liquefiable hydrocarbons may include propane and butanes. As long as those compounds are transported in gaseous form, they are part of the natural gas stream and regulated as such. If these liquids are transported as entrained natural gas liquids (NGLs), title to which may be retained by the shipper for purposes of downstream processing and recovery of the NGLs, the transportation of the liquids is not regulated under NGA, although the pipeline must allocate costs to the services it provides in transporting such NGLs.

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30 Bridger Pipeline LLC, 126 FERC ¶ 61,182, at ¶ 16 (2009).
31 While ICA also applies to refined petroleum products such as aviation jet fuel, diesel fuel, gasoline, heating oil, and kerosene, the authors’ analysis focuses on upstream products rather than the typical products of a crude oil refinery.
32 Deep South Oil Co. v. F.P.C., 247 F.2d 882, 888 (5th Cir. 1957) (Deep South).
34 Deep South, 247 F.2d at 888.
36 In re Permian Basin Area Rate Cases, 390 U.S. 747, 820 n. 111 (1968); Mobil Oil Corp. v. F.P.C., 483 F.2d 1238, 1249 (D.C. Cir. 1973) (Mobil Oil).
37 Mobil Oil, 483 F.2d at 1243.
[b] Oil

The jurisdiction of FERC under ICA applies to the transportation of oil. That term clearly encompasses crude oil. Courts have also ruled that the history of the legislation conferring authority under the ICA to FERC demonstrates that Congress intended a broader meaning of oil than the ordinary usage of the word. Thus, the jurisdiction of FERC under ICA extends to pipeline-transported refined petroleum products such as gasoline, kerosene, and diesel fuel.\(^{38}\)

NGLs separated from the gas stream and recovered in liquid form from processing natural gas are oil for purposes of regulation under ICA. In addition, ICA, not NGA, applies to transportation of condensate recovered in liquid state from the production of natural gas.\(^{39}\) Nevertheless, anhydrous ammonia, an agricultural fertilizer manufactured from natural gas, is not oil for purposes of regulation by FERC under ICA.\(^{40}\)

There is sometimes a misperception that transportation of condensate produced with natural gas is governed by NGA rather than ICA. This misperception can be especially problematic if the condensate is being gathered separately from the natural gas, through parallel separate gas and liquid pipeline gathering systems. Because the gathering versus transportation distinction made under NGA does not apply under ICA, gathering of condensate through a parallel pipeline system may be regulated under ICA, even though the equivalent activity relating to natural gas is exempt from regulation under NGA.

Accordingly, in developing plans for gathering and transportation of condensate separately from natural gas, particular attention must be paid to application of ICA regulatory principles in addition to those applied under NGA to the natural gas stream itself.

§ 28.03 NGA Jurisdiction Over Transportation of Natural Gas


Section 1(b) of NGA\(^{41}\) expressly exempts “production or gathering of natural gas” from utility-type regulation under NGA. NGA does not define either transportation, which falls within FERC jurisdiction if interstate in

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\(^{39}\) See Mobil Oil, 483 F.2d at 1249.

\(^{40}\) CF Industries, 925 F.2d at 476-77.

\(^{41}\) 15 U.S.C. § 717(b) (elec. 2010).
character, or gathering, which is exempt from FERC’s authority under NGA.

The Supreme Court has “consistently held that ‘production’ and ‘gathering’ are terms narrowly confined to the physical acts of drawing the gas from the earth and preparing it for the first stages of distribution.” The Commission’s long-held definition of gathering is “the collecting of gas from various wells and带来了它 by separate and several individual lines to a central point where it is delivered into a single line.” More recently, the D.C. Circuit has defined gathering as “the process of taking natural gas from the wells and moving it to a collection point for further movement through a pipeline’s principal transmission system.” Despite both regulatory and judicial efforts to more precisely delineate the jurisdictional limits of the NGA, the D.C. Circuit observed, “[t]he line between jurisdictional transportation and nonjurisdictional gathering is not always clear.”

[a] Historical Evolution of Gathering Tests

For many years the Commission employed two principal tests to differentiate transportation from gathering. Developed in the onshore context, these tests were the behind-the-plant test and the central-point-in-the-field test. The behind-the-plant test presumes that all facilities located between the wellhead and a processing plant are nonjurisdictional gathering lines, while facilities downstream of the processing plant are presumptively transportation facilities. For gas that requires no processing, the central-point-in-the-field test applied. Under the central-point-in-the-field test, lateral lines collecting gas from separate wells that then converge into a single larger line (typically at the point where the gas is compressed for transportation by the pipeline) were classified as gathering facilities.

[b] The Primary Function Test

In 1983, the Commission subsumed these two tests into a primary function analysis to determine “whether a facility is devoted to the collection of gas from wells—gathering—or to the further (‘downstream’) long-distance

44 Conoco Inc. v. F.E.R.C., 90 F.3d 536, 539 n.2 (D.C. Cir. 1996) (Conoco) (citing Nw. Pipeline Corp. v. F.E.R.C., 905 F.2d 1403, 1404 n. 1 (10th Cir. 1990)).
45 Conoco, 90 F.3d at 542.
movement of gas after it has been collected—interstate transportation.”48 The major elements of the primary function test were formulated in *Farmland Industries, Inc.*49 Among the criteria identified in *Farmland* as elements of the primary function analysis are:

1. the length and diameter of the pipeline;
2. whether the pipeline extends beyond the central point in the field;
3. the geographical configuration of the system;
4. the location of compressors and processing plants;
5. whether there are wells along all or part of the pipeline; and
6. the operating pressure of the system.

In 1994, the Commission issued a pair of orders in *Amerada Hess Corp.*50 and *Superior Offshore Pipeline Co.*51 setting forth new standards for application of the primary function test with respect to pipeline facilities located upstream and downstream from a processing plant. FERC continues to adhere to those standards today. Commission decisions have also added consideration of nonphysical factors to the primary function analysis.52

Under the primary function test, no single factor is determinative, and not all factors apply in all situations.53 The Commission “gives consideration to all of the facts and circumstances of the case rather than mechanically applying a facilities configuration standard.”54 Most important, under the primary function analysis, the Commission does not apply any overarching bright-line standard.55

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48 *Conoco*, 90 F.3d 543.
52 See discussion and cases cited, *infra* at § 28.03[1][b][vii].
54 *W. Tex. Gathering Co.*, 45 FERC ¶ 61,386, at 62,219 n.4 (1988); *see also Conoco*, 90 F.3d at 543.
55 *EP Operating Co. v. F.E.R.C.*, 876 F.2d 46, 48 (5th Cir. 1989) (EP Operating) (discussing primary function test under *Ben Bolt Gathering Co.*, 26 F.P.C. 825, 827 (1961), *aff’d*, 323 F.2d 610 (5th Cir. 1963), and *Farmland Indus., Inc.*, 23 FERC ¶ 61,063, at 61,143 (1983)).
[i] Length and Diameter

Over the years, the Commission has found a wide variety of lengths and diameters to be consistent with the gathering function. Generally, smaller diameter pipe has been viewed as consistent with a gathering function, while larger diameter pipe has been viewed as consistent with a transportation function. Likewise, shorter length pipelines have been viewed as consistent with a gathering function while longer pipelines, on the order of hundreds of miles in length, have been viewed as reflecting a transportation function. Nevertheless, even relatively large diameter pipes of substantial length have been found to perform a gathering function. For example, in *CNG Transmission Corp.*, the Commission found a 24-inch diameter pipeline performed a gathering function. In *Columbia Gas Transmission Corp.*, the Commission found that a 26-inch diameter pipeline, 34.1 miles long, performed a gathering function.

In *EP Operating Co. v. F.E.R.C.*, the Fifth Circuit reversed FERC’s determination that a 51-mile long, 16-inch diameter offshore pipeline performed a transportation function. In holding the pipeline exempt as a gathering facility, the Fifth Circuit dismissed FERC’s reliance on the 51-mile length of the pipeline, as dictated by the distance of the production platform from existing transportation infrastructure, and the 16-inch diameter of the pipe, as dictated by the anticipated level of production.

[ii] Extension Beyond the Central Point in the Field

Under the central-point-in-the-field test, any facilities located upstream of the central point are generally considered gathering facilities, while facilities located downstream of the central point are jurisdictional transmission facilities. The Commission does not apply the central-point-in-the-field test when there is processing or the pipeline is a backbone type of structure. In certain geographic locations, the Commission has also found that the central-point-in-the-field test is not applicable. Furthermore, the Commission has acknowledged that while the central-point-in-the-field test is relevant to the jurisdictional determination, the Commis-

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57 79 FERC ¶ 61,045, at 61,210 (1997) (Columbia).

58 876 F.2d 46, 49 (5th Cir. 1989); *see also* N. Am. Res. Co., 75 FERC ¶ 61,286 (1996) (NARCO).


60 *Id.*

sion does not apply the test rigidly. “The Commission has found that even where facilities extend beyond the central point in the field, the facilities may nonetheless be gathering if other relevant factors indicate a gathering function.” Thus, while the central-point-in-the-field test may be a factor considered in the jurisdictional analysis—particularly when it supports a determination that the facilities perform a gathering function—it is not necessarily essential to a finding of nonjurisdictional status and is rarely determinative of the outcome.

[iii] Geographical Configuration

Gathering lines have been found in a variety of configurations, including tree-like, heavily branched, web-like, or hub-and-spoke configurations. The Commission has recognized three basic configurations as performing a gathering function:

1. the web-like or spoke-and-hub system, commonly found in field gathering systems;
2. the backbone system, which consists of a pipeline that connects to numerous feeder lines along its entire length; and
3. short, small diameter pipelines that connect a few wells directly to the transmission system.

Unbranched, point-to-point lines generally have been viewed as consistent with a transportation function, although the presence of wells along the line has been viewed as evidence that the line performs a gathering function.

Unlike some of the physical factors enumerated under the modified primary function test that are rarely outcome determinative, the configuration and location of wells is a critical factor. At a minimum, the Commission has required that a system at least have the potential of meeting one of the above configurations before the Commission has classified the system as performing a gathering function. In North American Resource Co., North American Resources Co. (NARCO) proposed constructing a 12.75-inch diameter, 18.75-mile pipeline that would connect an existing gathering system with a different interstate pipeline with greater takeaway capacity. NARCO acknowledged that the pipeline would not be connected

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64 See Amerada Hess Corp., 67 FERC ¶ 61,254 at 61,847 (1994).
66 75 FERC ¶ 61,286, at 61,921 (1996).
to any wells during the initial phase. However, NARCO stated that the pipeline would traverse an extensive production area, and, as new wells were developed, NARCO expected to connect those wells to its line. In reliance on NARCO's representations, the Commission held the line performed a gathering function, stating that once the new wells were connected the facility would have a backbone configuration.\textsuperscript{67}

\textbf{[iv] Location of Compressors and Processing Plants}

In \textit{EP Operating Co.},\textsuperscript{68} the Fifth Circuit rejected the Commission's attempt to apply a bright-line standard, and reversed the Commission's determination that an offshore line performed a transportation, rather than gathering, function based solely on the length of the line. Following the Fifth Circuit's reversal of the Commission's application of the primary function test, FERC revised its primary function analysis, articulating a modified primary function analysis in \textit{Amerada Hess I}\.\textsuperscript{69}

\textit{Amerada Hess I} presaged a trend of Commission decisions declaring ever-larger onshore facilities to be nonjurisdictional gathering facilities, and included a series of subsequent Commission decisions declaring that pipelines of substantial length carrying pipeline quality gas downstream from a processing plant performed a gathering function.\textsuperscript{70} Ultimately that trend culminated in the \textit{Amerada Hess II}decision initially declaring a 60-mile pipeline downstream from a processing plant to be an exempt gathering line.

\textit{Amerada Hess II} represented a turning point in the evolution of the Commission's policies under the primary function test respecting facilities downstream from a processing plant. Williston Basin Interstate Pipeline appealed the Commission's decision in \textit{Amerada Hess II} to the D.C. Circuit. FERC then requested the D.C. Circuit to remand the record to permit the Commission to revisit its application of the primary function analysis.\textsuperscript{72} On remand, FERC recognized that its post-\textit{Amerada Hess I} decisions had effectively eliminated the location of the facilities relative to processing

\textsuperscript{67} Id.

\textsuperscript{68} 876 F.2d 46, 48 (5th Cir. 1989).

\textsuperscript{69} 52 FERC ¶ 61,268 (1990).


plants from the primary function analysis, and had created a de facto bright-line standard that was not viable under *EP Operating*.

In *Amerada Hess III* and *SOPCO*, FERC announced a new policy whereby “the Commission generally will find that facilities located beyond a processing plant” are jurisdictional transportation facilities. Subsequently, the Commission specifically rejected reliance on cases involving longer-length pipelines downstream from a plant decided prior to *Amerada Hess III* as no longer valid precedents.

Significantly, *SOPCO* and *Amerada Hess III* also recognized an exception to the processing plant as the line of demarcation between gathering and transportation where downstream facilities were “incidental to the operations of the upstream facilities.” In *SOPCO*, FERC recognized that even absent additional wells along a pipeline’s length, relatively short stub lines downstream from a plant may be considered to be “an incidental extension of plant operations or of the behind-the-plant gathering system.” *SOPCO* made clear that the test for determining whether the downstream facilities are an incidental extension of the behind-the-plant gathering system depends “on the length of the facilities downstream of a plant owned by the behind-the-plant gatherer in relationship to the size of [the] gathering facilities behind the plant.”

In *SOPCO*, two downstream 12-inch diameter stub lines were involved: one was two miles in length; the other five miles long. By comparison, the behind-the-plant gathering lines were 38 miles and 73 miles in length, respectively. FERC found this relationship sufficient to treat the downstream-of-the-plant stub lines as extensions of the behind-the-plant gathering systems, and therefore nonjurisdictional. In subsequent decisions

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74 *Amerada Hess III*, 67 FERC at 61,847; *SOPCO*, 67 FERC at 61,834-35.

75 ONEOK Midstream Pipeline, Inc., 93 FERC ¶ 61,042, at 61,093 (2000).


77 *SOPCO*, 67 FERC at 61,835 (sometimes referred to as “the SOPCO stub-line exception”).

78 *SOPCO*, 67 FERC at 61,835.

79 *SOPCO*, 67 FERC at 61,836.

80 *id*.

81 *SOPCO*, 67 FERC at 61,835–36.
applying the *Amerada Hess III* and *SOPCO* decisions, the Commission generally has not extended the *SOPCO* stub-line exception beyond the five miles approved in *SOPCO*.\textsuperscript{82}

Compression is a somewhat trickier criterion to apply inasmuch as compression can be used for more than one purpose—both to move the gas through a pipeline and to compress the gas to pressures adequate to enter a higher-pressure transportation facility. In *Questar Pipeline Co.*,\textsuperscript{82} the Commission articulated the general rule for determining whether a compressor performs a nonjurisdictional gathering function or a jurisdictional transportation function. A compressor generally will be deemed to perform a gathering function if it is used to compress production volumes to transmission pressures. Conversely, if the compressor is used to move gas along the mainline, it is performing a transportation function. Obviously in many cases compression performs both functions and there is no bright line between the two functions. For this reason, like the pressure of the gas in the system, the jurisdictional determination rarely turns on the location of the compressor.

In the absence of a processing plant, the critical and often determinative factor appears to be the geographic configuration of the facilities, including whether there are wells located along the pipeline, rather than the location of the compression station. Although locating the compressor at the interconnect with a transmission line will not guarantee that the upstream trunkline is deemed a gathering facility, it appears likely that location of the compressor at the central point in the field will result in the downstream trunkline being declared a transmission facility. Thus, even though the Commission has not directly ruled that the location of compression is analogous to the location of processing facilities, parallels do exist and the location of compression may impact the Commission’s jurisdictional determination.

[v] Location of Wells Along the Pipeline

As previously indicated in *NARCO*, the company proposed constructing a 12.75-inch diameter, 18.75-mile pipeline that would connect an existing gathering system with a different interstate pipeline with greater takeaway capacity. Although the new pipeline would not be connected to any wells

\textsuperscript{82} For application of the five-mile limit to a residue gas line located in a North Dakota shale play, see *Whiting Oil & Gas Corp.*, 126 FERC ¶ 62,119 (2009), in which a producer was required to obtain a limited jurisdiction certificate for a 17-mile stub line. Whiting Oil and Gas subsequently modified the operation of the processing plant so that it no longer produced pipeline quality residue gas and FERC granted an order approving abandonment of the limited jurisdiction certificate, subject to certain conditions. *Id.*

\textsuperscript{83} 84 FERC ¶ 61,076, at 61,312 (1998).
during the initial phase, the pipeline would traverse an extensive production area and, as new wells were developed, NARCO expected to connect them to its line. Relying on NARCO’s representations, the Commission found that once the new wells were connected, the pipeline would have a backbone configuration typical of a gathering function.  

[v] Operating Pressure
As with length and diameter, a lower operating pressure is indicative of gathering, while higher operating pressures are consistent with a transportation function. Nevertheless, the Commission has found that many facilities with relatively high operating pressures performed a gathering function. For example, in ANR Pipeline Co., the Commission found a system with operating pressures up to 1,050 psig performed a gathering function. In Eagle Rock, the Commission found a system with operating pressures ranging from 50 to 1,000 psia performed a gathering function.

[vii] Nonphysical Factors
As previously indicated, Commission decisions have added consideration of nonphysical factors to the primary function analysis, including the primary business of the owner/operator of the facilities, whether the jurisdictional determination is consistent with the objectives of NGA and NGPA, and, more recently, the changing technical and geographic nature of exploration and production activities.

[c] Application of the Primary Function Test—Perils and Pitfalls
The challenge in applying the primary function test is that for almost every physical characteristic, a case can be found where a particular facility was determined to be an exempt gathering line or a jurisdictional pipeline,

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85 ANR Pipeline Co., 76 FERC ¶ 61,153, at 61,914 (1996).
86 Eagle Rock De Soto Pipeline, L.P., 126 FERC ¶ 61,092, at ¶ 17 (2009) “Psig” refers to pounds per square inch gauge, a unit of pressure relative to the surrounding atmosphere; “Psia” refers to pounds per square inch absolute, a unit of pressure calibrated to read zero in a vacuum.
87 Amerada Hess Corp., 67 FERC ¶ 61,254 at 61,846 n. 34 (1994) (Amerada Hess III). But see Nw. Pipeline Corp. v. FERC, 905 F.2d 1403 (10th Cir. 1990) (fact that owner of natural gas gathering facilities had as its primary function interstate transportation of gas did not transform gathering facilities into transportation facilities subject to FERC regulation).
88 Questar Pipeline Co., 84 FERC ¶ 61,076, at 61,311 (1998); Tarpon Transmission Co., 60 FERC ¶ 61,041, at 61,150 (1992) (and cases cited therein at note 11).
despite the existence of an outlier—a factor not typical of the ultimate classification. Whether that involves the four-inch diameter jurisdictional pipeline, or the 40-inch diameter nonjurisdictional gathering line, the temptation is to string together a series of cases involving isolated and individual outliers in the hope of making the case for a particular jurisdictional determination (usually classification as an exempt gathering facility), on the basis of those supposed precedents.90

There is great danger in doing so, particularly where a request for declaratory order is not sought,91 because such attempts are rarely successful. It is the overall character of the facility that will determine its primary function, and reliance on cases in which the particular characteristic was not the basis for classification—indeed where the classification was made despite the characteristic—will not advance the argument in favor of a classification at odds with the weight of the caselaw concerning a particular characteristic. This is where experience and judgment play a key role.

In addition, the fact-specific nature of the application of the primary function test sometimes makes a declaratory order the only safe option. This is particularly the case when the specific facility is schizophrenic—possessing several characteristics typical of gathering, and several typical of transportation—such that weighting, or reliance on nonphysical characteristics, may be needed to tip the scales one way or the other. Indeed, many of the reported cases should be viewed from the perspective that there must have been some factor that warranted requesting a declaratory order, and prudence suggests that an effort should be made to discern what that factor was. This inquiry will sometimes shed important insight onto the reported jurisdictional determination.

[d] Offshore Gathering Standard

As part of revisiting the primary function analysis following the EP Operating decision, FERC developed separate criteria applicable to offshore gathering facilities. The most pronounced of those criteria is the presump-

90It would also be incorrect to assume a pipeline that crosses a state line cannot be a gathering line (see Sid Richardson Energy Servs. Ltd., 104 FERC ¶ 61,024 (2003)), or that a short pipeline located entirely within a single state cannot be an interstate pipeline. See Norten Pipeline Co., 94 FERC ¶ 61,022 (2001) (natural gas facilities consisting of metering and tap facilities and three pipelines totaling approximately three miles in length held to be an interstate pipeline).

91If a system owner incorrectly concludes that its system is an exempt gathering facility when, in fact, it performs jurisdictional transportation, the penalties can be severe. The Commission has a host of civil and criminal remedies available to it under NGA. See Black Marlin Pipeline Co., 15 FERC ¶ 63,021 (1981). An option to reduce these risks is a request for a declaratory order from FERC regarding the jurisdictional status of the proposed pipeline.
...tion that offshore facilities located in depths of 200 meters or more perform a gathering function.92

[e] Interstate Gathering

It is worth noting that the exemption of gathering from regulation under NGA means that if the primary function of an activity is classified as gathering, the activity and related facilities are exempt from NGA regulation even though the gathering system itself crosses a state line.93 On the other hand, an equally important corollary to this rule is that the subsequent transportation of this gas, even if only within a single state, involves interstate commerce subject to federal regulation because the gas originated in another state:94

The history of Commission and court interpretation of Section 1(b), . . . makes clear that there is a distinction between gathering and transportation, such that the two functions are mutually exclusive. Consequently, otherwise non-jurisdictional production or gathering does not become jurisdictional on the basis that the facilities employed therefor cross a state line.95

This rule can have special significance for transportation facilities located within a single state downstream from an offshore gathering system which gathers gas from the federal OCS to onshore transportation facilities. By definition, the downstream transportation pipeline is transporting natural gas in interstate commerce because the gas crossed the state line between offshore state lands and the federal offshore domain, and will be subject to the jurisdiction of FERC unless some jurisdictional exclusion applies.96

This jurisdictional wrinkle demands special attention under such fact situations to safeguard against an unanticipated application of federal regulatory jurisdiction to transportation facilities assumed to be intrastate in character.

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94 Maryland v. Louisiana, 451 U.S. 725, 755 (1981) (“Gas crossing a state line at any stage of its movement to the ultimate consumer is in interstate commerce during the entire journey.”).


96 E.g., the Hinshaw pipeline exception, or if the transportation is authorized under NGPA § 311(a)(2) (codified at 15 U.S.C. § 3371(a)(2) (elec. 2010)).
[f] Limited Jurisdiction Certificate

Although the jurisdictional determination is truly an either/or issue—a facility must be one or the other and cannot be both—the Commission has found an interesting way in which to deal with those rare circumstances in which a facility is found to perform primarily a transportation function, yet no regulatory purpose would be served by imposing full NGA regulation. Such has been found to be the case where all of the gas moved through the pipeline will be owned by the owner/operator of the pipeline. The regulatory halfway point adopted by FERC is the limited jurisdiction certificate in which the Commission will issue a certificate of public convenience and necessity under NGA, but exempt the facility from most other regulatory obligations, such as periodic reporting, filing a tariff, and cost-of-service-based rate regulation. This alternative, although not frequently employed, should always be an option to consider if the primary function analysis fails to yield the desired nonjurisdictional result.

[2] Other Nonjurisdictional Opportunities for Midstream Development

Gathering facilities are not the only nonjurisdictional activities engaged in by developers of midstream infrastructure. Other nonjurisdictional activities include providing interstate transportation service under NGPA § 311 by an intrastate pipeline; providing transportation as a Hinshaw pipeline (including interstate transportation under Part 284 blanket certificate authority to the same extent that intrastate pipelines are authorized under NGPA § 311 to transport natural gas in interstate commerce exempt from NGA regulation); and delivering gas directly to commercial and industrial end users. These and related regulatory options for other forms of midstream development are discussed below.

[a] Interstate Transportation by Intrastate Pipelines—Natural Gas Policy Act (NGPA) Section 311

Section 311(a)(2) of the NGPA authorizes an intrastate pipeline (defined in section 2(16) of the NGPA) to transport natural gas in interstate commerce. If a pipeline meets the FERC

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99 15 U.S.C. § 3301(16) (elec. 2010) (“any person engaged in natural gas transportation (not including gathering) which is not subject to the jurisdiction of the Commission under the [NGA] (other than any such pipeline which is not subject to the jurisdiction of the Commission solely by reason of [the Hinshaw exemption])”). If a pipeline meets the FERC
commerce without becoming subject to the jurisdiction of FERC\textsuperscript{100} if the transportation is provided on behalf of an interstate pipeline or a local distribution company served by an interstate pipeline.\textsuperscript{101} Several aspects of section 311 transportation warrant attention from a jurisdictional perspective.

First, section 311 authorizes transportation, not gathering.\textsuperscript{102} The Commission applies the same primary function analysis for purposes of this determination as it applies for purposes of the jurisdictional analysis under section 1(b) of the NGA.\textsuperscript{103}

Second, the Commission has established settled principles for qualification as an eligible beneficiary on whose behalf section 311 transportation service may be rendered without imposition of NGA jurisdictional consequences. Under these principles, the interstate pipeline or LDC must have (1) had physical custody of and transported the gas at some point in the journey, or (2) held title to the gas at some point in the transaction for a purpose related to the beneficiary’s role as an interstate pipeline or LDC.\textsuperscript{104} Satisfying this requirement rarely presents significant problems.

Third, what constitutes an intrastate pipeline may present opportunities where a particular facility cannot qualify as a gathering facility exempt from regulation under NGA. Because the service to be provided under such circumstances would be transportation, qualification of the facility as an intrastate pipeline rendering transportation service under NGPA § 311 may present an attractive nonjurisdictional alternative. In this regard, the Commission has established some useful precedents infusing section 311 with considerable scope. Thus, intrastate pipelines eligible to provide transportation service under NGPA § 311 are not limited to those intrastate pipelines in existence at the time of enactment of NGPA.\textsuperscript{105}

test for being an interstate pipeline, then it cannot be an intrastate pipeline for purposes of section 311 transportation.


\textsuperscript{103} Id.

\textsuperscript{104} 18 C.F.R. § 284.122(d) (elec. 2010); Order No. 537-A, 57 Fed. Reg. 46,496 (Oct. 9, 1992).

\textsuperscript{105} Texas Sea Rim, 6 FERC at 61,285–86 (”Although Sea Rim has never transported gas in intrastate commerce, . . . it will be engaged in transportation which is not subject to NGA jurisdiction upon completion of all facilities construction. . . .”).
What jurisdictional factors, therefore, qualify a new pipeline as an intrastate pipeline for purposes of providing NGPA § 311 service? First, and most important, the mere fact that an entity already is providing intrastate transportation service through noncontiguous facilities is irrelevant.\(^{106}\) Rather, it is essential that the proposed intrastate pipeline have an indigenous source of gas supply within the state (preferably to which the proposed intrastate pipeline is directly connected or is indirectly connected through other intrastate pipelines), and a bona fide intrastate market which the pipeline proposes to serve.\(^{107}\) If these two elements exist, i.e., instate gas supply and an intrastate market, the pipeline connecting those two will qualify as an intrastate pipeline, which then may also provide additional interstate transportation services under NGPA § 311 without becoming subject to FERC’s regulatory jurisdiction under NGA. The latter is important because, while service under NGPA § 311 is also regulated by FERC, FERC does so under regulations that are generally more flexible than those applicable to interstate pipelines regulated under NGA, and in some significant respects these regulations are deferential to existing state regulation.\(^{108}\)

Thus, qualification of a facility as an intrastate pipeline providing transportation under section 311 may provide an attractive alternative means to avoid FERC regulation under NGA where the facility does not perform a gathering function under FERC’s primary function analysis.\(^{109}\)

[b] Hinshaw Pipeline Exemption

Like NGPA § 311, the application of the Hinshaw pipeline exemption may also provide a nonjurisdictional alternative to a jurisdictional inter-

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\(^{106}\) Egan Hub Partners, L.P., 73 FERC ¶ 61,334 (1995). See also Norteño Pipeline Co., 94 FERC ¶ 61,022 (2001), \textit{rehg denied}, 94 FERC ¶ 61,247 (2001) (transfer of interstate facilities to an existing intrastate pipeline will not change the jurisdictional status of the facilities as interstate facilities; the system was not going to be integrated operationally with the applicant’s existing intrastate system and potential intrastate uses were purely speculative).

\(^{107}\) Texas Sea Rim, 6 FERC at 61,285 (existence of a contract between an intrastate seller and an intrastate purchaser found to be “indicative” of intent to transport gas in intrastate commerce). See also El Paso Natural Gas Co., 116 FERC ¶ 62,081 (2006) (transportation of gas from outlet of existing natural gas processing plants in Texas for delivery to two municipal gas distribution customers and certain industrial end users in Texas held to be intrastate transportation).


\(^{109}\) However, transportation under section 311 of NGPA cannot be used to circumvent FERC jurisdiction under NGA. For example, a 10.5 mile pipeline built in two sections (one in North Dakota and one in South Dakota) by intrastate pipeline companies was held to be an interstate pipeline. The owners were found to have violated NGA, and FERC referred the matter to the Office of General Counsel, Market Oversight and Enforcement, for further review and appropriate action. White Rock Pipeline L.L.C., 98 FERC ¶ 61,220 (2002).
state pipeline at the consuming end of the transportation system. As previously discussed, in *East Ohio Gas*, the Supreme Court was confronted with a high-pressure pipeline located wholly in a single state. East Ohio Gas Co. (East Ohio) received natural gas that had been produced in another state and transported through an interstate pipeline to the point of delivery to East Ohio. East Ohio then delivered the gas through a high-pressure pipeline to its affiliate's local distribution system where the gas was distributed and consumed.

The issue in *East Ohio* was not whether the gas was flowing in interstate commerce. In a series of previous cases, the Supreme Court had held that even though gas was transported wholly within a single state, the gas was in interstate commerce.¹¹⁰ Indeed, the Supreme Court noted that East Ohio “do[es] not and cannot claim [its] gas is not in interstate commerce.”¹¹¹ Rather, the issue was whether the gas was transported and therefore subject to regulation by the Federal Power Commission (FPC) under NGA. The Supreme Court concluded that East Ohio's movement of gas through a high-pressure pipeline, albeit solely within the state in which the gas was consumed, was “transportation of natural gas in interstate commerce” subject to regulation by the FPC under NGA.¹¹²

In response to *East Ohio*, Congress amended NGA by creating the so-called Hinshaw exemption.¹¹³ Under the Hinshaw exemption, a pipeline that would otherwise be subject to federal regulation is not subject to regulation under NGA if the natural gas is received in or at the boundary of the state, all of the natural gas is ultimately consumed in the receiving state, and the pipeline's rates are subject to state regulation.¹¹⁴ This jurisdictional loophole does not come without a price, however, in that the pipeline's rates must be subject to state regulation. Nevertheless, if that criteria is met, a Hinshaw pipeline may be a nonjurisdictional strategic option worth considering where facilities in a consuming state are involved.

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¹¹² *East Ohio*, 338 U.S. at 473 (“East Ohio comes directly within the express provision granting power to the [FPC] to regulate ‘transportation of natural gas in interstate commerce.’.”).


¹¹⁴ Id.
[c] The Natural Gas Delivery Function and Local Distribution

In recent years, development of midstream infrastructure for direct delivery of natural gas to large industrial and commercial users, outside the framework of traditional local distribution facilities, has become of special interest to unregulated natural gas marketers and their large industrial and commercial customers.

In this regard, if the delivery service constitutes transportation of natural gas, the service would be the last stage in the transportation process and, therefore, jurisdictional under NGA. It is well established that “[t]he legislative history of the Natural Gas Act . . . undercuts any suggestion that final delivery to an end user transforms the terminal stage of transportation into distribution.”\(^\text{115}\) On the other hand, if the service is local distribution, the service will be exempt from federal regulation and, therefore, potentially subject to state regulation. From the perspective of most unregulated marketers, the determination whether particular facilities are jurisdictional is the key to avoiding local regulation designed to prohibit by-pass. This distinction therefore requires at least an overview of NGA exemption for local distribution.

[i] Prior to Enactment of NGA—Pre-1938 Analysis

Prior to enactment of NGA, the Supreme Court delineated the permissible range of state regulation and the scope of federal regulatory power under the Commerce Clause.\(^\text{116}\) The Supreme Court applied a variety of analytic methods in identifying the area, known as the Attleboro Gap,\(^\text{117}\) in which the Supreme Court had historically held that states were precluded from regulating under the so-called dormant Commerce Clause.\(^\text{118}\)

In one line of cases, the Supreme Court applied a mechanical test that conceptually divided intrastate commerce from interstate commerce at the point where the natural gas was reduced in pressure for distribution to local retail customers.\(^\text{119}\) In another set of cases, the Court used a local


\(^{117}\) Named after one of the lead cases on the subject, Attleboro Steam.

\(^{118}\) This term is used to describe the preclusive effect on state authority of the constitutional delegation to Congress of the power to regulate interstate commerce, even where Congress has not acted (hence the term dormant) to regulate such commerce.

interest analysis, and instead of trying to confine state power to some point at which interstate commerce turned into intrastate commerce, the Court simply found some forms of state regulation of interstate commerce were acceptable within the confines of the dormant Commerce Clause.\textsuperscript{120} The Supreme Court has suggested that by 1938, the mechanical test represented the proper mode of analysis.\textsuperscript{121}

Congress enacted NGA to fill the regulatory gap created by the Supreme Court’s decisions respecting the line between state and federal regulatory spheres.\textsuperscript{122} In doing so, Congress drew a jurisdictional distinction between wholesale sales in interstate commerce (jurisdictional) and retail sales (nonjurisdictional),\textsuperscript{123} and further between interstate transportation (jurisdictional) and distribution (nonjurisdictional).\textsuperscript{124} Congress did not, however, further elaborate on what constitutes transportation and what constitutes distribution. That task has fallen to FERC and the courts.

[iii] \textit{East Ohio Gas}

As previously discussed, the lead Supreme Court decision on the distinction between jurisdictional interstate transportation and nonjurisdictional local distribution is \textit{East Ohio Gas}. In that case, the Supreme Court held that federal regulatory jurisdiction extended over “the high-pressure trunk lines to the point where pressure was reduced and the gas entered local mains.”\textsuperscript{125} However, \textit{East Ohio Gas} did not rely exclusively on application of a so-called mechanical test relying on pressure alone. In \textit{East Ohio Gas}, the Court explained further, “[w]hat Congress must have meant by ‘facilities’ for ‘local distribution’ was equipment for distributing gas among consumers within a particular local community.”\textsuperscript{126} Indeed in an earlier case involving the same company, local distribution was originally found to be excluded from the Commission’s jurisdiction under NGA in part because it involved both dividing the gas and supplying it at retail.\textsuperscript{127}


\textsuperscript{121} See F.P.C. v. East Ohio Gas Co., 338 U.S. 464, 470 n.10 (1950) (East Ohio Gas); Cascade Natural Gas Co. v. F.E.R.C., 955 F.2d 1412, 1416 n.5 (10th Cir. 1992) (Cascade).


\textsuperscript{123} Cascade, 955 F.2d at 1419 (“Congress cleanly adopted the bright line between sales for resale and direct retail sales drawn by the earlier Commerce Clause cases.”).


\textsuperscript{125} East Ohio, 338 U.S. at 470.

\textsuperscript{126} Id. at 469-70.

\textsuperscript{127} East Ohio Gas Co. v. Tax Comm’n of Ohio, 283 U.S. 465, 470-71 (1931).
[iii] **CPUC v. F.E.R.C. and Cascade**

More recently, several courts of appeals cases have addressed the transportation versus distribution dichotomy in the context of by-pass of local distribution facilities. The most significant of those cases are *California Public Utilities Commission v. F.E.R.C.*,¹²８ and *Cascade Natural Gas Co. v. F.E.R.C.*¹²９ These cases warrant particular attention.

*CPUC v. F.E.R.C.* involved the question whether the California Public Utilities Commission (CPUC) had jurisdiction over the last segment of an interstate pipeline transporting gas from Wyoming and other states directly to end users’ facilities in California.¹³₀ The primary focus of the court’s analysis was on whether the activity in question constituted transportation rather than local distribution.

The case rejected the contention of CPUC that “delivery to an end user would be nonjurisdictional” distribution despite the fact that it is “merely the final stage in interstate transportation under *East Ohio.*”¹³¹ The Tenth Circuit held that “acts which constitute ‘transportation’ for §1(b) purposes under *East Ohio,*” i.e., movement of the gas through high-pressure trunk lines to the point where pressure was reduced, “remain such even though they end in delivery (at high pressure) to end users.”¹³²

Recognizing the fundamental changes in the structure of the natural gas industry that have taken place in recent years following restructuring under Order No. 636, the D.C. Circuit rejected the invitation to construe *East Ohio Gas* narrowly to limit federal regulatory authority only to “high pressure transmission without delivery to an end user.”¹³³ The D.C. Circuit also placed its own gloss on the term local distribution: “Distribution conjures up receiving a large quantity of some good and parcelling it out among many takers.”¹³⁴ The D.C. Circuit went on to observe, “[i]nsofar as congressional committees spoke to the matter [of the meaning of local distribution], . . . they appear to have viewed distribution as confined to its

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¹²９ 955 F.2d 1412 (10th Cir. 1992) (Cascade).
¹³₀ CPUC v. F.E.R.C., 900 F.2d at 273.
¹³¹ Id. at 276.
¹³² Id. at 277.
¹³³ Id.
¹³⁴ Id. at 276.
parcelling out function and (probably) even more narrowly, to parcelling out accompanied by retail sales.”

*Cascade* addressed a by-pass of the local distribution company by an end-user-owned delivery line. The issue was whether the component of the last segment of the interstate pipeline essential to the pipeline’s ability to deliver the gas to the end users (i.e., a delivery tap, meter, and pressure regulation equipment) were transportation facilities exclusively subject to federal regulation rather than local distribution facilities subject to state regulation. FERC had found the facilities to be jurisdictional. As a result, FERC’s issuance of a certificate of public convenience and necessity authorizing the construction of the by-pass facilities preempted state regulatory authority (which presumably would be called upon to block the by-pass).

In *Cascade*, the Tenth Circuit held that local distribution under NGA must be defined in the historical context of how “Congress viewed the term.” After reviewing the constitutional caselaw that provides the historical context for the enactment of NGA in 1938, and the legislative history of NGA itself, the Tenth Circuit concluded that local distribution involves “two components: the retail sale of natural gas and its local delivery, normally through a network of branch lines designed to supply local consumers.” *Cascade* places far more emphasis on the relationship between the exclusion for federal jurisdiction of local distribution and the exclusion for retail sales: “The phrases ‘any other . . . sale’ and ‘local distribution’ are similar in scope. As understood by Congress, both entail local retail sales to consumers, whether these sales were made by the local distributing companies or directly by the interstate pipelines.” In holding that the interstate pipeline’s delivery tap and meter, etc., did not perform a distribution function, the court indicated that the case turned on the fact that “a local retail sale is conspicuously missing.”

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135 *Id.*


137 *Cascade Natural Gas Co. v. F.E.R.C.*, 955 F.2d 1412, 1420-21 (10th Cir. 1992) (citing *Ute Indian Tribe v. Utah*, 716 F.2d 1298, 1303 (10th Cir. 1983)) (“In determining legislative intent it is necessary to consider the legislation in its historical context and not as if it was passed today.”) *Cascade*, 955 F.2d at 1418.

138 *Cascade*, 955 F.2d at 1421.

139 *Id.* at 1418.

140 *Id.* at 1421.
[d] End-User-Owned Facility Doctrine

An administratively developed and judicially recognized counterpart to the exclusion of local distribution from federal regulation under NGA applies to certain end-user-owned delivery facilities. FERC has essentially determined that user-owned delivery lines are part of the plant and that no federal interest would be served by regulation of those lines.\(^{141}\)

Two important limitations apply to this exemption, however. The first is that the delivery line must be owned by the end-user; apparently not even ownership by an affiliate will suffice.\(^{142}\) The second is that, unlike the statutory gathering exemption, which applies even though the gathering facility crosses a state line, if the end-user-owned delivery line crosses a state line, the exemption will not apply.\(^{143}\)

The end-user-owned-facility doctrine is of particular interest both to marketers interested in providing service to an end-user without becoming subject to federal regulation, while at the same time avoiding state regulatory efforts to prohibit by-pass, and to end-users desiring to by-pass uneconomic local distribution facilities. However, because FERC deems transportation in interstate commerce to have ceased upon delivery of the gas at the meter to the end-user delivery line,\(^{144}\) federal preemption principles may not provide a complete protection against local regulatory efforts designed to prevent by-pass.

The history of this exemption is one of narrow application that neither FERC nor the courts appear willing to expand. Nevertheless, under appropriate circumstances the Commission has issued a limited jurisdiction certificate where facilities did not meet all the requirements of the end-user owned facility doctrine, for example where the delivery line crossed a state line.\(^{145}\) Once again, the limited jurisdiction certificate represents an alternative where a better known or more commonly utilized structure is found to be inapplicable.

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\(^{143}\) Int’l Paper Co. v. F.P.C., 438 F.2d 1349, 1357 (2d Cir. 1971).


FERC’s Shipper-Must-Have-Title Rule and Buy/Sell Prohibition

Two hallmark principles of FERC’s open-access transportation program for natural gas are FERC’s shipper-must-have-title rule and the prohibition against buy/sell transactions used to circumvent the shipper-must-have-title rule. Although commonly associated with FERC Order No. 636, the shipper-must-have-title rule originated in a Texas Eastern Transmission Corp. proceeding years before Order No. 636.\textsuperscript{146} As its name implies, the rule requires the shipper of natural gas under an interstate pipeline’s blanket transportation certificate to have title to the gas being transported. For this purpose,\textsuperscript{147} the shipper is generally the person in whose name the capacity utilized to transport the gas is held. The buy/sell prohibition is a corollary to the shipper-must-have-title rule, and was adopted in connection with Order No. 636.\textsuperscript{148} For our purposes it is important to note that some natural gas marketing arrangements typically engaged in by operators of natural gas producing properties may present issues under FERC’s shipper-must-have-title rule, as discussed in greater detail below in § 28.05.

§ 28.04 Jurisdiction Under ICA

[1] Introduction

Most oil and gas producers are familiar with the gathering exemption under NGA and with FERC’s open-access transportation requirements which permit shippers to reserve a specific amount of capacity in an interstate pipeline by signing up for firm transportation service. This familiarity can cause problems for producers needing to arrange for oil pipeline transportation because they may erroneously assume that the same rules apply. In fact, the federal regulation of oil pipeline transportation is significantly different from the federal regulation of gas pipeline transportation and the differences affect how oil and gas infrastructure is developed and utilized.

Federal regulation over the interstate transportation of natural gas began in 1938 with the passage of the NGA, a statute that was specific to natural gas. In contrast, the governing statute for oil transportation is the Interstate Commerce Act of 1887 (ICA), a statute originally enacted in Queen Victoria’s time to regulate the railroad industry. The focus of ICA was on


\textsuperscript{147} The authors also leave aside Asset Management Arrangements (AMAs) approved by FERC under Order No. 712. Promotion of a More Efficient Capacity Release Market, Order No. 712, 123 FERC ¶ 61,286 (2008).

\textsuperscript{148} Order No. 636, 59 FERC ¶ 61,031, reh’g denied, 60 FERC ¶ 61,117 (1992).
ensuring just and reasonable rates and prohibiting discriminatory fares or secret rebates.\textsuperscript{149} The Interstate Commerce Commission (ICC) was the agency in charge of enforcing ICA. Oil pipelines were made subject to certain provisions in part I of ICA through enactment of the Hepburn Act in 1906.\textsuperscript{150} Jurisdiction over oil pipelines was not transferred to FERC until 1977, and is based upon that portion of part I of ICA that was applicable to oil pipelines as the part existed on October 1, 1977.\textsuperscript{151} Therefore, absent congressional action, FERC cannot regulate oil pipelines in as comprehensive a manner as it regulates gas pipelines.

One of the significant differences in regulation under ICA as compared to regulation under NGA is that oil pipelines are common carriers.\textsuperscript{152} ICA states that, “[i]t shall be the duty of every common carrier subject to this chapter to provide and furnish transportation upon reasonable request therefor. . . .”\textsuperscript{153} Among other things, this means that a common carrier cannot simply refuse to accept a tender (of passengers or goods) “if his coach be full.”\textsuperscript{154} For oil pipelines, this has been interpreted to mean that there can be no entitlement to firm transportation service.\textsuperscript{155} If there is a capacity constraint on an oil pipeline, the available capacity is prorated.\textsuperscript{156}

\textsuperscript{149} “The chief purpose of the act was to secure uniformity of treatment to all, to suppress unjust discriminations and undue preferences, and to prevent special and secret agreements in respect of rates for interstate transportation. . . .” Kan. City S. Ry. Co. v. C.H. Albers Comm’n Co., 223 U.S. 573, 597 (1912). ICA was passed in response to practices of railroad tycoons (also referred to as robber barons) who charged lower rates to large customers or paid secret rebates to large customers, thus discriminating against farmers, small businesses, and passengers. The Act was later amended to also cover transportation by oil pipelines (1906), water, and motor vehicles.


\textsuperscript{151} While the statutes regulating railroads and other forms of transportation have continued to evolve, in 1978 the portion of part I of ICS that included regulation of oil pipelines was repealed as to all but oil pipelines, and it remains fixed on the books as it was in 1977, appearing now only in an appendix to Title 49 of the U.S. Code, available at http://ferc.gov/legal/fed-sta-asp?new=sc4. See note 9, supra.

\textsuperscript{152} ICA, 49 U.S.C. App. § 1(b) (1988).

\textsuperscript{153} Id. § 1(4). ICA also incorporates by reference the common law of common carriers. Id. § 22(1).

\textsuperscript{154} Belle Fourche Pipeline Co., 28 FERC ¶ 61,150 at 61,281 (1984) (rejecting an oil pipeline tariff that would have given the pipeline the discretion to refuse tenders when it had reached capacity).

\textsuperscript{155} See Texaco Pipeline Inc., 74 FERC ¶ 61,071 (1996) (Texaco) (tariff provision held to grant an unreasonable preference by designating a portion of the pipeline for the exclusive use of a special class of shippers without being subject to prorating).

\textsuperscript{156} Tariffs specify the method of prorating which may be based on historical tenders, current tenders, or other methods.
Funding for new interstate gas pipeline construction often is made possible by the execution of precedent agreements by anchor shippers for firm transportation service entitling them to exclusive use of a specified portion of the capacity of the new pipeline and obligating them to pay for such capacity, whether used or not. In contrast, the common carrier obligations of oil pipelines make it difficult for anchor shippers to receive sufficient capacity assurances to be willing to make long-term financial commitments.\textsuperscript{157} Care must also be taken to avoid a violation of the Elkins Act, a criminal statute passed in 1906 which, among other things, provides:

\begin{quote}
[I]t shall be unlawful for any person, persons, or corporation to offer, grant, or give, or to solicit, accept, or receive any rebate, concession, or discrimination in respect to the transportation of any property in interstate or foreign commerce by any common carrier subject to said [chapter] . . . whereby any such property shall by any device whatever be transported at a less rate than that named in the tariffs published and filed by such carrier, as is required by said [chapter] . . . , or whereby any other advantage is given or discrimination is practiced.\textsuperscript{158}
\end{quote}

Thus, there is a tension between the common carrier obligation and the need to be able to provide some sort of capacity assurance to anchor shippers in order for new or expansion oil transportation capacity to be built. To date, this tension has been addressed by FERC through issuance of declaratory orders or approval of offers of settlement that provide differing levels of commitment reflected in differing tariff rates and prorationing provisions for new or expansion capacity. The common requirement is that these proposals must be nondiscriminatory and provide an opportunity for all shippers to participate.\textsuperscript{159} Parties investigating possible avenues for new or expansion pipeline construction need to be aware of these differences between the federal regulation of oil and natural gas, and proceed accordingly.

Further, unlike natural gas, there is no gathering exemption for oil transportation. The transportation of oil is either intrastate or interstate in character. Also unlike natural gas, the same pipeline may provide both intrastate and interstate service over the very same pipeline segments.\textsuperscript{160}

\textsuperscript{157} Texaco is an example of tariff-based remedies, directed at addressing this problem, which have been rejected by FERC.


\textsuperscript{160} Amoco Pipeline Co., 62 FERC ¶ 61,119 at 61,803 (1993).
For oil pipelines, the issue is whether a particular shipment is intrastate or interstate in nature and the commingling of oil streams is not a factor in determining jurisdiction under ICA.\textsuperscript{161}

As noted above, under ICA, FERC must look at the essential character of the transportation to determine whether it is interstate in character.\textsuperscript{162} The primary factor used to determine the essential character of the commerce is the “fixed and persisting transportation intent of the shipper at the time of shipment.”\textsuperscript{163} This standard is notably different from the tests applied by the FERC under NGA where the shipper’s and the transporter’s intent are irrelevant, and where transportation of natural gas has been found to be jurisdictional despite the shipper’s and the transporter’s intent to the contrary, and despite the best efforts of parties to avoid federal regulation.\textsuperscript{164}

[2] Essential Character and Persisting Intent Standards

It should be noted that it is the intent of the shipper of the oil, not the pipeline transporter, that is controlling.\textsuperscript{165} Moreover, it is the intent of the shipper at the time of shipment that is controlling.\textsuperscript{166} With respect to the oil which a pipeline transports for third parties, the same principles apply, but the analysis may be complicated by the pipeline’s lack of knowledge respecting the intent of the third-party shippers.

To determine the shipper’s intent, the Commission looks at a number of factors: the character of the billing (whether local or through); change in ownership during the course of transportation; processing, inventory, or storage before reshipment; character and length of transaction at the point of interruption of transportation; knowledge and/or intent of the shipper with respect to the final destination; separately arranged transportation movements; commingling of the commodity with other shipments of the commodity; power of the owner to divert the shipment after the initial movement is begun; and the general practices and customs prevailing in the industry.\textsuperscript{167} These factors are reviewed for indicia of whether there is continuous interstate movement.

\textsuperscript{161} Id.

\textsuperscript{162} Atlantic Coast Line RR. Co. v. Standard Oil Co., 275 U.S. 257 (1927).

\textsuperscript{163} Dep’t of Def. v. Interstate Storage & Pipeline Co., 353 I.C.C. 397 (1977).

\textsuperscript{164} E.g., California v. Lo-Vaca Gathering Co., 379 U.S. 366 (1965).

\textsuperscript{165} Dep’t of Def. v. Interstate Storage & Pipeline Co., 353 I.C.C. 397 (1977).

\textsuperscript{166} Id.

[3] Continuous Interstate Movement

If oil is transported through a pipeline wholly within a single state, but thereafter the oil is transported by another pipeline to markets in another state, the upstream transportation of the oil within the state in which it was produced may be subject to regulation under ICA as interstate transportation if the transportation is an integral part of an interstate transportation scheme.\textsuperscript{168}

A break in the transportation of oil may isolate nonjurisdictional upstream transportation from downstream jurisdictional interstate transportation, such that the upstream transportation is not deemed to have been in interstate commerce and therefore is not subject to regulation by FERC under ICA.\textsuperscript{169} For example, the fact that the oil comes to rest, even if only briefly, in third-party storage tanks before being moved onward in interstate commerce, may support the conclusion that the upstream transportation is nonjurisdictional,\textsuperscript{170} provided that there is a nonjurisdictional intrastate disposition of the oil available at the storage facility. On the other hand, a break in the flow of interstate transportation is not likely to be recognized for ICA jurisdictional purposes where the oil merely comes to a temporary rest at a point from which the only disposition of the oil is in a continuation of interstate transportation.

Applying these principles, several considerations may become relevant to whether there has been a break in the flow of the interstate movement of the oil or condensate sufficiently to render the upstream or downstream movement nonjurisdictional based upon the fact that the upstream or downstream pipeline is located wholly within a single state:

1. Whether the shipper intends to continue transport of the oil or condensate through a pipeline that will cross a state line.
2. Whether the oil or condensate is likely to remain in storage tanks for a predictable length of time and is not being received and discharged from the storage tanks simultaneously, with the storage tanks merely


\textsuperscript{169} Ultramar, Inc. v. Gaviota Terminal Co., 80 FERC ¶ 61,201 (1997) (refining of crude oil causes a break in transportation such that interstate transportation downstream of the refinery does not render jurisdictional, upstream movement of oil from the OCS to onshore facility); Interstate Energy Co., 32 FERC ¶ 61,294 (1985) (storage with orders for delivery after oil reaches terminal constitutes a break in movement sufficient to isolate nonjurisdictional movement from jurisdictional movement).

\textsuperscript{170} Northville Dock Pipe Line Corp., 14 FERC ¶ 61,111 (1981) (24-hour interruption in transportation by storage in tanks).
serving as a buffer between two pipelines to accommodate for differences in timing of flows.

(3) Whether a viable local market alternative exists.

[4] The Uncle Sam Oil Company Exception

In United States v. Ohio Oil Co. (Pipeline Cases),¹ the seminal case on the jurisdictional reach of ICA, the Supreme Court held that ICA applies regardless of the status of a pipeline as a common carrier under common law.¹¹ Thus, depending on whether or not the pipeline was engaged in interstate commerce, ICA may apply to pipelines that are common carriers under the common law, i.e., those which hold themselves out to provide transportation service for third parties. In addition, ICA may apply to otherwise proprietary pipelines, that do not qualify as common carriers at common law, if the pipeline engages in buy/sell transactions or exchanges.¹² While such buy/sell transactions or exchanges may suffice to avoid common carrier status under the common law, they do not suffice to escape regulation under ICA.

Nevertheless, in the Pipeline Cases, the Supreme Court recognized an exception, known as the Uncle Sam Oil Company exception, whereby an interstate pipeline used solely for the purpose of carrying oil from the company’s own wells to its own refinery is a nonjurisdictional proprietary pipeline.¹³ It is important to recognize that the Uncle Sam Oil Company exception has been interpreted very narrowly. Thus, in Valvoline Oil Co. v. United States,¹⁴ the Supreme Court held that the Uncle Sam Oil Company exception was not applicable because although all the oil Valvoline transported was owned by Valvoline, some of the oil Valvoline transported had been purchased by Valvoline from third-party producers.¹⁵

¹¹ 234 U.S. 548 (1914).

¹² Id. at 559-60.

¹³ When, as in this case, a company is simply drawing oil from its own wells across a state line to its own refinery, for its own use, and that is all, we do not regard it as falling within the description of the act, the transportation being merely an incident to use at the end.

¹⁴ Valvoline Oil Co. v. United States, 308 U.S. 141 (1939) (Valvoline).

¹⁵ Valvoline, 308 U.S. at 146.
In *United States v. Champlin Refining Co.*, Champlin Refining Co. (Champlin) owned and operated a pipeline that ran from its refinery in Oklahoma to its terminals in Kansas, Nebraska, and Iowa. No other refiner had connections with the line, and none had ever shipped products through it. Champlin's line did not connect with any other pipeline. The Supreme Court held that Champlin was engaged in transportation within the meaning of ICA, and upheld an order by the ICC requiring the company to submit valuation data, maps, charts, and other documents relating to its operations.

Subsequently, in a case involving the same pipeline, the Court recognized a limitation on the general rule set forth in the *Pipeline Cases*. Despite the Court's earlier ruling in *Champlin I*, the Supreme Court held that “it would be strange to suppose that Congress” intended to make “common carriers for hire out of private pipelines whose services were unused, unsought after, and unneeded by independent producers, and whose presence fosters competition in markets heavily blanketed by large ‘majors.’” In reconciling *Champlin II* with the earlier holding in *Champlin I*, the Court noted that the “[c]ollection of information has a significance independent from the imposition of regulations.” Apparently oil pipelines otherwise exempt from regulation under the exception established in the *Pipeline Cases* may be jurisdictional for some purposes under ICA, e.g., information collection, while not jurisdictional for rate-making purposes.

Although FERC has only addressed the jurisdictional status of oil pipelines in a small number of cases, in those cases the Commission has applied the judicial precedents discussed above.

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176 329 U.S. 29 (1946) (Champlin I).
177 Champlin I, 329 U.S. at 34.
179 Reserved.
180 Champlin II, 341 U.S. at 298.
181 Id. at 296.
182 The Supreme Court has noted a similar distinction under NGA. F.P.C. v. Panhandle E. Pipeline Co., 337 U.S. 498, 505-06 (1949).
183 See Texaco Refining & Mktg., Inc. v. SFPP, L.P., 80 FERC ¶ 61,200 (1997) (finding the pipeline to be jurisdictional); Hunt Refining Co., 70 FERC ¶ 61,035 (1995) (finding the pipeline to be jurisdictional); Interstate Energy Co., 32 FERC ¶ 61,294 (1985) (finding the pipeline to be nonjurisdictional under the Uncle Sam Oil Company exception).
Whose Oil Is It for Purposes of the Uncle Sam Oil Company Exemption?

The scope of the Uncle Sam Oil Company exemption is often of particular concern to producers interested in developing midstream transportation facilities for crude oil or condensate upstream from an existing interstate oil pipeline regulated under ICA. This interest is likely due to the lack of an exemption under ICA for gathering lines, and the fact that the producer-owned pipeline may not qualify as located upstream from a break in interstate movement that would insulate the producer-owned line from interstate commerce. Under such circumstances, the pipeline developer’s options for avoiding federal regulatory jurisdiction under ICA may be limited.

One option for avoiding ICA regulation, that has its own set of commercial and economic drawbacks, is development of the pipeline on a joint venture basis with each owner owning an undivided interest in the capacity used to transport its own production. This option is premised upon a variation on the Uncle Sam Oil Company exception, and assumes that each pipeline owner transports only its own production over its own portion of the proprietary line. The other option is the application of the Uncle Sam Oil Company exemption itself.

As we have seen, however, the Uncle Sam Oil Company exemption has been narrowly applied by FERC and the courts. Accordingly, it would be risky to assume that transportation of crude oil or condensate produced by working interest owners other than the owner of the pipeline, including producers with working interests in the same wells from which the pipeline owner’s oil and condensate are produced, would qualify for the Uncle Sam Oil Company exemption. The fact that FERC currently lacks authority to impose civil penalties for violations of ICA is likely to be small comfort to the pipeline developer facing the prospect of application of rate regulation to a pipeline developed on the assumption that it would not be regulated. Under such circumstances, prior caselaw strongly suggests

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184 While there appears to be no caselaw directly on point that provides authority for this as a viable option to avoid ICA regulation altogether, it is a logical extension of the property principles upon which the Uncle Sam Oil Company exception is based. In any event, the particulars by which this option is implemented are beyond the scope of this chapter. Frequently, the operational and accounting complexities involved in implementing such an option render the option undesirable, and cause developers to look for other regulatory solutions that preserve the economics of a commercially preferred arrangement while not involving joint ownership.

185 It should be noted that ICA provides for damages as well as criminal penalties for violations of the statute, and it is not only a crime to give a rebate, it is also a crime to receive a rebate. See ICA § 10, 49 U.S.C. App. A § 41(1) (1988).
that regulation would not be avoided, and the Uncle Sam Oil Company exemption would not apply, when the owner of the pipeline purchases the oil or condensate from the other working interest owners in the wells, regardless of whether the purchaser intends to retain ownership for its own account or is obligated to redeliver equivalent volumes to the other working interest owners under a buy/sell transaction.

§ 28.05 Intersection of Regulatory Principles and Property Law

[1] Regulatory Principles Implicated

This chapter previously has identified regulatory criteria under which a particular jurisdictional outcome may turn on application of state property law principles. For example, FERC may issue a limited jurisdiction certificate when all of the gas transported through a particular facility is owned by the owner/operator of the facility. Unlike the limitations placed by Valvoline on the application of the Uncle Sam Oil Company exemption, however, how the operator of a limited jurisdiction pipeline acquired ownership of the natural gas transported through the pipeline does not present jurisdictional consequences. The shipper-must-have-title rule applied by FERC to open-access transportation of natural gas under FERC Order No. 636 is another example of a regulatory principle which may turn on application of state property law. Specifically, who owns the natural gas being transported by an operator of a producing property, where the gas was attributable to the interests of third-party working interest owners, may be significant to compliance with FERC’s shipper-must-have-title rule. Finally, how the pipeline owner came to own the oil being transported is of critical jurisdictional significance under the Uncle Sam Oil Company exception.

[2] Property Law—Ownership of Oil and Gas

Depending on local law and the terms of the Joint Operating Agreement (JOA) in place between the operator of a proprietary oil pipeline (who we assume for this purpose is also the operator of the properties from which the oil or condensate is produced) and the other working interest owners in the producing properties, the application of the Uncle Sam Oil Company exemption may turn on the manner in which ownership of oil is structured under the law of tenancy-in-common and the terms of the JOA. Similarly, local property law and the structure of the JOA may determine whether an operator, who markets natural gas attributable to the interests of third-party working interest owners in the gas producing property, satisfies the requirements of the shipper-must-have-title rule.
[a] Tenancy-in-Common

The existence of a tenancy-in-common, as delineated in Torgeson v. Connelly, among working interest owners in oil and gas leases is well established: The owners of undivided portions of oil and gas rights in and under real estate are tenants in common and each of them may enter upon the premises to explore for and develop gas and oil. Torgeson followed the seminal case in the field, Earp v. Mid-Continent Petroleum Corp. The courts of Oklahoma and other producing states have strictly adhered to the reasoning in Earp.

While courts have consistently recognized one cotenant’s general right to develop and dispose of a well’s production without the consent of another cotenant, several cases have also addressed the narrower question whether this right enables one cotenant to sell 100% of current production when another cotenant chooses not to or is unable to sell its proportionate share of the production. In Anderson v. Dyco Petroleum Corp., Panhandle Eastern Pipeline Company (Panhandle) purchased natural gas from various working interest owners with which Panhandle had contracted. Panhandle refused, however, to purchase gas from the working interest owners of the well with which Panhandle had not contracted. The noncontracted owners brought an action against Panhandle for conversion of their gas, seeking an order requiring Panhandle to purchase the uncontracted working interest owners’ share of production (or to pay the uncontracted working interest owners their proportionate share of the proceeds from Panhandle’s purchase of the full well stream). The Oklahoma Supreme Court rejected the premise of this claim on the ground that “because each cotenant has the right to . . . market production under the common law,” sale of the production by one cotenant ordinarily does not involve conversion of the uncontracted cotenant’s gas by the purchaser.

186 348 P.2d 63 (Wyo. 1959) (Torgeson).
186.1 Id. at 70.
187 27 P.2d 855 (Okla. 1933) (Earp).
188 See, e.g., Anderson v. Dyco Petroleum Corp., 782 P.2d 1367, 1371 (Okla. 1989) (Anderson); Byrom v. Pendley, 717 S.W.2d 602, 605 (Tex. 1986); Fife v. Thompson, 708 S.W.2d 611 (Ark. 1986); Dilworth v. Fortier, 405 P.2d 38, 49 (Okla. 1964); Torgeson, 248 P.2d at 70.
191 Id. at 1371-72. Much of the caselaw relating to tenancy-in-common of natural gas pertains to the obligation of a selling cotenant to “account” to the non-selling cotenant.
Thus, the majority rule is that when one tenant-in-common chooses not to take and dispose of its proportionate share of oil or gas, the other cotenants have the right to take, sell, and dispose of the non-taking owner's share of the oil or gas (subject to the obligation to account), and an imbalance is created.\textsuperscript{192} Although the courts generally do not speak in terms of who has title to the production taken by the taking interest owner in excess of its proportionate working interest share (where not all working interest owners exercise their right to take their share of production in kind), it appears to be reasonably well settled that title to the production vests in the taking interest owner at the time of production and no purchase of production from the non-taking interest owner by the taking interest owner is involved.\textsuperscript{193}

Application of these rules should be dispositive of the ownership issues for both oil and natural gas regulatory purposes. It appears likely that the courts would reject any attempt by FERC to construe ownership, conferred by operation of the law of tenancy-in-common, of production in excess of a cotenant's proportionate working interest share, as resulting from a sale of the non-taking interest owners' share of production to the other cotenant. In \textit{Mobil Oil Corp. v. F.P.C.},\textsuperscript{194} FERC's predecessor, the FPC, attempted to subject the royalty provisions of conventional oil and gas leases to regulation under NGA as sales of natural gas. The D.C. Circuit rejected FPC's ruling as inconsistent with the "ordinary usage" of the term "sale" as likely understood by Congress.\textsuperscript{195} A similar result would be likely if FERC were to construe ownership, conferred by operation of the law of tenancy-in-common, as equivalent to ownership resulting from a sale for purposes of invoking the \textit{Valvoline} exception to the Uncle Sam Oil Company exemption established in the \textit{Pipeline Cases}.

The method of accounting does not, however, affect the ownership of the condensate for purposes of qualifying for the Uncle Sam Oil Company exception from ICA jurisdiction.

\textsuperscript{192} \textit{Torgeson}, 348 P.2d at 70. If a contemporaneous accounting occurs, however, no imbalance exists. Any imbalance which is created may be resolved by balancing in-kind or by cash balancing, either on a periodic basis or at the end of production. See \textit{Kaiser-Francis}, 870 F.2d at 569-70 (discussing forms of balancing). See Eugene Kuntz, "Gas Balancing Rights and Remedies in the Absence of a Balancing Agreement," 35 \textit{Rocky Mt. Min. L. Inst.} 13-1, 13-8 to 13-10 (1989) (discussing majority and minority rules).

\textsuperscript{193} David E. Pierce, "The Law of Disproportionate Gas Sales," 26 \textit{Tulsa L.J.} 135, 140 (1990) (the production "is owned" solely by the taking cotenant); Kuntz, \textit{supra} note 192, at 13-10 to 13-11 (non-taking cotenant has no "ownership" in production taken by the taking cotenant).

\textsuperscript{194} 463 F.2d 256 (D.C. Cir. 1971) (Mobil Oil II).

\textsuperscript{195} \textit{Mobil Oil II}, 463 F.2d at 263.
[b] Joint Operating Agreements (JOA) and Cotenancy-Like Relationships

The subject becomes more complicated (not to say muddled), however, where so-called cotenancy-like relationships are created under other contractual arrangements, including, for example, joint operating agreements (JOAs). Professor Pierce points out that “reported cases have failed to clearly distinguish between common law cotenancy and cotenant-like relationships created by contract.” A number of cases discuss whether language in a JOA establishes the existence of cotenancy-like ownership of the natural gas or oil production. Unfortunately, the cases are far from clear as to the attributes of cotenancy-like relationships created under a JOA as compared to the well-established characteristics and consequences of common law tenancy-in-common. Also less than clear is the potential for provisions of a JOA to undermine the otherwise applicable consequences of the law of tenancy-in-common to ownership of oil or natural gas in excess of a cotenant’s proportionate working interest share, where the other cotenants choose not to take their share of production in kind.

For example, the following is representative JOA language:

In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil and/or gas produced from the Contract Area, Operator shall have the right, . . . but not the obligation, to purchase such oil and/or gas or sell it to others . . . for the account of the non-taking party at the price which operator is receiving for its production. Any such purchase or sale by Operator shall be subject always to the right of the owner of the production to exercise at any time its right to take in kind, or separately dispose of, its share of all oil and/or gas not previously delivered to purchaser. Any purchase or sale by Operator of any other party's share of oil and/or gas shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of thirty (30) days.

The italicized language of the illustrative JOA text clearly contemplates one of two transactions:

1. a purchase of the non-taking party’s share of production by the Operator; or

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197 Pierce, supra note 193, at 141.

198 See, e.g., Harrell, 980 P.2d at 103; Doheny v. Wexpro Co., 974 F.2d 130, 134 (10th Cir. 1992) (Doheny) (rejecting cotenancy-like ownership under JOA); Questar Pipeline Co. v. Grynberg, 201 F.3d 1277, 1285-86 (10th Cir. 2000) (distinguishing Doheny).
(2) an agency relationship for the account of the non-taking party in which the Operator sells the non-taking party’s share of production to a third-party purchaser.

Either arrangement would serve to defeat the application of the Uncle Sam Oil Company exemption. The purchase of the non-taking party’s share of production would disqualify the pipeline from proprietary status under Valvoline. The sale of the non-taking party’s gas by the operator under an agency arrangement would likewise disqualify the pipeline from proprietary pipeline status under the rule in the Pipeline Cases. In the latter case the operator would be transporting production for a third party because title to the production would have remained in the non-taking interest owner while the operator was merely authorized under the JOA to sell the production as agent for the non-taking interest owner. Likewise, construction of the JOA as establishing an agency relationship for natural gas marketed by the operator of a well on behalf of other working interest owners could also raise problems under FERC’s shipper-must-have-title rule.199

A JOA often provides a mechanism for resolving imbalances that would otherwise result from the operator’s taking of more than its proportionate working interest share of the production and selling it all for its own account. This language is generally less problematic. A typical JOA provision provides:

In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil and/or gas produced from the Contract Area, Operator shall have the right, . . . to purchase such oil and/or gas or sell it to others . . . , for the account of the non-taking party at the price which operator is receiving for its production.

The italicized language is consistent with the majority rule requirement at common law for the tenant-in-common, who takes more than its proportionate working interest share of production, to account to the other cotenants. As previously indicated, such accounting may occur through balancing in kind, through periodic cash balancing, or through cash balancing at the end of production. The italicized text in the second excerpt of illustrative JOA language is a form of periodic cash balancing. Accordingly, this accounting language alone, or equivalent contract-based cash accounting mechanisms, should not fundamentally transform the nature of the shipper’s common-law-based ownership of the production taken in

199 For natural gas regulatory purposes, the construction of the JOA as constituting a “sale” of the non-operator’s working interest share of production to the operator would not result in a violation of FERC’s shipper-must-have-title rule, or present regulatory problems under FERC’s buy/sell prohibition except in the unlikely event that the operator sold the gas back to the non-operating working interest owner following the transportation of the gas in interstate commerce.
excess of the shipper’s proportionate working interest share, to one based upon an imputed purchase and sale transaction (which, under *Valvoline*, would defeat the application of the Uncle Sam Oil Company exception).  

### 3 Structuring Transactions to Reduce Regulatory Risk

Relying on the existence of common law tenancy-in-common under the oil and gas leases is preferable to reliance on the terms of the JOA as the basis for the shipper’s ownership of the production not taken by the nonoperating working interest owners. Depending on the terms of the JOA, contact language may be needed to reduce the risk that the basis for a shipper’s ownership of 100% of the production being transported will be misconstrued.  

As we have seen, a typical JOA may provide for the purchase of the non-taking party’s share of production by the operator or establish an agency relationship for the account of the non-taking party in which the operator sells the non-taking party’s share of production to a third-party purchaser. Either arrangement could defeat the application of the Uncle Sam Oil Company exemption, and the agency relationship construction could raise shipper-must-have-title concerns for the transporter of natural gas. In such cases, an amendment to the JOA should be considered to confirm the vesting of ownership of the oil or gas in the taking interest owner under common law principles of tenancy-in-common, rather than under the potentially problematic language of the JOA.  

A JOA often contains language for resolution of any imbalance created by the exercise of the operator’s common law rights as a tenant-in-common. The question arises whether such balancing language should have any jurisdictional regulatory consequences. Although the issue is an open one, it may prove to be determinative that such language can rarely be construed as a subterfuge to escape NGA or ICA regulation, as arguably were the oil buy/sell and exchange transactions rejected in the *Pipeline Cases*, and the natural gas buy/sell transactions prohibited in Order No. 636 and *El Paso Natural Gas Co.* The accounting mechanisms of a JOA is typically consistent with the common law requirement for the taking working interest owner to account to its cotenants, and were developed for reasons unrelated to ICA or NGA jurisdiction. Where a transaction is otherwise

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200 In this context, the reference to the “shipper” includes the owner/operator of a “proprietary” oil pipeline.

201 Such contractual language may take the form of a formal amendment to the JOA or, in appropriate cases, a separate agreement.


properly structured under the law of tenancy-in-common, these factors should adequately distinguish *Valvoline* and the arrangements rejected in the *Pipeline Cases*, as well as the grounds for rejection of natural gas buy/sell transactions and adoption of the shipper-must-have-title rule.

\section*{§ 28.06 Conclusion}

Despite the fact that natural gas and oil are major components of a single industry, dramatically different regulatory regimes apply to transportation of natural gas versus that of oil. NGA and ICA employ fundamentally different statutory frameworks, with differing jurisdictional consequences.

FERC is armed with substantial remedial powers, including refunds (reparations) under ICA and civil penalties under NGA (and NGPA), that can make an error in structuring transportation and related arrangements extremely costly. These regulatory risks warrant careful attention to the structure of most midstream development projects to ensure that exposure to regulatory requirements are minimized and, if possible, avoided entirely.

Particular care must be taken in dealing with transportation of oil and natural gas attributable to the interest of third-party working interest owners in properties operated by the entity later transporting the oil or natural gas. While the law of tenancy-in-common provides a sound basis for avoiding undesirable regulatory consequences, a JOA sometimes threatens to muddy the waters. Wherever possible, relying on the law of tenancy-in-common is preferable to relying on tenancy-like relationships created under a JOA.

The provisions of any JOA must be carefully reviewed for consistency with the law of tenancy-in-common on which critical regulatory consequences may depend. Where necessary, appropriate amendments should be adopted to clarify the basis on which the shipper (including the operator or a proprietary oil pipeline) acquired ownership of production otherwise attributable to the interest of another working interest owner. This is particularly important in jurisdictions which do not apply the so-called majority rule of tenancy-in-common, as the JOA may provide the only defense to a potential regulatory violation. In either case, failure to review the JOA and adopt appropriate amendments may jeopardize the salutary benefits which ordinarily flow from the law of tenancy-in-common, and lead to undesirable and costly regulatory consequences.