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The Federal Power Commission Does Not Have Jurisdiction Over the Sale of a Developed Leasehold Interest of Gas in Formation-*Marr v. FPC*

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RECENT DEVELOPMENTS

The Federal Power Commission Does Not Have Jurisdiction Over the Sale of a Developed Leasehold Interest of Gas in Formation—*Marr v. FPC*

Independent gas producers[1] erected producing wells upon certain land to extract leased mineral interests. This development of the leasehold[2] supplied geological information from which the amount of gas reserves was estimated. The gas leasehold was then sold to Texas Eastern Transmission Company, an interstate pipeline company that sought additional reserves. Texas Eastern applied to the Federal Power Commission for a certificate of public convenience and necessity to connect its transportation system to the field.[3] The FPC asserted jurisdiction over the sale of the leasehold in order to investigate the cost aspects of the transaction. Because the details of the sale appeared to adversely affect the ultimate price of gas to the consumer, the FPC refused to grant the requested certificate.[4] On appeal, *held,* the Federal Power Commission does not have jurisdiction over the sale of a developed leasehold interest of gas in formation.[5] *Marr v. FPC*, 33 U.S. L. WEEK 2074 (5th Cir. Aug. 8, 1964).

The Natural Gas Act[6] is applicable to the "sale in interstate commerce of natural gas for resale for ultimate public consumption,"[7] but it expressly exempts the business of "production or gathering" from FPC jurisdiction.[8] The ultimate classification of a transaction into one category or the other is left to the FPC and the judiciary. At present, a direct sale of natural gas to an interstate pipeline is within the jurisdiction of the FPC; it is not part of production and gathering.[9] But, the sale of an *undeveloped* leasehold

1. An "independent gas producer" produces, gathers, processes, and sells natural gas, but neither transports it in interstate commerce nor is affiliated with any interstate pipeline company. Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672, 674-75 (1954).

2. Development of a leasehold consists of drilling wells and bringing them into production. An area remains undeveloped if production is not obtained, even though exploratory or discovery wells are drilled. WILLIAMS & MEYERS, OIL AND GAS TERMS 61 (1957).

3. Extension of facilities for the interstate transportation or sale of natural gas requires approval by the FPC through the issuance of a certificate of public convenience and necessity. Natural Gas Act § 7(c), 52 Stat. 824 (1938), as amended, 15 U.S.C. § 717f(c) (1958).

4. Texas E. Transmission Corp., 29 F.P.C. 249, 257-58 (1963).

5. "Gas in formation" refers to gas situated in fault traps or other natural geological formations beneath the ground. WILLIAMS & MEYERS, *op. cit. supra* note 2, at 93.

6. 52 Stat. 821 (1938), as amended, 15 U.S.C. § 717 (1958).

7. Natural Gas Act § 1(b), 52 Stat. 821 (1938), as amended, 15 U.S.C. § 717(b) (1958).

8. *Ibid.*

9. Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954). Commentators, prior to the *Phillips* decision, erroneously, but almost unanimously, believed that FPC assertion of jurisdiction over this transaction would not be sustained because Congress

is an aspect of production and gathering and, therefore, not subject to Commission control.[10] The transaction in the present case appears to lie between these two areas.[11]

Several arguments may be advanced to support FPC jurisdiction over this sale of a developed leasehold. First, the financial aspects of the transaction closely resemble those of a direct sale of natural gas by the independent producer to the interstate pipeline.[12] The similarity between this conveyance and a direct sale of gas, over which the FPC has jurisdiction, suggests it would be illogical to deny FPC jurisdiction over this transaction. Second, the FPC can always regulate this business activity indirectly. Having jurisdiction over interstate transportation facilities, the FPC can issue or deny certificates of public convenience and necessity for pipeline facilities leading to the wells from which the company is to obtain gas if the price involved in the original transaction is determined to be excessive.[13] This is true even when the original transaction is clearly outside the Commission's juris-

had not intended the economic repercussions in the industry that would follow such a move. *E.g.*, Berger & Krash, *The Status of the Independent Producers Under the Natural Gas Act*, 30 TEXAS L. REV. 29 (1951); Kulp, *The Federal Natural Gas Act*, 5 OKLA. L. REV. 128 (1952); 59 YALE L.J. 1468 (1950). *But see*, Comment, 17 U. CHI. L. REV. 479 (1950); 4 MIAMI L.Q. 233 (1950). Post-*Phillips* discussions have been very critical of the holding. *E.g.*, Fulbright, *The FPC Gas Producer Exemption Is in the Consumer's Interest*, 57 PUB. UTIL. FORT. 13 (1956); Comment, 40 CORNELL L.Q. 328 (1955); Comment, 1954 ILL. L.F. 509; 25 FORDHAM L. REV. 374 (1956); 44 GEO. L.J. 695 (1956); 8 VAND. L. REV. 142 (1954). *But see* Durfee, *Wisconsin and the Phillips Case*, 55 PUB. UTIL. FORT. 70 (1955); 54 COLUM. L. REV. 1149 (1954). For judicial development of the holding of the *Phillips* decision, see note 17 *infra*.

10. FPC v. Panhandle E. Pipe Line Co., 337 U.S. 498 (1949).

11. Later in the same year, the FPC again held that it had jurisdiction in a case factually similar to the principal case. Tennessee Gas Transmission Co., 30 F.P.C. 759 (1963).

12. For example, in a direct sale of gas the total price is determined by multiplying the specific volume by an accepted price per unit of volume. In this transaction, the same price specificity was achieved by periodic redeterminations of the gas reserves and adjustments in the price per unit of volume. Texas E. Transmission Corp., 29 F.P.C. 249, 254 (1963).

13. Natural Gas Act § 7(c), 52 Stat. 824 (1938), as amended, 15 U.S.C. § 717f(c) (1958). In addition, the FPC can condition certification of new pipeline facilities on the price to be paid the independent producer for the gas. Natural Gas Act § 7(e), 52 Stat. 824 (1938), as amended, 15 U.S.C. § 717f(e) (1958); Texaco, Inc. v. FPC, 290 F.2d 149 (5th Cir. 1961). Unfortunately, the necessity for agreement between the company and the Commission on the conditions for the issuance of a conditional certificate and the consequent construction of the pipeline facilities conflicts with the providing of adequate service to the public. Hence, it would seem that the Commission would be in a less powerful bargaining position on the issue of the producer's price when its only statutory authority relates to the certification of facilities than would be the case if it could certify the construction of the pipeline with minimum delay and then exercise direct rate-making power as between the producer and the pipeline. *Cf.* note 15 *infra*. During the rate proceeding, the Commission would have the power to order refunds of overcharges occasioned by the producer's price and passed on to consumers by the pipeline company. Natural Gas Act § 4(e), 52 Stat. 822 (1938), as amended, 15 U.S.C. § 717c(e) (Supp. V, 1964).

diction.[14] But this indirect control lends itself to evasive activities by the pipelines, which in turn require time-consuming countermaneuvers by the FPC. Hence, indirect control is probably less effective and efficient—or at least thought by the FPC to be less effective and efficient—than direct control.[15] Since the FPC can already exercise ultimate control over this situation, it can be argued that such control should be as direct and efficient as possible. Finally, there is a general trend toward expansion of FPC regulation over the independent gas producer. It began with *Phillips Petroleum Co. v. Wisconsin*[16] and has since continued to expand,[17] with no parallel extension of the exemption for production and gathering.

FPC v. Panhandle E. Pipe Line Co.,[18] however, casts authoritative doubt on the assertions of jurisdiction by the FPC over the transaction in the principal case. There it was held that a sale of an undeveloped leasehold is within the express exemption to FPC jurisdiction. Language in that opinion indicated that *all* activity involving leases might fall within the express exemption,[19] and this language formed the basis of decision in the principal case.[20] However, the *Panhandle* case can be distinguished from the principal case because it involved an undeveloped, rather than a developed, leasehold.[21] If the sale of undeveloped leases were within

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

15. The need to service consumers precludes a continuing battle between the FPC and a pipeline over prices when the FPC's statutory authority is only to reject those prices suggested by the transporter. Natural Gas Act § 4(a), 52 Stat. 822 (1938), as amended, 15 U.S.C. § 717c(a) (1958). See Texas E. Transmission Corp., 29 F.P.C. 249, 256 (1963).

16. 347 U.S. 672 (1954).

17. FPC jurisdiction has been upheld in the following situations: (1) sales made by a producer to an extraction plant that resells the processed residue gas, Deep South Oil Co. v. FPC, 247 F.2d 882 (5th Cir. 1957); (2) sales made to an extraction plant that processes the gas and returns it to the producer, who then sells it to an interstate pipeline company, Argo Oil Corp., 15 F.P.C. 601 (1955); (3) sales of gas not transmitted interstate until after being stored underground for some time at a place removed from the point of sale, Continental Oil Co. v. FPC, 247 F.2d 904 (5th Cir. 1957); (4) gas sold in the wellhead before reaching the final regulating valve controlled by the buyer, Continental Oil Co. v. FPC, 266 F.2d 208 (5th Cir. 1959). See Mosburg, *Regulation of the Independent Producer by the Federal Power Commission*, 16 OKLA. L. REV. 249 (1963); Comment, *Federal Regulation of Producer's Price Under the Natural Gas Act*, 9 KAN. L. REV. 431 (1961); Comment, *Federal Control Over the Independent Gas Producer*, 35 TEXAS L. REV. 690 (1957).

18. 337 U.S. 498 (1949). See text accompanying note 27 *infra*.

19. "We now adhere to this natural and clear meaning of the words and their obvious expression of congressional intent. Of course *leases are an essential part of production.*" *Id.* at 505. (Emphasis added.)

20. Principal case at 2075.

21. Although other distinctions were suggested by the FPC in the principal case, that between developed and undeveloped leaseholds is the only one having apparent legal merit. The other distinctions were addressed to the trend of authority in the area, to the retention by the seller of certain mineral rights, production payments, and management of the field, and to the fact that the gas in *Panhandle* was destined for

FPC jurisdiction, the FPC could conceivably regulate the sale of all property that possibly contains gas in formation that might be ultimately resold in interstate commerce; but, the distinction between developed and undeveloped leaseholds would overcome the fear of such extensive bureaucratic control over the price of general property transactions.[22] This distinction also preserves some meaning for the statutory exemption to FPC jurisdiction because it permits the continued applicability of the express exemption to the physical aspects of production and gathering. Distinguishing developed from undeveloped leaseholds has the additional value of not diluting the FPC's ability to carry out the aim of the Natural Gas Act—the safeguarding of the public interest.[23]

Although the above distinction appears to have some practical value, independent gas producers could condition the sale of *undeveloped* leaseholds upon the discovery of gas in paying quantities, and the price could be adjusted as the volume was ascertained. Such a sale would accomplish the same economic purpose as the sale of a developed leasehold, and yet, applying the distinction between developed leaseholds and undeveloped leaseholds, the transaction would be outside FPC jurisdiction; it would require a strained construction to fit the sale of an undeveloped leasehold within the statutory term "sale in interstate commerce of natural gas."[24] The FPC would then be forced to rely on the less effective indirect control that can be exercised upon transactions outside its jurisdiction.[25] The facility with which the producers could utilize this distinction to avoid direct FPC control diminishes its value.[26]

The FPC may prefer to argue, in defense of its claim of jurisdiction, that *Panhandle* should be overruled, rather than distinguished. This argument might be favorably received because there are indications that the present Supreme Court would not extend the production and gathering exemption as far as did the majority

intrastate commerce. Texas E. Transmission Corp., 29 F.P.C. 249, 255 (1963). This latter fact, however, did not form any part of the holding of the *Panhandle* Court.

22. This fear was expressed by FPC Commissioner Woodward in his dissenting opinion in Tennessee Gas Transmission Co., 30 F.P.C. 759, 771 (1963).

23. Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672, 685 (1954). *Accord*, FPC v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1 (1961); Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. 137 (1960).

24. Natural Gas Act § 1(b), 52 Stat. 821 (1938), as amended, 15 U.S.C. § 717(b) (1958).

25. See note 15 *supra*.

26. The propensity of producers and pipelines to avoid direct FPC control is amply demonstrated by noting the activity of Texas Eastern in the principal transaction. At first, there was a direct sale of gas to Texas Eastern. When it became apparent that the FPC was going to question the price of the transaction by asserting jurisdiction, the form of the transaction took the shape of a sale of a leasehold in order to avoid direct FPC price control. Texas E. Transmission Corp., 29 F.P.C. 249, 250-51 (1963).

in the *Panhandle* decision.[27] It was, perhaps, this prospect of reinterpretation of legislative intent that prompted the FPC to assert jurisdiction at this particular time.

The foregoing discussion of the "legal" aspects of the problem as articulated by the judiciary indicates that the power asserted by the FPC would probably be sustained on appeal to the Supreme Court, with *Panhandle* being either distinguished or overruled. However, other considerations indicate that the FPC may have chosen an inopportune time to assert jurisdiction over the sale of developed leaseholds of gas in formation. Congress has been disturbed by past developments resulting in the expansion of FPC control over the independent producer. When the FPC indicated in 1948 that it was going to assert a broader jurisdiction, resulting in more direct control over the independent producers,[28] Congress responded with a bill which would have arrested the growth of FPC jurisdiction over such producers.[29] But, that enactment was vetoed by President Truman in 1950.[30] After the *Phillips* decision in 1954, congressional resentment of what it considered to be a mistaken conception of the aim of the production and gathering exemption[31] manifested itself in another bill designed to restrict FPC jurisdiction.[32] President Eisenhower vetoed that bill in 1956.[33]

27. In *Panhandle* there was a dissent by Mr. Justice Black in which Mr. Justice Douglas concurred. Their basic position is that the exemption must be construed narrowly because effective FPC control, as contemplated by the Natural Gas Act, requires jurisdiction over this type of transaction. FPC v. Panhandle E. Pipe Line Co., 337 U.S. 498, 516 (1949) (dissenting opinion). This view would probably be supported by a majority of the present Court. In addition to Justices Black and Douglas, Mr. Chief Justice Warren has indicated his support of a construction of the Natural Gas Act favoring restrictive federal control of the natural gas industry. FPC v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1 (1961). Mr. Justice Brennan has endorsed similar views. Northern Natural Gas Co. v. State Corp. Comm'n, 372 U.S. 84 (1963); Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. 137 (1960). To total a majority, Mr. Justice Goldberg can be counted by virtue of his concern for the protection of the consuming public by the appropriate federal regulatory agency. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963).

28. See H.R. REP. No. 1140, 81st Cong., 1st Sess. (1949); S. REP. No. 567, 81st Cong., 1st Sess. (1949).

29. H.R. 1758, 81st Cong., 1st Sess. (1949). This bill would have specifically exempted from FPC jurisdiction any arm's-length sale made by a producer prior to the delivery of the gas to interstate transmission facilities.

30. H.R. Doc. No. 555, 81st Cong., 2d Sess. (1950). The veto was designed to protect the public by preventing excessive and unreasonable prices in the gas industry.

31. H.R. REP. No. 992, 84th Cong., 1st Sess. (1955); S. REP. No. 1219, 84th Cong., 1st Sess. (1955).

32. H.R. 6645, 84th Cong., 1st Sess. (1955). This legislation defined "sale in interstate commerce of natural gas" to exclude sales made prior to the entrance of the gas into interstate transmission facilities. For an excellent detailed case study of this bill, see READ, MACDONALD & FORDHAM, LEGISLATION 559-636 (1959).

33. H.R. Doc. No. 342, 84th Cong., 2d Sess. (1956). President Eisenhower indicated that he would have approved the legislation under other circumstances, but he was prevented from endorsing the measure by the gas industry's "arrogant" lobbying while the measure was being considered by Congress.

With the major advocates of restrictive legislation still in Congress and likely to remain there for some time,[34] and with a man in the Presidency who issued the Senate Report on the 1949 bill[35] and authored a blistering denunciation of the *Phillips* holding in 1954,[36] the time seems ripe for another effort to give the production and gathering exemption the effect which Congress has long felt was originally intended.

Three factors militate against the likelihood of effective legislation in this area: (1) the probable reluctance of the President to give support to a measure which might raise a politically embarrassing cry of favoritism, (2) the difficulty of "evicting" an agency that has already ensconced itself in an area of regulation, and (3) the highly speculative nature of any prediction of congressional sentiment. Nevertheless, oilmen are encouraged by their legislative strength, and a veto by President Johnson would seem unlikely, however strongly he disassociates himself from such a measure in its earlier stages. If such a bill should be passed and signed into law, it would seem that the FPC's decision to focus on the jurisdictional problem in the first place may have been a chronological error which will jeopardize more effective FPC control over the independent gas producer in the future.

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34. Still in Congress are the co-sponsors of the 1955 bill. Representative Oren Harris and Senator J. William Fulbright, both Democrats of Arkansas. Representative Harris was first elected in 1940, and has been re-elected eleven times since. Senator Fulbright's fourth term began in 1962, which insures his presence in Congress until the First Session of the Ninety-first Congress.

35. See note 28 *supra.*

36. "The basic proposition enunciated by the U.S. Supreme Court . . . is as clear as it is shocking and as alarming as it is far-reaching . . . . The majority decision flies in the face of congressional intent and of past court decisions. There can be no doubt that Congress never intended the federal regulation of natural gas at the wellhead. The debates on the subject can be searched in vain for any contrary indication." Johnson, *The Phillips Case Decision and the Public Interest,* 54 PUB. UTIL. FORT. 473-74 (1954).