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Ability of a Lessee to Invoke Natural Gas Act Jurisdiction over the Reversionary Interest: California v. Southland Royalty Co.

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The above analysis is an example of the subchapter S traps which Judge Hall criticized in her dissenting opinion as unintended by Congress.[54] Subchapter S was created to benefit small corporations realizing losses in their initial tax years.[55] It seems ludicrous to argue that Congress intended to penalize subchapter S corporations for going bankrupt, when subchapter S was initally created to benefit small corporations incurring heavy start-up costs. The termination of a subchapter S election through bankruptcy can be avoided by simply including an estate in bankruptcy within the definition of estate under section 1371(a). This could be accomplished by revising Revenue Ruling 66-266.

IV. CONCLUSION

The decision in *Abdalla* is a compromise solution, taking the middle road between statutory language that would seem to preclude a NOL deduction in the year of a bankruptcy and broad legislative intent that mandates a full NOL flow through. As a result, shareholders of a bankrupt subchapter S corporation will be allowed to deduct their pro rata share of the corporation's NOL, but only to the extent that it is allocable to the period preceding the bankruptcy.

David Stieber

Ability of a Lessee to Invoke Natural Gas Act Jurisdiction Over the Reversionary Interest: California v. Southland Royalty Co.

Gulf Oil Corporation held the exclusive right, under 1925 lease agreements, to produce and market oil and natural gas from certain Texas real estate[1] for a fixed fifty-year period.[2] Gulf commenced sales of casinghead gas[3] from the subject property in 1951 to El Paso Natural Gas Company, an interstate pipeline. In 1956, in compliance with the United States Supreme Court decision of *Phillips Petroleum Co. v. Wisconsin*,[4] Gulf re-

54. *See* note 45 *supra* and accompanying text.
55. *See* notes 6 & 7 *supra* and accompanying text.

1. There were two leases involved, one covering 45,771 acres in Crane County and the other covering 19,840 acres in Ector County.
2. Gulf had contended in state court that its 50-year term did not include certain periods in which production was delayed. While the lease provisions stated that "the time of such delay . . . shall not be counted against the leassee," the Court held this served only to excuse the lessee from involuntary failure to engage in operations required by the lease. Gulf Oil Corp. v. Southland Royalty Co., 496 S.W.2d 547, 552 (Tex. 1973).
3. Gas produced in connection with oil production. BLACK'S LAW DICTIONARY 273 (4th ed. 1968).
4. 347 U.S. 672 (1954). In *Phillips* the Court held that a sale for resale by an independ-

quested and was granted a certificate of public convenience and necessity from the Federal Power Commission authorizing the sales.[5] In anticipation of the lease's expiration, the holders of the reversionary interest[6] made arrangements to sell production from the remaining gas reserves to an intrastate buyer.[7] Seeking to protect its supply, El Paso Natural Gas Company petitioned the Federal Power Commission[8] for a declaration that the reversioners could not divert the gas to the intrastate market without obtaining abandonment approval under section 7(b) of the Natural Gas Act.[9] The Commission ruled for El Paso Natural Gas Company, stating that once gas is dedicated to the interstate market under a certificate of unlimited duration, it may not be withdrawn without Commission approval.[10] Southland Royalty Company, a partial owner of the reversionary interest,[11] sought review of the adverse ruling in the Fifth Circuit Court of Appeals. The court of appeals reversed, holding that Gulf could not dedicate more than it owned and was therefore incapable of encumbering the reversionary interest.[12] The Supreme Court granted certiorari.[13] *Held, reversed*: The production and sale of natural gas under a certificate of public convenience and necessity authorized by section 7(c) of the Natural Gas Act creates an obligation to serve interstate commerce that attaches to the gas itself and binds all who exercise dominion over it, regardless of the manner in which dominion is acquired. California v. Southland Royalty Co., 436 U.S. 519 (1978).

ent producer was a jurisdictional event under the Act. The effect of the holding was to subject independent producers of natural gas to the same certification procedures which had been developed to apply to interstate pipelines. The requirement was promulgated as a rule in 18 C.F.R. § 157.23 (1978).

5. Gulf's certificate was one of many issued in a consolidated proceeding. The certificates issued in this proceeding were determined to be of unlimited duration in Sun Oil Co. v. FPC, 364 U.S. 170 (1960).

6. There were over one hundred separate reversioners for the Crane County lease alone. El Paso Natural Gas Co., 54 F.P.C. 145, 10 P.U.R.4th 344, 345 (1975).

7. Diverting gas from the interstate market was motivated by the higher prices then prevailing in the unregulated intrastate market. Intrastate sales have since been subjected to federal price regulation by the Natural Gas Policy Act of 1978, Pub. L. No. 95-621, § 105, 92 Stat. 3366 (1978)(to be codified as 15 U.S.C. § 331).

8. Texaco, Inc., holder of a reversionary interest in the Ector County lease, petitioned for a declaration on the same question. Although the interests of the two petitioners were adverse, the cases were consolidated. El Paso Natural Gas Co., 54 F.P.C. 145, 10 P.U.R.4th 344 (1975).

9. 15 U.S.C. § 717f(b) (1976).

10. 54 F.P.C. 145, 10 P.U.R.4th 344, 348 (1975).

11. Southland had an interest in both properties, but its interest in the Crane County lease was much more substantial. Southland Royalty Co. v. FPC, 543 F.2d 1134, 1136 (5th Cir. 1976).

12. *Id.*

13. 433 U.S. 907 (1977). The writs were filed by El Paso Natural Gas Company, the Federal Energy Regulatory Commission, successor to the Federal Power Commission under the Department of Energy Reorganization Act, 42 U.S.C.A. §§ 7101-7352 (West Supp. 1977) [both agencies are hereinafter referred to as the Commission], and the State of California which intervened to protect its supply of natural gas received through El Paso Natural Gas Company.

I. THE NATURAL GAS ACT AND ITS EXPANDING JURISDICTIONAL SCOPE

The Natural Gas Act[14] was enacted in 1938 in response to a Federal Trade Commission investigation[15] of the structure of the natural gas industry. The industry at that time consisted of three well-defined tiers: producers, which extracted the gas from the ground; interstate pipelines, which bought from the producers and transported the gas to local distributors; and local distributors, which sold directly to municipal and industrial users of the gas.[16] The interstate pipelines enjoyed a monopoly position vis-à-vis the local distributors and were able to extract from them a price far in excess of the pipelines' cost[17] in transactions that the states were prohibited from regulating by the commerce clause of the United States Constitution.[18] The legislative history indicates that in enacting the Natural Gas Act, Congress intended to provide for federal jurisdiction over the interstate pipelines, thus closing the gap in which the states were unable to act.[19] Congress, however, did not intend to usurp state authority in areas where state regulation was permissible.[20]

The jurisdictional scope of the Natural Gas Act is spelled out in section 1(b),[21] which provides for jurisdiction over the activities of interstate trans-

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14. 15 U.S.C. §§ 717-717w (1976).

15. FEDERAL TRADE COMMISSION, FINAL REPORT, S. DOC. NO. 92, 70th Cong., 1st Sess., pt. 84-A (1936).

16. Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672, 691 (1954) (Clark J., dissenting). *See also* Note, *New Approaches by the FPC to the Regulation of Natural Gas Producers: an Evaluation*, 17 VAND. L. REV. 1200, 1202 (1964).

17. *See generally* Conine & Niebrugge, *Dedication under the Natural Gas Act: Extent and Escape*, 30 OKLA. L. REV. 735, 738 (1977); Flittie & Armour, *The Natural Gas Act Experience—A Study in Regulatory Aggression and Congressional Failure to Control the Legislative Process*, 19 SW. L.J. 448, 449 (1965).

18. *See* Missouri v. Kansas Natural Gas Co., 265 U.S. 298 (1924), holding that state regulation of the interstate pipelines would be a burden on interstate commerce, impermissible under the commerce clause. *See also* Public Utils. Comm'n v. Attleboro Steam & Elec. Co., 273 U.S. 83 (1927), which discussed similar problems with state regulation of the interstate movement of electricity.

19. H.R. REP. NO. 709, 75th Cong., 1st Sess. 2 (1937); 81 CONG. REC. 6720 (1937).

20. "It is therefore the purpose of this legislation to close the gap now existing between Federal and State regulation . . . ." *Id.* at 6723. The legislative purpose has been acknowledged by the Supreme Court: "The purpose of [the Act] was . . . to preserve in the States powers of regulation in areas in which the States are constitutionally competent to act." Interstate Natural Gas Co. v. FPC, 331 U.S. 682, 690 (1947). *See also* FPC v. Hope Natural Gas Co., 320 U.S. 591, 610 (1944); Public Utils. Comm'n v. United Fuel Co., 317 U.S. 456, 467 (1943). The extent to which present-day judicial thinking has deviated from this view is illustrated by Corporation Comm'n v. FPC, 415 U.S. 961 (1974) (mem.) (enjoining constitutionally permissible state regulatory activity), and Northern Natural Gas Co. v. State Corp. Comm'n, 372 U.S. 84 (1963) (holding constitutionally permissible state activity invalid because it conflicts with federal jurisdiction granted by the Act).

21. 15 U.S.C. § 717f(b) (1976) states:

> The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

portation[22] and interstate sale for resale of natural gas and over natural-gas companies.[23] Three areas are specifically exempted from the Act's coverage: any other transportation or sale, encompassing both intrastate transportation and sales and direct sales not for resale; local distribution and the facilities connected therewith; and the production or gathering of natural gas. The trend in judicial interpretation of the Act has been to extend its jurisdictional scope, primarily through a narrow reading of the various statutory exceptions.

The trend is most notable in the judicial treatment of the "production or gathering" exception. This exception had served for several years to provide a blanket exemption from the Act's coverage for the independent producer,[24] even when the producer engaged in activities that would otherwise be jurisdictional, such as interstate sales for resale. The FPC had so interpreted the Act,[25] not seeking to exercise jurisdiction over independent producers. This interpretation is consistent with the Act's purpose because independent producers are susceptible to state regulation[26]and thus are not within the area that the Act was intended to address.[27] In *Phillips Petroleum Co. v. Wisconsin*,[28] however, the Supreme Court ruled that sales for resale made by an independent producer occur after "production or gathering" activities have been concluded and are therefore not within the statutory exception. The Court reasoned that the statutory language granting jurisdiction over transportation *or* sales indicates an intent to regulate producers as well as pipelines, since pipelines engage in these activities concurrently and not separately. The conjunction "or" would be unnecessary if only pipelines were sought to be regulated.[29] The Court recognized that prior decisions had held the activities in question to be within the state regulatory power[30] and thus seemingly not part of the regulatory gap which the Act was intended to address. It concluded, however, that the cases so holding had expanded the scope of

22. In accord with established constitutional doctrine the specific sales transaction need not cross a state line to be in interstate commerce; the gas need merely be committed to an interstate journey. Interstate Natural Gas Co. v. FPC, 331 U.S. 682, 687-89 (1947).

23. "Natural-gas company" is defined as "a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale." 15 U.S.C. § 717a(6) (1976).

24. *See* Crenshaw, *The Regulation of Natural Gas*, 19 LAW & CONTEMP. PROB. 325, 338 (1954). Nevertheless, both prior and subsequent to the *Phillips* decision, legislation has frequently been attempted which would expressly exempt independent producers from Commission jurisdiction. Twice both houses have passed such a measure and each time a Presidential veto was employed. H.R. 6645, 84th Cong., 1st Sess. (1955); H.R. 1758, 81st Cong., 2d Sess. (1950). *See generally* Note, *supra* note 16, at 1217-18.

25. Phillips Petroleum Co., 10 F.P.C. 246 (1951); Columbian Fuel Corp., 2 F.P.C. 200 (1940).

26. *See* Phillips Petroleum Co. v. Oklahoma, 340 U.S. 190 (1950); Cities Serv. Gas Co. .v. Peerless Oil & Gas Co., 340 U.S. 179 (1950).

27. H.R. REP. No. 709, 75th Cong., 1st Sess. 2 (1937); 81 CONG. REC. 6721 (1937).

28. 347 U.S. 672 (1954).

29. *Id.* at 681-82. For a critique of the Court's analysis, see Flittie & Armour, *supra* note 17, at 470.

30. Cases so holding include Phillips Petroleum Co. v. Oklahoma, 340 U.S. 190 (1950); Cities Serv. Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179 (1950).

the state power beyond the original 1938 limits. Hence, the states were unable to regulate these activities at the date of the Act's enactment, and the activities were within the jurisdictional grant.[31] Subsequent decisions have extended the *Phillips* holding by upholding FPC jurisdiction over sales by independent producers made after gathering but prior to processing,[32] sales made at the wellhead,[33] and sales of gas in place.[34]

The remaining exception clauses of section 1(b) have been similarly limited, although the impact of such limitations has not been as great. The exception of "any other transportation or sale" exempts two activities from federal regulation: direct sales to end users and intrastate transportation or sales. Judicial decisions interpreting this exception primarily have involved the direct sale situation.[35] A seller may experience difficulty in classifying a particular transaction as a direct sale under the test formulated in *California v. Lo-Vaca Gathering Co.*[36] In *Lo-Vaca* a producer had sold gas to an interstate pipeline, the contract stipulating that the gas was solely for the pipeline's personal use in its boilers.[37] The parties used care in monitoring the delivery levels so that in fact no more gas was taken than was used for internal purposes.[38] The Court held, however, that since there was physical commingling of the producer's gas with other gas, some of the gas delivered would actually be resold. The transaction, therefore, was not a direct sale, but a sale for resale.[39] Even if the transaction qualifies as a direct sale under the strict *Lo-Vaca* test, the Commission may properly regulate such activity indirectly by refusing to certify the transportation facilities necessary to effect the sale.[40] Additionally, the Commission may affect direct sales by imposing a curtailment plan, which

31. 347 U.S. at 684. It is not, however, necessary to conclude from the fact that the 1950 decisions were the first to uphold state jurisdiction, that such jurisdiction was lacking before those decisions. The more likely inference is that the problem simply was not before the courts until 1950. *See* Flittie & Armour, *supra* note 17, at 463 n.85.

32. Deep South Oil Co. v. FPC, 247 F.2d 882 (5th Cir. 1957).

33. Saturn Oil & Gas Co. v. FPC, 250 F.2d 61 (10th Cir. 1957), *cert. denied*, 355 U.S. 956 (1958).

34. United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392 (1965). *But see* FPC v. Panhandle E. Pipe Line Co., 337 U.S. 498 (1949) (holding that a sale of undeveloped reserves was within the production or gathering exception). *Panhandle* was distinguished in *United Gas* because *United Gas* involved the sale of reserves for which the supply was proven and the production facilities were well developed. The *Panhandle* holding may still apply to the sale of substantially undeveloped reserves that are not related to interstate commerce. *See* Conine & Niebrugge, *supra* note 17, at 747-48.

35. This is because the line of demarcation between intrastate and interstate commerce has been drawn in other contexts and does not present an issue unique to the Act. *See* note 22 *supra* and accompanying text.

36. 379 U.S. 366 (1965).

37. *Id.* at 367.

38. *Id.* at 368.

39. *Id.* at 369. This doctrine is termed a "molecular theory" and is sharply criticized by Justice Harlan in his dissent. *Id.* at 371-77. For a comprehensive treatment of the commingling theory, see Sullivan, *Federal Power Commission Jurisdiction over Commingled Sales of Natural Gas: A Problem in Judicial and Administrative Legislation*, 30 GEO. WASH. L. REV. 638 (1962).

40. FPC v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1 (1961). In this case the FPC refused to certify facilities that would make possible a direct sale for industrial use because it feared that the sale would restrict pipeline capacity available for other uses and

allocates delivery quotas for a seller experiencing a reduction in supply.[41]

Judicial limitation of the third exception, "local distribution," has been countered by legislative amendment. In *FPC v. East Ohio Gas Co.*[42] the Court refused to apply the local distribution exception to a company engaged in distribution to consumers on a statewide basis, holding that gas was not in local distribution until the pipeline pressure was reduced.[43] Congress reacted in 1954 by passing the Hinshaw Amendment,[44] which returned statewide distribution to the realm of exclusive state jurisdiction and in explicit language made the pressure level irrelevant.

The judicial practice of narrowly interpreting the statutory exceptions to Natural Gas Act jurisdiction has had substantial impact on the independent producer of natural gas. The *Phillips* decision first subjected the independent producer to FPC jurisdiction, and subsequent cases have expanded the range of producer activities deemed jurisdictional.[45] Application of the statutory regulatory framework to the independent producer, however, was not contemplated by Congress. As a result, several provisions of the Act can be applied to the independent producer only by a strained reading of the statutory language. Application of the Act's certification requirements[46] to the independent producer has been especially difficult, and the resulting statutory interpretation has contributed to a further extension of the Act's jurisdictional scope.

II. NATURAL GAS ACT CERTIFICATION OF THE INDEPENDENT PRODUCER

The certification requirements of the Natural Gas Act are contained in sections 7(b) and (c). Section 7(c)[47] requires that natural gas companies be issued a certificate of public convenience and necessity before commencing

that the high price would have an adverse effect on gas prices generally. The Commission was upheld.

41. FPC v. Louisiana Power & Light Co., 406 U.S. 621 (1972). Jurisdiction was based on transportation, not sales. The Court indicated that the "other transportation or sales" exception forecloses only rate-making jurisdiction over direct sales. *Id.* at 637-38.

42. 338 U.S. 464 (1950).

43. *Id.* at 472-73. The FPC did not take full advantage of its jurisdictional victory in this instance, imposing only accounting standards on companies in this situation, and declining to exercise rate-making jurisdiction. *See* Flittie & Armour, *supra* note 17, at 483-84.

44. 15 U.S.C. § 717(c) (1976). The amendment exempted all sales made within a state "if all the natural gas so received is ultimately consumed within such State." The legislative history, 99 CONG. REC. 10,563 (1953), and FPC interpretation, 18 C.F.R. §§ 152.1-.4 (1978), indicate that this section is to apply only where actual state regulation is being exercised.

45. *See* notes 32-34 & 36-39 *supra* and accompanying text.

46. 15 U.S.C. §§ 717f(b), (c) (1976).

47. 15 U.S.C. § 717f(c) (1976), which provides:

> No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations . . . .

jurisdictional activities, and section 7(b)[48] requires a second certificate before jurisdictional "facilities" or "service" can be abandoned. Section 7(b) is difficult to apply to independent producers because the function of a producer is to make "sales," not to provide "service" or to construct "facilities."[49] To bring the independent producer within the terms of section 7(b) it is necessary to consider that "sales" made by the independent producer are a "service."

The identification of sales as services has consequences affecting certification procedures under the Act, as illustrated in the case of *Sunray Mid-Continent Oil Co. v. FPC*.[50] In *Sunray* the FPC had tendered a certificate of unlimited duration[51] under section 7(c) to a producer, in spite of the producer's contention that the agency lacked authority to tender a certificate effective beyond the term of the producer's contractual obligation to his buyer. The producer reasoned that the Commission was empowered to authorize only proposed sales, and the only sales proposed by the application were those to be made under the original contract.[52] The Court rejected the producer's argument, identifying the sales as a service and holding that the underlying service is not limited by the duration of the initial sales contract.[53] The Commission can thus certify the underlying service for an unlimited duration, despite the limited term of the contractual sales obligation.[54] Once commenced, the service cannot be abandoned without Commission approval under section 7(b).[55]

The *Sunray* holding allowed the FPC to require any person making an interstate sale for resale of natural gas to operate under a certificate of unlimited duration. The certified person could then be prevented indefinitely from diverting gas to the intrastate market. Gas sold interstate could be considered dedicated to interstate commerce.[56] The FPC could

48. 15 U.S.C. § 717f(b) (1976), which provides:

> No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

49. *See* Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. 137, 160, 163 (1960) (Harlan, J., dissenting); Conine & Niebrugge, *supra* note 17, at 798, 802.

50. 364 U.S. 137 (1960).

51. The significance of a certificate of unlimited duration is that activities under such a certificate can never be terminated without obtaining abandonment approval, whereas a limited certificate in effect offers a "pregranted abandonment" at the expiration of the certificate term. The FPC had contended that it had no authority to grant a limited certificate, but this contention was rejected in FPC v. Moss, 424 U.S. 494 (1976). Despite its authority to grant a limited certificate, the Commission has the option of tendering an unlimited one in virtually every case under the *Sunray* holding. *See* notes 53, 54 *infra* and accompanying text.

52. 364 U.S. at 148.

53. *Id.* at 151-54.

54. *Id.*

55. *Id.* at 153.

56. The concept of dedication is not expressly mentioned in the Act but nevertheless plays an important role in its judicial interpretation. For a thorough discussion of the con-

also prevent diversion of dedicated gas reserves by subsequent assignees of the certified party by considering the assignment itself to be an abandonment, but waiving the requirement of abandonment approval if the assignor assures equivalent interstate service from his assignee.[57] Although neither the Supreme Court in *Sunray* nor the FPC in developing these practices focused on the jurisdictional issue, there is no conflict between either practice and the section 1(b) standards. Persons, such as the producer in *Sunray*, who have made interstate sales for resale are susceptible to jurisdiction as natural-gas companies.[58] Subsequent assignees of these persons are less clearly within the jurisdictional ambit, but their consent to agency jurisdiction can be required before the assignment is approved. When, however, dominion over the reserves shifts not by contractual assignment but by operation of law, such as on the expiration of a lease, jurisdictional problems arise. In this instance, the FPC has no leverage to procure the reversioner's consent to provide interstate service because it cannot prevent the termination of the lease.[59] Additionally, if the reversioner has engaged in no jurisdictional activities he is not susceptible to jurisdiction as a natural-gas company.

III. CALIFORNIA V. SOUTHLAND ROYALTY CO.

The substantive issue addressed by the Court in *California v. Southland Royalty Co.* was whether a lessee natural-gas company under a fixed-term lease could, by making interstate sales of natural gas under a section 7(c) certificate of unlimited duration, obligate the lessor upon reversion to continue serving the interstate market. The Court framed the issue in light of the fundamental purpose of the Natural Gas Act "to assure an adequate and reliable supply of gas at reasonable prices"[60] and, in a four-to-three decision,[61] extended application of the service obligation concept developed in *Sunray* to parties acquiring dominion over dedicated gas by operation of law. The Court noted the jurisdictional issue only briefly and

cept, see Conine & Niebrugge, *supra* note 17. With the enactment of the Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3351 (to be codified as 15 U.S.C. §§ 3301-3432), dedication is no longer determinative of whether the gas will be regulated but of whether the special price regulations for dedicated gas in § 104 are to be applied. The 1978 Act defines dedicated gas in § 2(18), which is discussed *infra* at note 85. Section 601(a)(1) (A) provides that gas not dedicated on the day before the enactment date of the 1978 Act is not subject to the provisions of the Natural Gas Act. Thus, in effect, there can be no new dedications of gas after November 10, 1978.

57. Mitchell Energy Corp. v. FPC, 533 F.2d 258 (5th Cir. 1976). The requirement that the assignor assure equivalent interstate service has been made a formal regulation. 18 C.F.R. § 2.64(a) (1978).

58. For the statutory definition of a "natural-gas company," see note 23 *supra*.

59. A lessor's reversionary interest in a fixed-term lease is a fully vested interest at the time of the lease's execution.

60. 436 U.S. at 523.

61. Justices Stewart and Powell took no part in consideration of the opinion. The majority opinion was delivered by Justice White, joined by Justices Brennan, Marshall, and Blackmun. The composition and argument of the dissent are discussed at text accompanying notes 75-81 *infra*.

termed it "somewhat beside the point."[62]

Sunray was cited by the Court for the principle that the underlying service obligation arising from the dedication of gas could not be terminated by private contractual arrangements.[63] The Court stated that the FPC had acted reasonably in interpreting the obligation as one attaching to the gas itself,[64] thus imposing federal jurisdiction on all parties with the power to make sales from the dedicated reserves.[65] The court of appeals had rejected the Commission's view of the service obligation on the basis of local property law, holding that since a lessee under a fixed-term lease has no right in the reversionary interest, he can create no rights in third persons affecting that interest.[66] The lessee cannot dedicate gas which he does not own.[67] The Supreme Court, however, dismissed this argument as arising from an ambiguity in the term "dedicate."[68] The gas in question, said the Court, has not been dedicated in the sense of being surrendered to public use; it has merely been placed within a regulatory category.[69] There has been no taking of property in the due process sense because there is statutory assurance of a just and reasonable rate of return.[70]

The Court also pointed out that a property owner entering into an oil and gas lease could reasonably expect that the lessee would make sales in interstate commerce and could therefore anticipate that federal jurisdiction

62. 436 U.S. at 528.

63. *Id.* at 525.

64. The service obligation, however, attaches only to gas reserves specifically referred to in the original application for a § 7(c) certificate, Harrison v. FERC, 567 F.2d 308 (5th Cir. 1978), and only when deliveries from the reserves are commenced. Wessely Energy Corp. v. Arkansas La. Gas Co., 438 F. Supp. 360 (W.D. Okla. 1977), *aff'd*, Nos. 77-1749-50 (10th Cir. Jan. 9, 1979). *Wessely* was decided between the court of appeals and Supreme Court decisions in *Southland Royalty* and its holding was based on alternative grounds. First, the holding of the court of appeals in *Southland Royalty* that a lessee's dedication has no effect on the reversionary interest was followed in determining that dedication by a lessee also has no effect on a subsequent lessee of the same reserves. Secondly, "whatever the ultimate disposition of *Southland* in the Supreme Court," 438 F. Supp. at 365, it was decided that jurisdiction does not attach to any reserves until the commencement of deliveries.

65. 436 U.S. at 525. The FPC admitted in originally adopting this view that it was supported by no case directly in point. El Paso Natural Gas Co., 54 F.P.C. 145, 149, 10 P.U.R.4th 344, 348 (1975). The Court held that *Lo-Vaca* authorized basing jurisdiction on the physical flow of the gas. Neither that decision nor *Sunray*, however, hold that jurisdiction attaches to the gas as such; rather both speak in terms of jurisdiction over activities and persons. *Compare* the formulation in Harper Oil Co. v. FPC, 284 F.2d 137, 139 (10th Cir. 1960) (emphasis added) ("[O]nce an independent producer of gas has dedicated his production to interstate commerce and thereby has come under the jurisdiction of the Commission, *he* remains thereunder as long as production continues.") *with* the formulation in *Southland Royalty*.

66. Southland Royalty Co. v. FPC, 543 F.2d 1134, 1137 (5th Cir. 1976).

67. *Id.*

68. 436 U.S. at 527.

69. *Id.* The Court analogized the regulatory status to a change in zoning that the lessee has the power to pursue. 436 U.S. at 527-28 n.5. The Court thus hints that natural gas dedication is not an encumbrance in the traditional property sense. An argument can nevertheless be made that such status is properly includable in a title abstract, since it is an important limitation on the use of property.

70. 436 U.S. at 527. A "just and reasonable" rate is assured by § 4 of the Act. 15 U.S.C. § 717c(a) (1976).

might be invoked,[71] citing *Louisville & Nashville Railroad v. Mottley*.[72] Thus there is no unfairness in subjecting the lessor to federal regulations promulgated subsequent to the lease.[73] A final factor in the Court's analysis was the fear that if a contrary holding were reached, Natural Gas Act jurisdiction could be easily avoided through manipulation of lease arrangements.[74] The Court referred again to the broad purpose of the Natural Gas Act and emphasized that local property law distinctions should not be allowed to hinder the Commission in effectuating this purpose.[75]

The opinion drew a dissent from Justice Stevens, joined by Chief Justice Burger and Justice Rehnquist. The dissent pointed out that while the lessee, Gulf, was a natural-gas company as defined in the Act, Southland Royalty, having engaged in no jurisdictional activities,[76] was not and thus was not susceptible to jurisdiction by the terms of section 1(b).[77] Nor did Southland become a natural-gas company by succeeding to the interest of a natural-gas company. A lessee's interest doesnot succeed to the lessor; it expires.[78] The dissent distinguished the *Sunray* case because it involved merely the scope of a party's dedication; *Southland Royalty* presented the threshold question of whether a party was affected by a dedication at all.[79] Finally, the dissent addressed the majority's fear that lease provisions could be structured to escape regulation. The dissent noted that in the instant case bad faith was not an issue since the lease was negotiated years before the Act was passed[80] and suggested that adverse effects could be neutralized if the Commission conditioned the issuance of future certificates on the consent of all necessary parties, including the lessor.[81] As a practical consideration, the dissent noted that there are very few fixed-term

71. 436 U.S. at 528-29.

72. 219 U.S. 467 (1911). *Mottley* held that one can reasonably anticipate that a contract affecting interstate commerce may be subsequently made unenforceable through use of the commerce power.

73. This analysis is questionable, however, when the regulations affect sales from the reversionary interest. Since the lessee is without authority to make these sales, the lessor would not expect the lessee to be able to affect them.

74. 436 U.S. at 530.

75. *Id.*

76. In Mobil Oil Corp. v. FPC, 463 F.2d 256 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 976 (1972), it was held that royalty owners do not make a sale of gas by the mere retention of their interests. *But see* Jicarilla Apache Tribe v. FERC, 578 F.2d 289 (10th Cir. 1978) (following *Southland Royalty* and holding that a royalty owner who has the option of taking his royalty in kind must file for abandonment before he can withdraw in kind payments from the interstate market).

77. 436 U.S. at 539.

78. *Id.* at 540.

79. *Id.* at 538. Cases involving railroad abandonment under the Interstate Commerce Act were held inapplicable because these cases made no attempt to impose agency jurisdiction to parties not susceptible under the statute as a "common carrier." *Id.* at 543. The majority had referred to these authorities only in a footnote. *Id.* at 529 n.6.

80. *Id.* at 541.

81. *Id.* at 545. The majority's objection to this plan is found in *Sunray*, 364 U.S. at 152, stating that the Commission cannot achieve indirectly what it cannot do directly. 436 U.S. at 530. The dissent's reply to this is that it is irrelevant since the Commission has the direct power to withhold a certificate pending a determination that the applicant has the power to make an unlimited dedication. *Id.* at 525 n.24.

natural gas leases in existence.[82]

The dissent's analysis fits squarely within the statutory framework of section 1(b) by focusing on the issue of whether Southland Royalty is a natural-gas company and rejecting claims of jurisdiction not based on a statutory category. The jurisdictional scope of the Natural Gas Act is contained within section 1(b), which provides for jurisdiction over certain activities and over the natural-gas companies who engage in these activities. The statute authorizes no additional category of jurisdiction attaching to the gas itself and reaching persons such as Southland, who are not natural-gas companies and have not engaged in jurisdictional activities. The majority opinion upholds the exercise of Commission jurisdiction in an area outside the positive jurisdictional grant of section 1(b) for the first time. Earlier decisions had expanded the Commission's jurisdiction by narrowly interpreting the section 1(b) exceptions, but did not deal with areas outside the positive jurisdictional grant. These decisions, however, did make possible the *Southland Royalty* decision by initially subjecting the independent producer to Natural Gas Act regulation.[83] The service obligation concept was developed as a means of adapting statutory language designed for the interstate pipelines to the situation of the independent producer.[84] *Southland Royalty* carries the service obligation to its logical extreme by extending it to cover anyone with dominion over dedicated gas.[85] Nevertheless, it presents a qualitatively different approach to Natural Gas Act

82. *Id.* at 544.

83. *See* text accompanying note 45 *supra.*

84. *See* text accompanying note 48 *supra.*

85. The conference report on the Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3351 (1978) (to be codified as 15 U.S.C. §§ 3301-3432), states that the definition of dedicated gas contained in § 2(18) is designed to limit further extention of the *Southland Royalty* holding. S. REP. No. 1126, 95th Cong., 2d Sess. 71 (1978). The conference report indicates that if the right to explore and sell gas that would otherwise be dedicated is vested in another person by the reversion of a lease, then the gas is not dedicated unless it was actually sold in interstate commerce for resale on May 31, 1978. *Id.* at 72. Under this test, if Southland had ceased interstate sales while the litigation was pending, the gas would not be dedicated. Similarly, other lessors in Southland's position who stopped interstate sales believing that they were under no obligation to continue them would not have their gas dedicated. The distinction seems unfair, since the only reason that Southland was making interstate sales on May 31, 1978, was that it had reached an understanding with the FPC that these sales themselves would not result in a dedication if Southland prevailed in the litigation. 436 U.S. at 523. Moreover, § 2(18) is not well drafted to achieve the result that the conference report suggests. Section 2(18)(B)(iii) provides that natural gas is not dedicated:

> which, but for this clause, would be committed or dedicated to interstate commerce . . . by reason of the action of any person (including any successor in interest thereof, other than by means of any reversion of a leasehold interest), if on May 31, 1978 (I) neither that person, nor any affiliate thereof, had any right to explore for, develop, produce, or sell such natural gas; and (II) such natural gas was not being sold in interstate commerce (within the meaning of the Natural Gas Act) for resale . . . .

The section achieves its intended purpose only if the use of the word "person" in the clause beginning "if on May 31, 1978" carries with it the parenthetical phrase "(including any successor in interest)" used to qualify "person" earlier in the section. The drafters could have achieved the identical result with much less strain by deleting the parenthetical from its present position and inserting it after the second occurrence of "person." The phrase is unnecessary in its present position because a successor in interest cannot effect a dedication of gas. Moreover, the present placement of the parenthetical potentially subjects the section