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Supreme Court Clarifies Federal Versus State Authority Over Natural Gas

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No man can serve two masters.

—*Matthew 6:24*

This maxim stretches back to ancient times. The natural gas industry is well familiar with this precept and is often bedeviled by it. Precisely stated, industry players often find themselves being called to account by two overlords: the federal government, which demands compliance from the vast interstate components of the industry, while the second set of erstwhile masters are the several states that insist they have the right to oversee the industry's more local operations.

These are no small questions, as typically they can be enormously expensive and time-consuming to industry members.

This duality is rife with contradiction and conflict, as the respective regulatory authorities jockey for position. And when it degrades into a hopeless muddle, what are industry players to do? Which master do they serve, to the exclusion and ire

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of the other? These are no small questions, as typically they can be enormously expensive and time-consuming to industry members caught between the opposing forces of national and state government. Moreover, the margin for error is virtually nonexistent.

Fortunately, a new Supreme Court case, *Oneok, Inc. v. Learjet, Inc.*,[1] addresses these very concerns. As the justices have done in the past, they have informed the industry of when federal regulation preempts all countervailing state claims to authority and those instances where various aspects of natural gas operations are still subject to state jurisdiction. The *Oneok* Court determined that Natural Gas Act (NGA) jurisdiction was not applicable when the state law in question was not directly aimed at NGA jurisdiction.

Providing the answer to these questions was not a simple task for the Court, as the controversy implicated grave issues of constitutional importance, not just for today, but also for the future. Moreover, industry players might not be altogether pleased with the majority's ultimate ruling, as it did accommodate state power over the industry with regard to certain aspects of its day-to-day operations. But regardless of how the decision is viewed, it is now the law of the land, and the industry needs to understand it.

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Thus, and to fully appreciate the reasoning and final holding in *Oneok*, by necessity we must first plumb the depths of the US Constitution, how the founding document sets forth the boundaries of national versus state jurisdiction, and then view that through the prism of natural gas regulation in this country for the last 80 years.

SUPREMACY CLAUSE IS FOUNDATIONAL

What puts the "United" in United States? Two things do, actually. The first is the Supremacy Clause, that modest phrase that prescribes that the Constitution and all the laws made by Congress pursuant thereto "shall be the supreme Law of the Land."[2]

After all, we are one nation, and the Supremacy Clause helps bring this about by assuring that federal law is paramount. Put another way, any contrary or conflicting state laws must yield to the power of federal enactments. Of course, this basic law leads to the second point: in what domains may Congress make law that is supreme from coast to coast?

COMMERCE CLAUSE SEPARATES FEDERAL AND STATE JURISDICTIONS

The second thing that puts the "United" in United States is the Commerce Clause. Congress, and only Congress, is empowered to make laws creating a common currency, regulating roads, waterways, and airways, and a few other items that, in truth, unite us as one nation.[3]

In these arenas, there is only room for one body of federal law that reigns supreme, and logically we are intolerant of any conflicting state enactments. And be mindful that Congress enjoys exclusivity in legislating in these domains not only by dint of the Supremacy Clause, but also what Congress makes into law reigns supreme.

Also on the above list, and highly pertinent to this discussion, is the power of Congress to regulate commerce between the states—hence, the appellation "Commerce Clause."[4] Only the federal government can legislate over commercial endeavors that cross state lines. The Commerce Clause is why those engaged in such multistate endeavors are subject solely to federal regulation.

What constitutes "interstate commerce"? The Supreme Court has repeatedly confirmed that interstate commerce is composed of three components: the "channels" of interstate commerce, such as highways and airways, by which goods move across state lines; the "instrumentalities" of interstate commerce, like stocks and bonds for instance, that intrinsically are in perpetual motion across state borders; and activities that substantially affect interstate commerce (for instance, pollution, because it knows no borders, which justifies federal environmental regulation).[5]

Relevant to the natural gas industry understanding *Oneok* is the following. Federal law is supreme, and overwhelms conflicting

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state law. Next, Congress may regulate interstate commerce, and when it does so, its promulgations constitute the supreme law of the land. And thus, a large part of the natural gas industry, undeniably being interstate in nature, can only be subject to the federal power.

But what happens when a state asserts regulatory power that contradicts federal mandates? Such controversies implicate the doctrine of "preemption."

TWO KINDS OF PREEMPTION—"FIELD" AND "CONFLICT"

As the above makes clear, contradictory state edicts must yield to the supremacy of federal authority. But how does one determine when a genuine conflict exists and the local law must be preempted? To be sure, if state law is not truly in conflict with federal authority, then it may remain in place.

To resolve such problems, the courts have devised the judicial doctrines of "field" and "conflict" preemption. "Field" preemption comes into play when Congress intends to fully "occupy the field." Field preemption means no parallel state enactments shall be tolerated.

The second doctrine is "conflict" preemption, triggered by a finding that a state law truly conflicts with a federal regulation. Notably, "conflict" preemption can be found even where "field" preemption is not. Obviously, "conflict" preemption is a bit more of a nuanced analysis. Yet the result is the same: the state proviso falls to the wayside in favor of the federal mandate.

Field and conflict preemption are the means by which businesses avoid serving two masters. When it is determined that Congress intends to occupy the field or that the state law conflicts with federal requirements, the affected party can confidently answer only the federal master. Yet the opposite is also true; if Congress has no wish to overtake the field or the state regulation does not conflict with national goals, then the state proviso remains fully enforceable.

Now against the constitutional backdrop, we have one last item to review before proceeding to *Oneok*: a brief history of natural gas regulation.

NATURAL GAS ACT: PIPELINES ARE TO BE FEDERALLY REGULATED

Congress promulgated the NGA in the late 1930s for the express purpose of regulating the interstate natural gas industry. Even before the advent of the NGA, Supreme Court precedent recognized that the Commerce Clause bestowed power upon Congress to regulate the undeniably interstate pipeline segment of the industry. Accordingly, the NGA was given ratemaking authority over those engaged in the interstate transportation of natural gas.[6] That regulation is carried out today by the Federal Energy Regulatory Commission (FERC).

Then and now, the NGA recognizes the basic truth that the industry is, more or less, divided into the following three main components: (1) natural gas producers, which are by and large intrastate in scope; (2) pipeline operators, with the nature of their business inherently interstate; and (3) distributors, who revert to more localized operations.

Such vital distinctions are recognized in the NGA nomenclature as "jurisdictional" and "nonjurisdictional" gas. The former includes the commodity and operations that are truly interstate in nature, and over which federal authority preempts any state attempt to regulate. For all intents and purposes, the latter is the industry at the local level: drillers, retail sellers, and the like. To be sure, there is no lack of regulations over these endeavors, but it is left to the states to oversee the matters closest to home.

This dichotomy has long been recognized by the Supreme Court, which over the years has delineated the borders between federal jurisdiction and state regimes. In matters that are truly interstate in tenor, the Court has long held that Congress intended to occupy the field of regulation and preempt all state authority, no matter how well-intended the latter might be.[7]

In contradistinction, segments of the industry and/or industry activities that are intrinsically *intrastate* can be lawfully controlled by the sovereign states, without offending federal supremacy. Put another way, there is no preemption, and state authority can take its normal course.[8]

The sum total of the above is that the jurisdiction of the NGA and FERC reflects the various constitutional principles outlined above, as applied to the present natural gas industry. Congress has the right to regulate the interstate portion of the natural gas industry, and when federal lawmakers exercise that power, the

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Supremacy Clause guarantees that the national law will reign.

Equally true is that the rest of the natural gas business has been left to state dominion, and rightly so, because Congress need not meddle in purely local affairs. This philosophy is quite pronounced in an industry such as natural gas, because some of its constituent parts are strictly local in scope. Thus, the current labels of "jurisdictional" and "nonjurisdictional" are not mere conveniences. Indeed, they are valuable tools in defining the contours of federal authority compared to state authority.

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But one could wish that it were only that simple. The reality is that different endeavors within the industry cannot be so easily classified as either interstate or local. Which master holds sway over such businesses? Particularly troublesome is this: even some interstate components of the natural gas industry engage in activities arguably local in effect. If so, is it not logical that state law pertain to those discrete portions of their operations?

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This pithy analysis of the NGA, when taken in conjunction with the constitutional law considerations discussed earlier, constitutes the necessary predicates for the analysis to follow. That done, we can finally turn to the latest Supreme Court landmark that holds such great portent for the natural gas industry.

ONEOK—PIPELINES SUED FOR ALLEGED STATE ANTITRUST VIOLATIONS

Oneok presented a group of plaintiffs that had directly purchased natural gas from interstate pipeline companies. The buyers sued the sellers, claiming the latter had engaged in anticompetitive behavior, in the form of price manipulations and overcharges, all of which were prohibited by various state antitrust laws.

There appears to be a tacit acknowledgment that the allegedly anticompetitive behavior affected both interstate commerce, the "jurisdictional gas" that unquestionably falls within the federal government's purview, and retail gas prices, the "nonjurisdictional" segment of the market left to state regulation. Be that as it may, the buyers insisted that their state antitrust claims could reach the defendants without offending federal supremacy over the natural gas industry.

The defendants thought otherwise. The pipelines argued that Congress clearly intended to occupy the field and had preempted state regulation with the promulgation of the NGA all those years ago. Permitting these antitrust lawsuits to proceed would enable state court judges and juries to usurp federal authority over the industry.

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In effect, the pipelines' key defense was that they could only rightly serve one master, and that overseer was the federal government.

JUSTICES SPEAK TO PREEMPTION

The Supreme Court first addressed the abovementioned maxims of preemption, "field" and "conflict." Writing for the majority, Justice Stephen Breyer was quick to declare that only the former was properly before the Court for adjudication this day. Apparently when arguing before the lower courts, neither side addressed the issue of conflict preemption. Given that oversight, it would be inappropriate for the justices to address the matter for the first time now.

That said, Justice Breyer now revealed the Court's ultimate conclusion. While acknowledging the force of the pipelines' arguments that the state antitrust lawsuits should be preempted on Supremacy Clause grounds, the majority nonetheless rejected the

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basic tenets of that position and declared there was no preemption of state law here.

There was no preemption of state law here.

Relying upon a number of precedents, the *Oneok* Court emphasized its numerous prior declarations that federal natural gas law, while pervasive, was nevertheless drawn with a "meticulous regard" to preserve the power of the states to continue to regulate matters of local concern. It is not among the goals of the NGA and its refinements to "handicap or dilute" state power in any meaningful way, said the Court.[9]

It is not among the goals of the NGA and its refinements to "handicap or dilute" state power.

At this juncture, Justice Breyer acknowledged the carefully drawn division between "jurisdictional" and "nonjurisdictional" gas and operations. More to the point, the federal courts must "proceed cautiously" when parsing industry activity into one of these two categories, because the application of these classifications shall, in turn, ultimately determine where and when Congress intended to occupy a particular field, and thereby preempt state regulation.

Such questions required a careful examination of "the *target* at which state law *aims* in determining whether that [state] law is pre-empted."

Oneok declared that the resolution of such questions required a careful examination of "the *target* at which state law *aims* in determining whether that [state] law is pre-empted." Cataloguing a number of its precedents, the Court reasoned that when the aim of the state proviso is to regulate or prohibit some activity in the natural gas industry that is predominantly local in nature, then said law may justly fall within the purview of the sovereign states, and without offending federal power. By way of comparison, when the reality of a state proviso is to exert local authority over matters truly interstate in nature, then that contrary state law is preempted on Supremacy Clause grounds.

To guide the Court's analysis, Judge Breyer made a quite pithy analogy to state "blue sky" laws, as found in the realm of securities regulation. "Blue sky" laws are state schemes to regulate the sales of stocks and bonds, and held sway before the Great Depression. Indeed, their ineffectiveness contributed to that economic calamity, and thus they were replaced with the current regime of federal securities laws. Blue sky laws exist to this day but are delimited to regulating what is now that relatively tiny part of the stock market that is strictly intrastate in nature.

The comparison has value here, opined Justice Breyer. The natural gas market, historically and in its present form, remains fragmented into discrete business sectors. Some, like pipelines, are irrefutably interstate in scope; others (drilling and retail sales come to mind immediately) remain highly localized.

In this regard, the natural gas industry in certain, localized endeavors is much like the remnants of the intrastate securities markets. Thus, if interstate and intrastate securities regulation can exist side by side, why not the same for concurrent national and state regulation of the natural gas industry, its business units still easily divisible into distinctly interstate and intrastate components?

Given that the heart of *Oneok* was a charge of violation of state antitrust laws, the Court further noted the similarities between the state regimes forbidding monopolistic acts on the one hand and those regulating local dealings in stocks in bonds on the other. Much as blue sky laws predated the federal securities acts, state antitrust laws were long in existence before federal antimonopoly statutes came into being. It is beyond argument that the states have long accorded relief, via both statute and theories of common law, to those complaining of anticompetitive behavior. Then why, opined the Court, could not state antitrust laws remain effective in the instant case, even in the face of federal oversight of the natural gas industry?

Another crucial point noted by Justice Breyer was that antitrust laws, like blue sky laws, "are not aimed at natural-gas companies in particular, but rather all businesses in the marketplace." While

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it is undeniable that Congress fully intended to occupy for itself the field of regulating natural gas, it does not necessarily follow that the federal lawmakers intended to displace all state enactments prohibiting other unlawful acts, such as anticompetitive behavior in local markets.

Accordingly, the Supreme Court found the pipelines' arguments of field preemption to be lacking, and so declined to rule that the Supremacy Clause would be violated here if the plaintiffs' state antitrust law cases were allowed to proceed to trial. With that, the Court returned the controversy to the trial courts for further adjudication.

CONCLUSION

Having now presented the extrapolations of the Supreme Court in *Oneok*, we can summarize and reach a number of straightforward conclusions that we trust shall be helpful to our readership.

First, the Court in *Oneok* exhibits great pragmatism. The justices recognize the truth of the matter, that the natural gas industry is by no means homogenous. Quite to the contrary, it is composed of a multitude of discrete operations. Some, like the pipeline sector, are clearly interstate in scope. Others, like drilling and retail sales, are far more local. The Court does the entire industry a great favor by acknowledging these realities of the latter's everyday business.

Court in *Oneok* exhibits great pragmatism.

Second, the Court confirms the template of regulation that has existed, and worked rather well, for some eight decades. It is beyond argument that federal law (the NGA and its relations) and the relevant federal agency (the FERC) reign supreme over the truly interstate operators in the natural gas marketplace. Local players remain under the sway of state law. More than just confirming what we already know to exist, *Oneok* is reassuring in that it once more acknowledges this divide between federal and state authority.

Third, when matters can be realistically deemed to be interstate in nature, the Supremacy Clause assures the exclusivity of federal regulation in occupying the field; state law is wiped off the table. The industry player need only answer to one master—the federal government.

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Conversely, there remain to this day state laws applicable to even interstate enterprises, due to their aim of regulating local activity. In *Oneok*, the Supreme Court characterized the state antitrust laws at issue here as being precisely such enactments. And because they touched upon the local aspects of a business, such laws did not run afoul of the "field" preemption nominally enjoyed by the interstate component of the natural gas industry.

Furthermore, we anticipate that the Court's pungent analogy here to state blue sky laws shall remain a touchstone for Supremacy Clause and "field" preemption challenges for years to come. Industry players would do well to be aware of how this comparison assures continued federal domination over their industry, while not necessarily preempting all state regulation.

We end where we began: "No man can serve two masters."

We end where we began: "No man can serve two masters." The final word on *Oneok* is that it now guides the natural gas industry in determining when it is answerable solely to its federal master and the instances when state overlords can exercise concomitant authority.

NOTES

1. ___ U.S. ____ (April 21, 2015).
2. CONST. Art. VI, cl. 2.
3. CONST. Art. I, Section 8.
4. CONST. Art. I, Section 8, cl. 3.
5. See *United States v. Lopez*, 514 U.S. 549 (1995).
6. See *Public Utility Commission of Ohio v. United Fuel Gas Co.*, 317 U.S. 456 (1943).
7. See *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293 (1988).
8. See *Northwest Central Pipeline Corp. v. State Corporation Commission of Kansas*, 489 U.S. 493 (1989).
9. See *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*, 332 U.S. 507 (1947).

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