Chapter 7

Dual Natural Gas Markets: The Antitrust Paradox of Deregulating a Market Tied to a Natural Monopoly

Devan K. Flahive
Robinson & McElwee PLLC
Clarksburg, West Virginia

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§ 7.01. Introduction.

As a supplement to market oversight exercised by the Federal Energy Regulatory Commission, antitrust law referees competition in the natural gas industry. Federal and state antitrust laws are directed at conduct and agreements that unfairly destroy competition. In the natural gas industry, antitrust concerns may be associated with offers to supply gas, gas prices, and restrictions on market structure for production, processing and transportation. While coordination between natural gas companies can generate legitimate procompetitive efficiencies, such as reduced operating costs, the
same agreements may raise red flags under antitrust law. Conduct that does not pass antitrust muster creates substantial liability for the parties involved.

Antitrust law can be used as a means for challenging efforts of traditional suppliers to retain or expand market share, as well as for contesting new arrangements to market energy and energy services. Unconventional shale production has brought about a renaissance in the natural gas industry, including substantial shifts in supply and demand dynamics. Particularly due to deregulation, antitrust enforcement is critical for preserving competition in increasingly complex natural gas markets. Thus far, however, antitrust courts have often misapplied antitrust principles to conduct engaged in by pipelines by failing to account for the inextricable link between the market for natural gas and the market for natural gas transportation. Pipelines can create bottlenecks for non-competitors by refusing access to their facilities. Although the market for natural gas is characterized by low barriers to entry, the market for natural gas transportation is a natural monopoly. Therefore, natural gas markets are adversely affected by the same issues that an antitrust court would address in a natural monopoly.

This chapter serves to outline how regulations impact antitrust exposure, address how antitrust law has been applied to address competitive effects of natural gas industry deregulation, and analyze market problems stemming from an antitrust court’s failure to account for the inextricable link between the market for natural gas and the market for transportation.

§ 7.02. The Sherman Act.

Federal antitrust policy began with the preeminent Sherman Act. The Sherman Act, adopted in 1890, gave American courts the opportunity to develop common law analysis for condemning restraints on trade. Thus, the process of antitrust lawmaking has largely been confined to courts. The Sherman Act affords relief to competitors, purchasers, sellers and consumers for harm suffered as a result of unlawful conduct, so long as the plaintiff’s antitrust injury is “inextricably intertwined” with the antitrust

1 The Sherman Act allows “any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws” to bring suit. 15 U.S.C § 15(a).
violation.2 Further, “injury to competition” is an essential element of every antitrust claim; economic injury to a plaintiff is insufficient.3

Antitrust theories concern horizontal and vertical structures, each of which antitrust law supposes may be used to suppress competition.4 Structure is horizontal when it involves only one market, as with reference to market share or an agreement among or between rivals.5 Structure is vertical when it links two markets in the same supply chain. The Sherman Act supports robust competition between channels of distribution.


Section 1 of the Sherman Act prohibits contracts, combinations and conspiracies in restraint of trade. Production, transportation, and sale of natural gas constitute a part of ‘trade’ for purposes of the Sherman Act.6 In interpreting Section 1, the U.S. Supreme Court has qualified the restraint as needing to be “unreasonable,” and there is no requirement of specific intent to destroy competition.7 Concerted action that violates Section 1 can be horizontal or vertical.

Fundamentally, Section 1 requires agreement. Agreement may or may not affect price,8 and can be inferred circumstantially, as when a unilateral price raise would be risky, but joint action would be profitable. Although Section 1 prohibits tacit agreements among competitors, mere parallel conduct does not constitute an unlawful conspiracy. Additionally, a restraint of trade that is ancillary to legitimate joint conduct is lawful so long as it is reasonably necessary.9

2 Hanover 3201 Realty, LLC v. Village Supermarkets, Inc., 806 F.3d 162, 176 (3d Cir. 2012).
5 Id.
7 Am. Ad. Mgmt. v. GTE Corp., 92 F.3d 781, 789 (9th Cir. 1996).
Courts assess the illegality of an agreement under either a *per se* rule or the “rule of reason.” An agreement is *per se* illegal if it is likely to have no beneficial effect and significantly impairs competition. Under the *per se* rule, agreements between competitors to fix prices are conclusively presumed to be unlawful without any inquiry into competitive effects. Practices that fall within the *per se* category include horizontal price-fixing, horizontal market division and boycotts among direct competitors. Agreements that require a more detailed economic analysis to determine competitive consequence are analyzed under the rule of reason, whereby the court will determine the legality of a joint agreement based on the balancing of its competitive effects in the marketplace.


Section 2 targets single firm pricing conduct that restrains competition: monopolization or attempted monopolization. Proof of a relevant market is the foundation for any Section 2 claim. Actual monopolization requires the possession of monopoly power in the relevant market. Monopoly power is the ability to raise price by restricting output. In determining monopoly power, courts typically assess a defendant’s aggregate market share, because “monopolization (is) an impossibility as a matter

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12 Even an agreement with the purpose or effect of depressing, fixing, or stabilizing the price of a commodity can constitute horizontal price fixing. Quest Exploration & Dev. Company v. Transco Energy, 1992 WL 682756 at *6 (S.D. Tex.).
16 Unless there is “direct evidence that the defendant controlled prices or excluded competition.” Rio Grande Royalty Co. v. Energy Transfer Partners, L.P., 786 F. Supp. 2d 1190, 1197 (S.D. Tex. 2009).
of law” with low market share.\textsuperscript{18} However, a large market share is not itself a violation of Section 2; “a finding of monopolization requires proof of exclusionary, anticompetitive conduct.”\textsuperscript{19} Antitrust liability does not attach where a firm having a lawful monopoly has valid business reasons for its activities.\textsuperscript{20} The related offense of attempting to monopolize does not require that actual possession of monopoly power be shown before the cause of action is established, although it does require specific intent to engage in predatory or anticompetitive conduct.

\section*{§ 7.03. \textit{(De)regulation of the Natural Gas Industry by the Federal Energy Regulatory Commission (FERC) and Its Effect on Antitrust Enforcement.}}

Natural gas markets traditionally consisted of three segments: producers, pipeline companies that transported the gas from the wellhead to local distributors around the county, and local distributors who sold the gas to consumers.\textsuperscript{21} By virtue of having control over both gas purchases from the wellhead and sales to local distribution companies,\textsuperscript{22} pipeline companies acquired monopoly power. As documented in a series of Federal Trade Commission reports, pipeline companies were abusing monopoly power to the detriment of consumers.\textsuperscript{23} Since state antitrust laws had limited reach, Congress enacted the Natural Gas Act of 1938 in response to this uncon-
trolled regulatory gap and in order to protect the public by restraining anti-
competitive behavior.24

The Natural Gas Act of 1938 provided for federal regulation of: (1) in-
terstate transportation or sale of natural gas; (2) natural gas companies that
provided natural gas pipeline transportation or storage services in interstate
commerce; as well as (3) natural gas companies engaged in interstate sales
of natural gas for resale (“wholesales”). In the 1954 decision Phillips Petro-
leum Co. v. Wisconsin, the U.S. Supreme Court ruled that producers selling
gas into interstate pipelines were also subject to regulatory oversight by the
Federal Power Commission (replaced by the Federal Energy Regulatory
Commission (FERC) in 1977).25 In short, the Federal Power Commission
then had authority to regulate independent natural gas producers’ wellhead
prices, even though there had been no finding of monopoly power among
producers.26 The effect of the Federal Power Commission’s rate regulation
system — using historical costs to set current prices — was to impose a
low price ceiling that disincentivized producers from investing in gas pro-
duction. Consequently, new supplies for gas remained undeveloped, and
“a growing imbalance between supply and demand became apparent.”27
Ironically, consumers were being harmed by the very price controls that
were intended to protect them.28 A serious gas shortage in the 1970s finally
prompted Congress to overhaul natural gas regulation. Regulatory reform
was intended to increase competition in the price and sources of natural
gas.

“Legislative changes mandated by the Natural Gas Policy Act of 1978
(NGPA)” and the Natural Gas Wellhead Decontrol Act of 1989 “fundamen-
tally transformed the way in which the wellhead and pipeline segments of
the industry were regulated.”29 “First sales” of gas from a producer directly

25  Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954) (interpreting the Natural
Gas Act as a comprehensive scheme that included federal regulation of wellhead prices).
26  Brown, supra note 24, at 107-108.
27  Id. at 110.
28  See Rowe, supra note 21.
29  Harry G. Broadman and Joseph P. Kalt, “How Natural Is Monopoly? The Case of
for consumptive use were no longer subject to price regulation, industrial customers were able to bypass local distribution companies (LDCs) by using pipelines as transporters rather than merchants, and gas marketers materialized.30 “With respect to (wholesale) sales of gas, the NGPA largely eliminated the requirement that gas be sold at “just and reasonable” rates and created instead several categories of gas, each with a ceiling price.31 Although the elimination of price control “encouraged a more competitive market at the wellhead, pipeline companies continued to ‘bundle’ their transportation service with their own natural gas sales and require customers to purchase both.”32 Because customers lacked the means of transporting gas to their facilities, consumers could not benefit from the more competitive market at the wellhead. Consequently, FERC mandated the “unbundling” of sales service from transportation service. Pipelines had to “file new transportation tariffs which provided unbundled transportation rates or rates which separately stated the cost components that made up the transportation rate.”33 As a consequence of unbundling, pipelines no longer had to purchase the gas they transported.34 Moreover, consumers could purchase natural gas as a commodity from one seller and then contract with a different seller to transport that gas by pipeline to the customer’s location.35 In this way, deregulation created a commodity-capacity market split in the natural gas industry. Recognizing that the formation of a competitive gas-sales market could be inhibited by upstream pipeline capacity limitations, FERC also required pipelines to assign the firm-transportation capacity that they held on upstream pipelines to their firm-transportation custom-

30 See County of Stanislaus v. Pacific Gas and Elec. Co., 114 F.3d 858, 861 (9th Cir. 1997) (“FERC adopted the “blanket marketing certificate” program [vesting interstate pipelines with the authority to make all sales at market-based rates] . . . authoriz[ing] interstate pipelines to transport gas in competition with their own gas on a first-come, first-served basis.”).
31 Hartigan, 730 F. Supp. at 837.
32 E. & J. Gallo Winery, 503 F.3d at 1037.
33 Hartigan, 730 F. Supp. at 855.
34 Id. at 853.
ers. Unfortunately for pipelines, most existing contracts with producers included take-or-pay clauses, requiring pipelines to purchase minimum quantities of gas from producers at a cost that turned out to be much higher than the market price of gas once the energy crisis ended. Thus, pipelines incurred substantial transition costs from contract penalties.

§ 7.04. Bars to Antitrust Challenges.

Anticompetitive behavior can exist even when a monopolist is regulated. Anticompetitive conduct in the natural gas industry is prohibited by both the Natural Gas Act and FERC rules in addition to federal and state antitrust laws. Antitrust laws are a judicial rather than administrative remedy for market manipulation and other anticompetitive actions. FERC has the authority to issue rules and regulations to prevent “any manipulative or deceptive device or contrivance” in connection with the purchase or sale of natural gas or the purchase or sale of transportation services subject to its jurisdiction, but does not have authority to adjudicate claims under antitrust laws. Moreover, FERC’s approval of a practice does not necessarily bar a subsequent antitrust lawsuit.

The U.S. Supreme Court has held that state law antitrust claims against FERC-regulated (i.e. “jurisdictional”) natural gas companies are not necessarily field preempted by the Natural Gas Act. In Oneok, Inc. v. Learjet,

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36 Id. at 1136.
40 Specific provisions in the Natural Gas Act are designed to prohibit certain antitrust violations, such as unjust or unreasonable rates, unreasonable refusal to sell, unreasonable discriminations in price and service and deterioration in standards of service. See 18 C.F.R. § 1 c.1 (prohibiting “any entity” from engaging in manipulation that is “in connection with” a jurisdictional transaction).
Inc., a group of retail pipeline customers sued a group of pipelines under state antitrust laws for anticompetitive price reporting behavior.\textsuperscript{44} Plaintiffs’ state law antitrust claims targeted anticompetitive activities that had affected federally regulated wholesale rates as well as non-federally regulated retail prices.\textsuperscript{45} The defendants argued that states couldn’t forbid the behavior because it fell within the field that Congress reserved exclusively to FERC.\textsuperscript{46} The \textit{Oneok} court, emphasizing that antitrust laws cover business in general rather than just natural gas, concluded that the state antitrust law claims were not field preempted because they were directed at retail prices: a matter firmly on the state’s side of the wholesale-retail dividing line.\textsuperscript{47}

Antitrust challenges to rates themselves — as opposed to practices affecting rates — are barred by the filed rate doctrine. Under Section 717b of the NGA, transporters and sellers of natural gas in interstate commerce are regulated by FERC and may only charge such rates as found by FERC to be “just and reasonable.”\textsuperscript{48} The filed rate doctrine is a judicially manufactured means of protecting exclusive agency jurisdiction and bars collateral attack on rates that are filed with and/or regulated by a federal agency.\textsuperscript{49} Allowing a court to award as damages a rate never filed with FERC — and thus never found to be unreasonable within the meaning of the NGA — would undermine the congressional scheme of uniform rate regulation.\textsuperscript{50} Thus, the filed rate doctrine precludes the recovery of damages from a supplier/seller of natural gas for an alleged overcharge resulting from a rate that has been set or approved by a regulatory agency — as opposed to a rate determined

\textsuperscript{44} Oneok, Inc. v. Learjet, Inc., 135 S. Ct. 1591, 1594 (2015).
\textsuperscript{45} \textit{Id.} at 1599.
\textsuperscript{46} \textit{Id.} at 1595.
\textsuperscript{47} \textit{Id.} at 1606.
\textsuperscript{50} \textit{See} Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571, 579 (1981) (applying the filed rate doctrine to preclude lawsuit against company based on rates filed with government agency).
by the sellers. In the first delineation of the filed rate doctrine, the U.S. Supreme Court held in *Keogh* that a plaintiff could not recover for damages caused by paying transportation rates that had been allegedly set in violation of the Sherman Act.

The filed rate doctrine does not provide true “immunity” from antitrust laws, but it bars antitrust damage claims based on tariff prices or terms and conditions that are intrinsically bound up with rates. For example, the rate filed with FERC supersedes any price that private purchasers may have contractually agreed to pay. Even if a complaint does not explicitly challenge a filed rate, the court must consider whether damages sought would effectively provide plaintiffs with a different rate than the one contained in the tariff. Courts have continued to invoke the filed rate doctrine despite deregulation and FERC’s more limited market oversight. The underlying issue for the *E. & J. Gallo Winery* court was whether the plaintiff was in fact challenging FERC-authorized rates that were no longer set through a statutory filed rate mechanism. The *Gallo* court answered this question in the affirmative, reasoning that market-based rates for transactions within FERC’s jurisdiction are FERC-authorized rates because the NGA no longer requires FERC to use any particular form of regulation in its quest to ensure reasonable rates. Thus, the *Gallo* court held that the filed rate doctrine applies to post-deregulation market-based rates. Due to the filed rate doctrine, direct natural gas purchasers harmed by rates that are the product of an antitrust violation do not have any judicial recourse against collud-

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51 *Id.* at 572.
52 *E. & J. Gallo Winery*, 503 F.3d at 1033 (citing *Keogh v. Chicago & Nw. Ry. Co.*, 260 U.S. 156 (1922)).
53 *Texas Commercial Energy v. TXU Energy, Inc.*, 413 F.3d 503 (5th Cir. 2005).
54 *Arkansas Louisiana Gas Co.*, at 682 (rejecting a natural gas seller’s claim for damages from a retroactively higher contract-based rate that had not been filed but that purchaser had agreed to pay pursuant to a most favored nations clause in the price schedule filed with FERC).
56 *E. & J. Gallo Winery v. Encana Corp.*, 503 F.3d 1027, 1033 (9th Cir. 2007).
57 *Id.* at 1043.
58 *Id.* at 1039.
59 *Id.* at 1040.
ing jurisdictional sellers. Importantly, however, the filed rate doctrine does not bar all antitrust suits against FERC-regulated wholesalers. A “non-rate anticompetitive activity” exception permits a competitor to sue based on anticompetitive actions relating to the formulation of a tariff.60

§ 7.05. Application of Antitrust Principles.

“The existence of a regulatory structure designed to deter and remedy anticompetitive harm significantly reduces the need to apply traditional antitrust principles.”61 Not surprisingly, deregulation paved the way for greater antitrust enforcement and introduced previously absent antitrust concerns for natural gas companies. Antitrust exposure for natural gas companies is often not easily delineated because the distinction between activities subject to business judgment rather than regulatory edict can be ambiguous.62 Antitrust laws are complementary to FERC regulations, both being designed to maximize consumer welfare.63 While there are many open questions as to when the Sherman Act condemns agreement or conduct by natural gas companies, existing case law can provide helpful guidance about industry practices likely to receive antitrust scrutiny.

Nearly all antitrust claims implicating natural gas markets somehow tie into issues of natural gas transportation. Pipelines and producers have been sued for price fixing; end-users and gas brokers have sued pipelines invoking monopolization, monopoly leveraging, and essential facilities; and competing LDCs have asserted territorial restriction claims against each other.64 “The earliest substantive examples of antitrust invocation arose from

60 Cf. Stand, 373 F. Supp. 2d 631 (determining that the filed rate doctrine does not bar Plaintiff’s claim seeking to enforce a tariff).
61 Stand, 373 F. Supp. 2d at 641 (citing Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, 540 U.S. 398, 412 (2004)).
62 LaRue, Paul H., “Antitrust and the Natural Gas Industry,” 11 Energy L.J. 37 (1990) (discussing waves of antitrust litigation coinciding with deregulation of the natural gas industry and the corresponding availability of cheap spot market gas); see Otter Tail Power Co. v. United States, 410 U.S. 366, 374 (1973) (“When . . . relationships are governing in the first instance by business judgment and not regulatory coercion, courts must be hesitant to conclude that Congress intended to override the fundamental national policies embodied in the antitrust laws.”).
63 Id. at 42.
producers’ dissatisfaction with pipeline refusals to transport gas except at excessive rates which had not been reviewed or approved by the Federal Power Commission.”65 Prior to deregulation, “such antitrust efforts were summarily rejected, usually on the grounds that the [Federal Power Commission] possessed primary jurisdiction over rates for gas transmission.”66 In response to subsequent deregulation, many pipelines created marketing affiliates, leaving the transportation business in a separate corporate entity.67 This step engendered antitrust controversy because the pipeline, with its monopoly on transportation, has the potential to exclude marketing competitors.68


When a court evaluates a monopolization claim against a natural gas company, it must invoke traditional market power analysis. Regulation precludes an inference of monopoly power from predominant market share69 although it doesn’t prevent a court from finding that a regulated entity wields monopoly power.70 Consequently, unless direct evidence indicates that a defendant controlled prices or excluded competition, the court’s threshold inquiry is into a defendant’s share of the relevant market. Market share is just the starting point for assessing market power, but some courts find market power when market share is at least above some level and there is no contrary evidence.

In the context of the natural gas industry, a natural gas field itself can constitute a relevant market for the purpose of determining monopoly power over the extraction of natural gas.71 Hence, restraining, hindering or

65  Id.
66  Id.
68  Id.
69  Paul H. LaRue, “Antitrust and the Natural Gas Indus.:” 11 Energy L.J. 37 (1990) (citing Consolidated Gas Co. of Fla. v. City Gas Co. of Fla., 880 F.2d 297, 300 (11th Cir. 1989)).
71  See Woods Exploration & Producing Co., Inc. v. Aluminum Co. of Am., 438 F.2d 1286, 1305 (438 F.2d 1286 (5th Cir. 1971) (reasoning that, “since adjoining land owners
eliminating other producers’ extraction of gas from a common gas reservoir in order to prolong the life of the field could be held unlawful under the Sherman Act.\textsuperscript{72}

While it can be difficult to predict a court’s conclusion about monopoly power solely based on market share, courts have found that: (1) a pipeline’s 17 percent market share was insufficient for purposes of an attempted monopolization claim;\textsuperscript{73} (2) a market share of 44 percent can be sufficient as a matter of law to support a finding of market power if entry barriers are high and competitors are unable to expand their output in response to supracompetitive pricing;\textsuperscript{74} and (3) having control of 90 percent of natural gas processing services in a relevant market renders a company a monopolist.\textsuperscript{75}


Tying occurs when the sale or lease of one product — the “tying product” — is conditioned on the sale or lease of another product — the “tied” product — from the same seller. An invalid tying arrangement lies in the seller’s exploitation of its control or monopoly power over the tying product to force the buyer into the purchase of a tied product that the buyer either did not want at all, or might have preferred to purchase elsewhere on different terms.\textsuperscript{76} The distortion created by tying injures buyers of the second product. Additionally, a tying arrangement may be used to evade price control in the tying product — such as rate-regulated natural gas transportation — through clandestine transfer of profit to the tied product.\textsuperscript{77} As with refusals to deal, tying can violate both Sections 1 and 2 of the Sherman Act.

In stark contrast to the structure of the natural gas industry existing before deregulation, bundling natural gas transportation and sale now con-

\begin{footnotesize}
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\item \textsuperscript{72} Id. at 1308.
\item \textsuperscript{73} Quest Exploration & Dev. Co. v. Transco Energy, 1996 WL 682756 (S.D. Tex.).
\item \textsuperscript{74} Rebel Oil Co. v. Atlantic Richfield Co., 51 F.3d 1421, 1438 (9th Cir. 1995).
\item \textsuperscript{75} Am. Central Eastern Texas Gas Co., v. Union Pacific Reserve Group Inc., 93 Fed. App’x 1, 2004 WL 136091, 8 (5th Cir. 2004).
\item \textsuperscript{76} Midwest Gas Servs. v. Indiana Gas Co., 317 F.3d 703, 712 (7th Cir. 2003).
\item \textsuperscript{77} See Paladin Assocs., Inc., 97 F. Supp. 2d at 1028.
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stitutes an antitrust violation under a “tying” theory. For example, in *Midwest Gas Services v. Indiana Gas Company*, the plaintiff claimed that a marketer of gas and gas transportation used its large market share to purchase natural gas in bulk, and sell that gas, along with the gas transportation it controlled, to consumers at a lower margin that its competitors because of its high sales volumes. In that case, the court dismissed the claim because the plaintiff did not adequately plead that its losses stemmed from anticompetitive behavior, such as predatory pricing. Importantly, it bears understanding that courts will entertain antitrust claims in the context of tying transportation services to gas purchases. Another arrangement found to be unlawful was the tying of gathering and meter services in *El Paso Natural Gas*, gas well owners who sought to use a gas gathering system had to purchase meter installation services.

**[3] — Monopoly Leveraging.**

Monopoly leveraging is in the same “family” as tying from the standpoint that it involves the imposition of anticompetitive effects on a secondary market. “Monopoly leveraging is defined as an attempt to use monopoly power in one market to monopolize another market.”

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79 *Midwest Gas Servs. v. Indiana Gas Co.*, 317 F.3d 703 (7th Cir. 2003).
80 *Id.* at 713 (“The antitrust laws do not require the courts to protect small businesses from the loss of profits due to continued competition, but only against the loss of profits from practices forbidden by the antitrust laws.”).
83 *Id.*
84 *Cost Management Services, Inc. v. Washington Natural Gas Co.*, 99 F.3d 937, 951 (9th Cir. 1996) (adding that proof of monopoly leveraging requires the plaintiff to demonstrate a dangerous probability of monopoly in the second market).
Pipelines have evaded liability under a Section 2 monopoly leveraging theory by having ceded the gas marketing function to an affiliate. For instance, in *Midwest Gas Services, Inc. v. Indiana Gas Co., Inc.*, “plaintiff’s monopoly maintenance claim involved both [a pipeline’s monopoly] over the sale of gas and its distribution within its territory via [a marketing affiliate], ProLiance.” The court dismissed plaintiff’s claim on the grounds that the pipeline could not have acquired monopoly control over something in which it was not a market participant: sales of natural gas.

**[4] — Refusals to Deal.**

In order to compete, a natural gas company must be able to access — directly or indirectly — distribution channels and/or processing facilities. Since FERC lacks authority to order a pipeline to transport gas for a competitor over its objection, even as a remedy for discriminatory conduct, FERC regulation does not necessarily constrain a pipeline’s ability to exercise monopoly power and does not ensure natural gas sellers meaningful access to jurisdictional pipelines. This provides a pipeline with a powerful weapon for preventing independent gas from entering captive supply markets. Refusals to deal can be either concerted or unilateral, but liability requires an actual refusal. A group boycott is a joint collaborative action designed to injure or exclude a competitor from access to the market. Generally, an individual firm is free to refuse to deal with others and a

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86 See, e.g., *Midwest Gas Servs., Inc.*, 317 F.3d 713.
87 Id. at 713.
88 Id.
89 Hartigan, 730 F. Supp. at 876.
90 See id. at 854.
91 See Tate v. Pacific Gas & Electric Co., 230 F. Supp. 2d 1086, 1090 (N.D. Cal. 2002) (rejecting gas marketer’s section 2 claim despite finding a natural gas distribution monopoly in the area of Santa Cruz, California, because the defendant’s offer to provide limited capacity was not predatory conduct).
92 See, e.g., *Venture Technology, Inc. v. Nat’l Fuel Gas Co.*, 685 F.2d 41 (2nd Cir. 1982) (addressing a Section 1 group boycott involving a plaintiff natural gas producer’s claim that a public utility, its producing subsidiary and another competitor had conspired to jointly prevent plaintiff’s entry into the gas production business in western New York).
refusal to cooperate is a matter of right. However, antitrust law deems such a refusal unlawful when it is intended to support another illegal restraint or is predicated on other anticompetitive goals.93

A monopolist’s refusal to deal may trigger the application of the essential facilities doctrine. The essential facilities doctrine in antitrust law requires a monopolist to provide access to its facilities or resources in some circumstances. The essential facilities doctrine stands for the proposition that the antitrust laws require a single firm in control of a facility essential to its competitors to provide reasonable access to the facility if possible.94 To be “essential” a facility need not be indispensable; it is sufficient if duplication of the facility would be economically infeasible and if denial of its use inflicts a severe handicap on potential market entrants.95 The doctrine is most likely to be useful when the monopoly facility is shared by numerous competitors, has excess capacity, and where the applicants seek access on the same terms as the incumbents.96

The Seventh Circuit set forth a leading formulation of the doctrine, under which a plaintiff must prove four elements to establish liability and defendant’s obligation to provide access: (1) control of the essential facility by a monopolist; (2) a competitor’s inability practically or reasonably to duplicate the essential facility; (3) the denial of the use of the facility to a competitor; and (4) the feasibility of providing the facility.97 By controlling an essential facility, a monopolist may extend monopoly power from one stage of production to another. Such vertical foreclosure, wherein a dominant firm can eliminate or exclude downstream competitors, negatively impacts consumer welfare.

A sticking point for antitrust courts has been how to apply the “essential facilities” doctrine to pipelines. Essential facilities claims directed toward a pipeline’s refusal to transport gas are unique because a pipeline is a

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93 Bork, supra note 4, at 345-46.
96 Id.
97 MCI Communications Corp. v. Am. Tel. & Tel. Co., 708 F.2d 1081, 1132-1133 (7th Cir. 1983).
natural monopoly. Natural monopoly occurs when a firm’s costs decline as output increases all the way to the market’s saturation point.\textsuperscript{98} Natural monopoly markets perform optimally when they are occupied by a single firm charging a competitive price because the single firm can produce the entire output of the industry at a lower average cost than can two or more firms.\textsuperscript{99} Since a natural monopolist is a monopolist nonetheless, it will charge its profit-maximizing price rather than a competitive price. The traditional solution to the problem of natural monopoly is price regulation.\textsuperscript{100} Due to Congress’ scaling back of regulation in the natural gas industry, antitrust law must assume the responsibility of preventing pipelines from abusing their natural monopoly.

As a natural monopoly, a pipeline has market power. As one federal district court observed, residual FERC regulation actually enhances the “essential” character of pipelines.\textsuperscript{101} Moreover, by definition, a pipeline cannot be practically or reasonably duplicated without decreasing consumer welfare. Yet, courts have declined to consistently apply the essential facilities doctrine the pipelines. In \textit{Illinois, ex rel. Burris v. Panhandle Eastern Pipe Line Co.}, the State of Illinois brought an antitrust suit “in its capacity as a natural gas consumer and as \textit{parens patriae} for a class of plaintiffs consisting of all of Panhandle’s indirect purchasers” served exclusively by Panhandle.\textsuperscript{102} “The [S]tate’s complaint alleged that Panhandle monopolized the sale of natural gas within central Illinois by refusing to transport non-system gas purchased by LDCs directly from independent producers,

\textsuperscript{99} \textit{Id}.
\textsuperscript{100} While in some cases it can create artificial barriers to entry, regulation also implements market management conducive to promoting consumer welfare. See, e.g., \textit{Aurora Gas Co. v. Preque Isle Elec. & Gas Co-op}, 1996 WL 627399 (E.D. Mich. 1996) (referencing a regulatory barrier to entry conferred by a natural gas distribution company’s acquisition of a multi-year franchise from a municipality to provide residential gas distribution).
\textsuperscript{101} \textit{Illinois ex rel. Hartigan v. Panhandle Eastern Pipeline Co.}, 730 F. Supp. 826, 927 (C.D. Ill. 1990) (“Far from negating the essential facilities character of the pipeline for competition in the area, FERC regulation imposed added entry barriers.”).
\textsuperscript{102} \textit{Illinois ex rel. Burris v. Panhandle Eastern Pipe Line Co.}, 935 F.2d 1469, 1470 (7th Cir. 1991).
thereby forcing them to purchase gas from Panhandle.”

Panhandle had refused to transport the gas on the ground that enabling its customers to obtain gas from other sources would dramatically reduce the demand for the expensive gas it was contractually obligated to purchase, exposing it to enormous take-or-pay liability. Panhandle’s captive, G tariff customers were party to an exclusive dealing contract approved by the Federal Power Commission prior to sweeping deregulation of the natural gas industry. Although the *Burris* court framed the issue as whether Panhandle’s efforts to maintain its G tariff violated the antitrust laws, it opined that Panhandle’s pipelines were not essential facilities because it would have been economically feasible for competitors to duplicate much of Panhandle’s system by means of interconnections and new pipelines.

Another reason that courts have declined to find a pipeline to be an essential facility is that the plaintiff is not an actual or potential competitor of the pipeline. In *Garshman v. Universal Resources Holding Inc.*, gas producer Universal alleged that another gas producer, System, and System’s interstate pipeline subsidiary, Transmission, “unlawfully utilized their market power as one of the largest vertically integrated gas producers in the United States to unfairly coerce [plaintiff] . . . into acquiescing to price cuts in order to secure access to gas transportation.” System and Transmission had leased holdings of natural gas exploration sites to Universal. Thus, Universal was a customer for exploration rights in mineral leaseholds owned by System and Transmission: not a competitor. The court found this relationship to be dispositive for purposes of Universal’s essential facilities claim. Moreover, the court explained that the result of defendants’ coercion was a reduction in the price the interstate pipeline had to pay Universal for extraction and delivery of gas, and a concomitant reduction in

103 *Id.*
104 *Id.* at 1488.
105 *Id.* at 1480.
107 *Id.* at 229.
108 *Id.* at 230.
109 *Id.*; see *Official Airline Guides Inc. v. FTC*, 630 F.2d 920 (2d Cir. 1980) (concluding that a non-competitor lacked anticompetitive motive or intent).
the price at which the gas could be offered for resale. Those effects were procompetitive, not anticompetitive.

While the Garshman court properly considered procompetitive, downstream market effects in analyzing plaintiff’s Section 2, other courts have summarily denied essential facilities claims in the context of natural gas transportation without doing so. When such a rejection of the essential facilities doctrine is premised solely on the fact that a plaintiff is a non-competitor of a pipeline, the court’s antitrust analysis will inevitably fall short of properly considering injury to competition. This was illustrated by the U.S. Supreme Court’s reversal of the Eleventh Circuit in Consolidated Gas Co. of Florida v. City Gas Co. of Florida, Inc. The market for natural gas does not exist independently from the market for natural gas transportation because gas must be transported by pipelines from production areas to consumers. By refusing to transport gas, a pipeline is harming natural gas sellers, marketers, and purchasers rather than other pipelines (i.e. non-competitors). In this way, a pipeline’s refusal to transport gas can cause actual competitive harm even if the refusal is directed at a purchaser rather than a competing pipeline.

In Consolidated Gas Co. of Florida v. City Gas Co. of Florida, Inc., Consolidated had obtained a FERC allocation to purchase wholesale gas either directly from City Gas or from the Florida Gas Transmission Company (FGT) using City Gas’ pipeline system for transportation of the FGT gas. Concluding that it would have been cost prohibitive for Consolidated to construct a new interconnect with FGT’s facilities as an alternate delivery point, the Eleventh Circuit enjoined City Gas from denying Consolidated access to the pipeline. Notably, the court also alluded to the possibility that natural gas itself could be considered an essential facility. Since ac-

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110 Id.
111 Id.
114 Id. at 299.
115 Id.
116 Id.
cess to gas transportation is necessary to participate in the separate market for natural gas sales, courts should not require a plaintiff to be an “actual or potential competitor” in order to prevail in an essential facilities claim against a pipeline. The analysis does become considerably more ambiguous under the essential facilities doctrine when a pipeline’s denial is not absolute, however, such as when the parties merely disagree on the price or terms at which access to some asset can be brought.

Judicial application of the essential facilities doctrine to pipelines was also influenced by the U.S. Supreme Court’s *Otter Tail Power Co. v. United States* decision.117 The *Otter Tail* court required a regulated electricity monopolist to give downstream retail competitors access to its wholesale electricity. Following *Otter Tail*, some courts proceeded on the basis that the threat of downstream monopolization is the *sine qua non* of an essential facilities claim.118 The Ninth Circuit conflated the essential facilities doctrine with a theory of monopoly leveraging in both *Paladin Associates, Inc. v. Montana Power Co.* and *Alaska Airlines, Inc. v. United Airlines, Inc.*

Relying on the undisputed fact that competition in the market for gas was not dependent upon a certain supply of gas, the *Montana Power* court held that a pipeline was not an essential facility because it did not carry the power to eliminate the sale of gas in the off-system downstream markets.119 The *Alaska Airlines* case involved American Airlines’ and United Airlines’ computer reservation services, and involved an analogous “dual market” scenario.120 Smaller airlines alleged that the larger airlines, in controlling the computer reservation service market, advertised their own flights in more desirable locations than those of the smaller airlines in order to gain a competitive advantage in the air transportation market.121 The court likewise held that the computerized air reservation systems controlled by United Airlines and American Airlines were not essential facilities because


119 *See Paladin Assoc.,* 97 F. Supp. 2d 1013, 1031.


121 *Id.*
the ability to charge supracompetitive booking fees did not threaten to con-
fer monopoly power upon American in the airline transportation market.122

§ 7.06. The Dual Market Phenomena and Its Paradoxical Effect on Antitrust Analysis in the Natural Gas Industry.

Competition in the market for natural gas is a function of transporta-
tion because sales of natural gas depend on the ability to transport the gas
to purchasers. Yet, in analyzing antitrust claims against natural gas trans-
portation companies, courts have often declined to consider effects on the
associated market for natural gas. This can lead to a result inimical to the
antitrust laws. The federal district court’s decision in Stand Energy dem-
onstrates an exception to this rule. The Stand Energy plaintiffs alleged that
defendants’ manipulation of the parking and lending service blocked non-
select shippers from access to the pipelines.123 The court allowed plaintiffs’
antitrust claims to withstand a motion to dismiss because it accepted plain-
tiffs’ assertion that ‘excluding the nonselect shippers from the marketplace
allowed the select shippers, acting in concert with the pipelines, to take
over the market and led to high prices to retail customers.”124 High prices
to retail customers constituted requisite “injury to competition.” “Injury to
competition” is an essential element of every antitrust claim. It is well estab-
lished that action harming a competitor is not an antitrust violation unless
that conduct harms competition itself. Yet, courts have accepted defenses
asserted by pipeline companies that do not in fact inure to the benefit of
natural gas consumers. For instance, in Gas Utilities Co. of Alabama v. S.
Natural Gas Co. and Alabama Gas Corp., plaintiff pipeline GUA sought
to bypass an LDC by acquiring a tap from pipeline Southern to serve in-
dustrial natural gas purchasers.125 Southern was “the only interstate pipe-

122 Id.
123 Stand, 373 F. Supp. 2d 631, 634, 642 (“The parking and lending service would allow shippers to park gas on the pipeline system as well as borrow gas from the pipeline system on an interruptible basis, which means it would be subject to interruption by higher priority shipping contracts.”). Id. at 634.
124 Id.
line capable of servicing the particular industrial end-users.”126 Southern claimed that it rejected GUA’s requests for delivery points to be constructed on the grounds that all end-users which GUA had identified could be served through existing Southern delivery points which were already connected to the LDC’s system.127 The court accepted Southern’s proffered business justification “that construction of new taps could result in its losing recovery of “take or pay” costs.”128 While the incurrence of “take or pay” costs unquestionably reduced the pipeline’s profit, Southern did not articulate any argument as to why retail natural gas customers would not benefit from having an alternative option from which to purchase gas: particularly since the option would have enabled it to bypass paying transportation costs to the LDC. Antitrust laws should not be concerned with protecting the profitability of an individual pipeline.

Fundamentally, however, antitrust enforcement in the natural gas industry is complicated by the fact that natural gas transportation is a natural monopoly. Pipelines’ natural monopoly was blamed as necessitating regulation of the natural gas industry, but deregulation did not impose structural changes to eliminate pipelines’ natural monopoly. Hence, pipelines maintain territorial monopolies despite loosed regulatory grip and the same competitive distortions persist. In fact, the paradox associated with deregulating the natural gas industry is a product of the inextricable link between natural gas sales and transportation. Even though the market for natural gas is not a natural monopoly, the “bottlenecking” effect that transportation has on natural gas sales mandates courts to consider the two markets together for antitrust purposes.

§ 7.07. Conclusion.

The basic hypothesis of deregulation was that by allowing pipelines to offer a fuller range of services, the cost of using infrastructure would decrease and markets across the U.S. would merge into one national natu-

126 Id. at 1560.
127 Id. at 1554.
128 Id.
Deregulation did eliminate certain market inefficiencies, as evident by producers of gas choosing to market their own product. Yet, deregulation did not integrate markets in a way that facilitates classical application of antitrust law. Competition in the market for natural gas is tied to transportation price in addition to pipeline access. Transportation is a transaction cost for natural gas sellers. Despite the low capital requirements for entering the market for natural gas sales, transportation costs can diminish return on investment in arbitrage, thereby distorting competition in the market for natural gas sales. The reverse also holds true, however; a pipeline’s offering additional transportation options can improve competition in the market for natural gas. Although the markets for natural gas and transportation are evidently complementary, antitrust law does not permit consideration of this market link for purposes of assessing the procompetitive effect of a restraint of trade. Unless antitrust courts adopt a more particularized analysis for cases involving natural gas markets to take into account the tie between gas sales and transportation, conduct that inures to the detriment of natural gas consumers may be incongruously condoned.

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129 Naturalgas.org, Industry and Market Structure (access at naturalgas.org (business/industry)).
130 See Hovenkamp, supra note 98, at 37.
131 Paladin, 97 F. Supp. 2d 1013, 1036 n. 11.
132 See United States v. Topco Assocs., Inc., 405 U.S. 596, 610 (1972) (“If a decision is to be made to sacrifice competition in one portion of the economy for greater competition in another portion this too is a decision that must be made by Congress and not by private forces or by the courts.”).