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contemporaneous because of a nontraumatic injury<sup>56</sup> or a peculiar state rule as in *Bizer*,<sup>57</sup> it is clear that state law determines *whether* an actionable wrong has been committed, but federal law determines *when* a "claim accrues" for the purpose of starting the federal period of limitations.

*Robert Ted Enloe, III*

## State Ratable Purchase Orders — Conflict With the Natural Gas Act

### I. STATE-FEDERAL DIVISION OF CONTROL

The Natural Gas Act of 1938<sup>1</sup> provides for Federal Power Commission control over the sale and transportation of natural gas in interstate commerce. The purpose of the Act was not to divest state commissions of their regulatory authority over conservation,<sup>2</sup> but to "fill the gap" thought to exist because of the constitutional limits on the states' power to regulate interstate commerce.<sup>3</sup> Although the exact line of federal-state demarcation is somewhat elusive, there are some areas in which the proper regulatory authority is relatively settled. The state's control over the "production and gathering" of natural gas is preserved by section 717(b) of the Natural Gas Act.<sup>4</sup> But this area of state control has been narrowly confined to the physical act of drawing gas from the earth<sup>5</sup> and does not include a producer's sales at the wellhead for resale in interstate commerce.<sup>6</sup> Within the area of "production and gathering," however, the state has control over the drilling and spacing of wells,<sup>7</sup> the conservation of oil and gas and their by-products,<sup>8</sup> and the protection of the correlative rights of owners in a common reservoir through proration or allowable orders directed at producers.<sup>9</sup>

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<sup>56</sup> See *United States v. Reid*, 251 F.2d 691 (5th Cir. 1958), discussed in notes 23-36 *supra* and accompanying text.

<sup>57</sup> *Bizer v. United States*, 124 F. Supp. 949 (N.D. Cal. 1954).

<sup>1</sup> 52 Stat. 821-33 (1938), 15 U.S.C. § 717(w) (1958).

<sup>2</sup> H.R. Rep. No. 709, 75th Cong., 1st Sess. 2 (1937).

<sup>3</sup> *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 684 (1954).

<sup>4</sup> 52 Stat. 821-33 (1938), 15 U.S.C. § 717(b) (1958).

<sup>5</sup> *Interstate Natural Gas Co. v. FPC*, 331 U.S. 682, 692 (1947); *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 589 (1945).

<sup>6</sup> *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954); *Deep So. Oil Co. v. FPC*, 247 F.2d 882, 887 (5th Cir. 1957).

<sup>7</sup> *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581 (1945).

<sup>8</sup> *Interstate Natural Gas Co. v. FPC*, 331 U.S. 682 (1947).

<sup>9</sup> *Thompson v. Consolidated Gas Util. Corp.*, 300 U.S. 55, 69 (1937); *Champlin Ref. Co. v. Corporation Comm'n*, 286 U.S. 210 (1932).

The federal government has exclusive control over gas rates in interstate commerce, and any attempt by a state to control rates directly has been held invalid both before<sup>10</sup> and after<sup>11</sup> the passage of the Natural Gas Act. Neither can the state indirectly affect interstate rates, for example, by ordering an interstate pipeline company to extend its facilities to more wells within the state.<sup>12</sup> Furthermore, a state cannot set minimum prices at the wellhead under the guise of conservation.<sup>13</sup> The United States Supreme Court announced in *Phillips Petroleum Co. v. Wisconsin* that "Congress sought to regulate wholesales of natural gas at both ends of the interstate transmission system."<sup>14</sup> When a sale for resale in interstate commerce takes place, the "gathering process" is over,<sup>15</sup> and at that point, the exclusive jurisdiction of the Federal Power Commission attaches.<sup>16</sup> Moreover, the Court has said: "[I]n a borderline case where congressional authority is not explicit we must ask whether state authority can practicably regulate a given area and, if we find that it cannot, then we are impelled to decide that federal authority governs."<sup>17</sup>

## II. RATABLE TAKE ORDERS AND THE FEDERAL-STATE DIVISION

Although various state statutes differ as to what constitutes ratable taking,<sup>18</sup> "the practical definition of ratability amounts to allowing each producer a fair opportunity to produce that share of the field reserve which is proportionate to his well's allocation factor."<sup>19</sup> Ratability is important in oil and gas production because non-proportionate taking causes low pressure points which force minerals in a common reservoir to flow toward the over-produced well. The basic interest of the state in this area, of course, is to protect correlative rights by balancing the production of the common reservoir owners. As early as 1900, the Supreme Court recognized the states'

<sup>10</sup> *Missouri v. Kansas Natural Gas Co.*, 265 U.S. 298 (1924).

<sup>11</sup> *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

<sup>12</sup> *Illinois Natural Gas Co. v. Central Ill. Pub. Serv. Co.*, 314 U.S. 498 (1942).

<sup>13</sup> *Cities Serv. Gas Co. v. Peerless Oil & Gas Co.*, 304 U.S. 179 (1950), held that minimum prices were no violation of the due process or equal protection clauses. *But see* *Natural Gas Pipeline Co. v. Panoma Corp.*, 349 U.S. 44 (1955), which held that such pricing encroached upon federal jurisdiction under the Natural Gas Act.

<sup>14</sup> 347 U.S. 672, 684 (1954).

<sup>15</sup> *Ibid.*; *Interstate Natural Gas Co. v. FPC*, 331 U.S. 682, 692 (1947).

<sup>16</sup> *Natural Gas Pipeline Co. v. Panoma Corp.*, 349 U.S. 44 (1955); see also *Cities Serv. Gas Co. v. State Corp. Comm'n*, 180 Kan. 454, 304 P.2d 528, 534 (1956), *rev'd*, 355 U.S. 391 (1958), construing a minimum price order as a condition precedent to production.

<sup>17</sup> *FPC v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 19-20 (1961).

<sup>18</sup> Comment, *Ratable Taking of Natural Gas*, 11 Sw. L.J. 358 (1957).

<sup>19</sup> *Jacobs, Governmental Regulation of Gas Production*, L.S.U. 4th Ann. Inst. of Mineral Law 43, 60 (1956).

power in this area by holding in *Ohio Oil Co. v. Indiana*,<sup>20</sup> that an Indiana conservation statute did not violate the due process clause of the fourteenth amendment. The Court stated that a state's "legislative power . . . can be manifested for the purpose of protecting all the collective owners. . . ."<sup>21</sup> This position has been sustained in numerous subsequent decisions.<sup>22</sup>

Thus, the state possesses an undisputed, legitimate interest in protecting the correlative rights of common owners. However, not all state orders designed to achieve ratability have been upheld. Seemingly inconsistent decisions may be reconciled by careful consideration of two decisive factors. First, confusion has arisen because different results have been reached depending on the *grounds* upon which various state orders have been challenged, *i.e.*, whether the orders were attacked as being a violation of the fourteenth amendment, an undue burden on interstate commerce, or an invasion of exclusive federal jurisdiction under the Natural Gas Act. Secondly, it now appears that although the end result sought by the state authorities may be within their power, the *means* used to achieve those ends will fail if conflict with federal authority results.

An illustration of the first point is presented in *Cities Service Gas Co. v. Peerless Oil & Gas Co.*<sup>23</sup> In that case, the Oklahoma Corporation Commission issued an order establishing a minimum wellhead price. The Supreme Court held that this minimum price order was not an undue burden on interstate commerce and that there was no violation of the due process or equal protection clauses of the fourteenth amendment. The Court specified that the question of whether the order was in conflict with the Natural Gas Act was not before the Court.<sup>24</sup> Five years later when a minimum price order was challenged as being in conflict with the Natural Gas Act, the Court held that the order was an invalid encroachment on exclusive federal jurisdiction.<sup>25</sup> Thus, it is clear that state orders previously upheld on constitutional grounds must be re-examined in light of the Natural Gas Act.

Secondly, it now seems that the *means* used by the state to achieve ratability make a vital difference in determining whether the state has validly exercised its authority. The Supreme Court has repeatedly

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<sup>20</sup> 177 U.S. 190 (1900).

<sup>21</sup> *Id.* at 210.

<sup>22</sup> *E.g.*, see *Patterson v. Stanolind Oil & Gas Co.*, 305 U.S. 376, 378 (1939); *Walls v. Midland Carbon Co.*, 254 U.S. 300, 317 (1920).

<sup>23</sup> 340 U.S. 179 (1950); see also *Phillips Petroleum Co. v. Oklahoma*, 340 U.S. 190 (1950).

<sup>24</sup> *Cities Serv. Gas Co. v. Peerless Oil Co.*, *supra* note 23, at 188-89.

<sup>25</sup> *Natural Gas Pipeline Co. v. Panoma Corp.*, 349 U.S. 44 (1955).

recognized the states' power to regulate ratable taking through orders directed at *producers*.<sup>26</sup> A leading case on this point, *Champlin Ref. Co. v. Corporation Comm'n*,<sup>27</sup> held that the state commission orders, limiting production to market demand and requiring ratable *production* by all producers from a common source, were not a violation of the commerce clause. The Court in *Champlin* pointed out: "[T]he proration established by the commission appl[ies] only to production and not to sales or transportation of crude oil or its products. Such production is essentially a mining operation and therefore is not a part of interstate commerce even though the product obtained is intended to be and in fact is immediately shipped in such commerce."<sup>28</sup> In subsequent cases, the Court has spoken only of the states' power to regulate *production*.<sup>29</sup> In *Northern Natural Gas Co. v. State Corp. Comm'n*,<sup>30</sup> state orders designed to achieve the same ends as those in the *Champlin* case were struck down by the Court. This decision brings to the foreground the possibility that the decisive factor in determining the validity of state orders is the means used by the state to achieve the desired ends rather than the ends themselves. The *Northern* case is the first to consider ratable purchase orders in this light.<sup>31</sup>

### III. *Northern Natural Gas Co. v. State Corp. Comm'n*<sup>32</sup>

Northern Natural Gas Co. is an interstate pipeline company whose pipeline system is connected to some 1,100 gas wells in the Kansas Hugoton Field. Northern's oldest gas contracts are with Republic Natural Gas Co., a producer, and under the "Republic A" contract, as modified,<sup>33</sup> Northern is required to purchase up to the maximum

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<sup>26</sup> *Hunter Co. v. McHugh*, 320 U.S. 222, 227 (1943); *Thompson v. Consolidated Gas Util. Corp.*, 300 U.S. 55, 76-77 (1937).

<sup>27</sup> 286 U.S. 210 (1932).

<sup>28</sup> *Id.* at 235. For a discussion of the fact that this interpretation of the commerce clause is now antiquated and that allowable orders may be in jeopardy, see text accompanying note 55 *infra*.

<sup>29</sup> See note 26 *supra*.

<sup>30</sup> 372 U.S. 84 (1963).

<sup>31</sup> The FPC, in denying jurisdiction over the orders involved in the *Northern* case, said: "[T]hese are matters which lie within the sphere of state control and cannot constitute as basis for intervention in the proceedings before the commission." Indeed, as the dissenting opinion points out, in the 1958 term the Court dismissed an appeal from a commission order requiring ratable purchasing. *Permian Basin Pipeline Co. v. Railroad Comm'n*, 358 U.S. 37 (1958), *dismissing appeal from* 302 S.W.2d 238. (Tex. Civ. App. 1957) *error ref. n.r.e.*

<sup>32</sup> 372 U.S. 84 (1963).

<sup>33</sup> The original "Republic A" contract fixed the minimum take requirements in terms of a percentage of Northern's requirements for a particular district. This original contract was modified by a decision of the Kansas Supreme Court in 1952 holding that Northern's purchases from Republic could not exceed Republic's allowables. Northern Natural Gas

production allowables from Republic's wells. Under its contracts with producers other than Republic, Northern was obligated to purchase only so much of its requirements as were not satisfied by purchases from Republic. Until 1958, Northern's requirements were such that its purchases were roughly ratable, but after 1958 this purchasing pattern resulted in substantial underages in wells other than Republic's and corresponding overages in Republic's wells.<sup>34</sup> To alleviate this situation and protect the correlative rights of the owners, the Kansas Corporation Commission issued an order directing Northern to purchase gas ratably from all wells to which it was connected.<sup>35</sup> Faced with the choice of complying with the Commission orders and breaching the Republic contract or of ignoring the Commission's orders and thereby subjecting itself to criminal penalties, Northern complied with the orders<sup>36</sup> and challenged them in the courts on the ground that they unconstitutionally invaded the exclusive jurisdiction of the Federal Power Commission under the Natural Gas Act. The Kansas Supreme Court sustained the orders of the Commission; however, on appeal the United States Supreme Court held that state orders directed at purchasers of natural gas are beyond the authority of the state because of the federal jurisdiction granted by the Natural Gas Act.

Speaking for the majority, Mr. Justice Brennan dismissed the Commission's contention that the orders were within the "production and gathering" exemption of the Natural Gas Act. Mr. Justice Brennan simply said that Northern, to whom the orders were directed, is a purchaser and that none of its activities in Kansas involves production and gathering. This conclusion is supported by the earlier decisions that a sale ends the production and gathering process.<sup>37</sup> "The danger of interference with the federal regulatory

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Co. v. Republic Natural Gas Co., 172 Kan. 450; 241 P.2d 708 (1952). The effect of this decision was to require Northern to purchase up to the maximum production allowables of Republic's wells before buying from other producers.

<sup>34</sup> The imbalance occurred in 1958 because of the increase in production allowables by the Kansas commission in the face of a relatively static demand. This forced Northern, under contract, to raise its purchases from Republic and lower correspondingly its take from the other producers.

<sup>35</sup> There was both a general order embodied in Kan. Corp. Comm'n Rule No. 82-2-219 and an order directed specifically at appellant. Both orders were authorized by Kan. Gen. Stat. Ann. § 55-703 (Supp. 1959). It is immaterial which order is considered because both were directed at purchasers and the effect of the Natural Gas Act would be the same. The order aimed directly at Northern is dated October 7, 1959, and reads as follows: "The Northern Natural Gas Company is hereby ordered to take gas ratably from all wells to which it is connected in the Kansas Hugoton field."

<sup>36</sup> Compliance with the orders resulted in a breach of the "Republic A" contract. At this writing, a suit is pending in the District Court of Stephens County, Kansas against Northern for breach of that contract.

<sup>37</sup> See notes 4-6 *supra* and accompanying text.

scheme arises because these orders are unmistakably and unambiguously directed at *purchasers* who take gas in Kansas for resale after transportation in interstate commerce.<sup>38</sup>

The issue that forms the heart of the opinion, and is important in the dissent as well, is whether state orders seeking to achieve a balance of correlative rights are valid in spite of a technical invasion of federal authority. The Court reiterated, "There is no doubt that the States do possess power to allocate and conserve scarce natural resources upon and beneath their lands."<sup>39</sup> According to the majority, the test is not the existence or even the scope of the state's power to conserve its natural resources, but the constitutional validity of the particular *means* chosen to exercise the state's conceded power. In light of the fact that these means are not within the "production and gathering exemption" because directed at purchasers rather than producers of natural gas, the Court concluded that such orders cannot stand "when they threaten, as here, the achievement of the comprehensive scheme of federal regulation."<sup>40</sup>

Although the Court discussed at some length the quantitative impact of these orders upon the cost structure of gas in interstate commerce, it must be emphasized that this was not the basis of the decision. This can be seen by examining two factors. First, the Court reaffirmed its decision in *Champlin Refining Co. v. Corporation Comm'n*<sup>41</sup> by stating that regulations aimed at *producers* are not part of interstate commerce and hence are under state regulatory control. Thus, if the Court continues to stand by its interpretation of the *Champlin* case, orders directed at producers would be valid regardless of the effect upon cost structures.<sup>42</sup> Secondly, the Court rejected the suggestion that the state orders would be valid if the "Republic A" contract could be harmonized with them so as to eliminate the "adverse" effect upon cost structures.<sup>43</sup> The Court said that this latter argument "misconceives the true nature of the question"<sup>44</sup> and that even if the suggested accommodations could be made, the validity of such a method would still have to be decided. Thus, the means chosen by Kansas to achieve ratability must fail regard-

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<sup>38</sup> 372 U.S. at 92 (1963).

<sup>39</sup> *Id.* at 93.

<sup>40</sup> *Id.* at 94.

<sup>41</sup> 286 U.S. 210 (1932); see also text accompanying notes 26-30 *supra*.

<sup>42</sup> *But see* text accompanying note 55 *infra*.

<sup>43</sup> Moreover, as the dissent points out, had the orders of the Kansas Corporation Commission been allowed to stand, they might have produced a favorable effect on interstate prices. Northern was paying more for the gas it purchased from Republic than from its other producers.

<sup>44</sup> 372 U.S. at 97 (1963).

less of the actual effect upon the prices of gas in interstate commerce. The dissent argued that the most direct impact on interstate commerce is the allowable order; the majority, however, would answer that if the means are legitimate, the orders will stand regardless of possible conflict with the federal regulatory scheme.

#### IV. CONCLUSION

By putting emphasis on the *means* chosen by Kansas to achieve ratatability, it is clear that the ratable purchase orders invaded the exclusive jurisdiction of the Federal Power Commission under the Natural Gas Act. Considering the decisions which clearly hold that federal regulation of natural gas begins at the wellhead,<sup>45</sup> or even before,<sup>46</sup> it is clear that state regulatory orders directed "unambiguously" at purchasers encroach upon federal control. With the exception of the "physical acts of drawing the gas from the earth,"<sup>47</sup> the regulation of natural gas destined for interstate sale is now federal ground upon which the state may not tread.

An important administrative problem raised by the principal case is the availability of *effective* alternatives by which a state can protect the correlative rights of owners from a common gas supply. Although the Court said, "The State does not, however, appear to be without alternative means,"<sup>48</sup> authorities in the field consider the ability to enforce ratable purchasing to be essential to achieve effective ratatability.<sup>49</sup> In *Railroad Comm'n v. Permian Basin Pipeline Co.*,<sup>50</sup> the court said:

Ratable production and ratable take or purchase are essential in preventing drainage between leases, and are related to the prevention of the above-ground waste, because if a producer cannot share the domestic full market, the operator will try to find some other market, one which might be inferior use of gas, such as the manufacture of carbon black.

<sup>45</sup> See note 15 *supra*.

<sup>46</sup> See note 16 *supra*.

<sup>47</sup> See note 5 *supra*; *Northern Natural Gas Co. v. State Corp. Comm'n*, 372 U.S. 84, 94 (1963).

<sup>48</sup> *Northern Natural Gas Co. v. State Corp. Comm'n*, *supra* note 47, at 94.

<sup>49</sup> Comment, *supra* note 18; Kelly, *Gas Proration*, 19 Texas B.J. 763 (1956), proposed that allowable orders have proven unsatisfactory in protecting correlative rights. Thompson, *Federal Encroachment On the Sovereign Power of the States*, Sw. Leg. Found. 6th Inst. on Oil & Gas L. & Tax. 33 (1955). "The foundation of the power of state conservation agencies is their authority to require ratable taking of gas among all the producers in an area." *Oklahoma Natural Gas Corp. v. State*, 161 Okla. 104, 17 P.2d 488 (1932). All important oil and gas producing states have long had "common purchaser" statutes to achieve ratatability. Tex. Rev. Civ. Stat. Ann. art. 6049a, §§ 8, 8a (1959); Okla. Stat. Ann. tit. 52, § 240 (1941). La. Rev. Stat. §§ 30:41-46 (1960).

<sup>50</sup> 302 S.W.2d 238, 253 (Tex. Civ. App. 1957) *error ref. n.r.e., cert. denied*, 358 U.S. 37 (1958).



Common Purchaser statutes are more vital to gas producers than to producers of oil since gas cannot be as readily stored as can oil, and is not transportable by truck.

The *Northern* case also may create two of the primary evils that the Natural Gas Act was designed to prevent. First, the Federal Power Commission has not asserted any authority over pipeline companies to require ratable purchasing, and until it does so,<sup>51</sup> there will be no regulatory authority with jurisdiction over this important aspect of gas production. Secondly, the decision may result in inequality in consumer prices. If nonratability results in favor of a producer with whom the purchaser has a low contract price, the result will be lower prices for consumers who have the good fortune to be serviced by that contract. However, this is little consolation to consumers faced with the reverse situation.<sup>52</sup>

An important legal problem also remains unanswered. What will be the Court's attitude toward a state allowable order directed at producers which materially affects the volume of gas already contractually committed to interstate commerce? A good case can be made both for or against the validity of such an order. On the one hand, the Court seemed to imply that the decisive point was that the orders were directed at purchasers. Following this reasoning, it would seem that an order directed at producers would be valid. As mentioned above, the Court reaffirmed its decision in the *Champlin* case<sup>53</sup> to the effect that state orders directed at producers are valid. On the other hand, such a position seems logically untenable. As the dissent forcefully points out, the most direct interference with the "federal regulatory scheme" is the allowable order, and certainly if ratability can be effectively achieved by the allowable method, there would be no difference in the result. Moreover, the Court pointed out, "The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas . . . or for state regulations which would indirectly reach the same result."<sup>54</sup> If the states attempt to achieve ratability through fluctuating allowables, it is clear that the result will be a very sub-

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<sup>51</sup> This power is not directly conferred upon the FPC anywhere in the Natural Gas Act. Even if the authority can be implied with regard to the interstate pipeline companies, the FPC would seem to lack the power to govern the intrastate companies. Ratability would be difficult under such circumstances.

<sup>52</sup> The dissent points out that this latter situation is present in the principal case. Mr. Justice Harlan contends: "If appellant could reduce its take from Republic wells without contractual liability, the over-all cost of its gas purchases would in all likelihood decrease." 372 U.S. at 105.

<sup>53</sup> See note 27 *supra* and accompanying text.

<sup>54</sup> 372 U.S. at 91.