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GAS CONSERVATION AND PUBLIC UTILITY REGULATION IN OUR NATIONAL FUELS POLICY

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Natural gas production today falls under two types of government regulation concurrently: public utility regulation at the Federal level and conservation regulation at the state level. The basic aim of both types of regulation is to serve the "public good" or maximize "social welfare" in every possible way; yet for both there is a lack of identification with the broad public interest. In addition there has developed a serious conflict between these two types of regulation. The result of this stumbling inefficient national fuel policy is "social waste."

In order to probe this problem, it is necessary first to examine the nature of Federal public utility regulation under the Natural Gas Act and to point out the lack of balance between the broad welfare goals and the specific methods used and goals sought by the Federal Power Commission and by Congress through the Federal Power Commission. A similar analysis must be made of state natural gas conservation regulations, to bring into focus the lack of a balanced approach to the public interest question shown by state legislatures and commissions.

A review of the pertinent Federal and state court and commission proceedings will isolate specific areas in which these two types of regulation have already clashed. The accumulated evidence indicates that there are unnecessary social costs incurred in this conflict which are apt to become greater unless the conflict is resolved. There is a great need for a rational, consistent fuels policy for the nation's natural gas resources, to replace the incomplete, incoherent, and contradictory policy currently in effect.

I. PUBLIC UTILITY REGULATION UNDER THE NATURAL GAS ACT

In our economy there are three types of government action through which the evils or potential evils of monopoly are controlled or eliminated. These are anti-trust regulation, public utility regulation, and government ownership. Public utility regulation applies to a group of industries with certain economic characteristics and with certain legal obligations.¹ This concept is included in, but is much narrower than, the concept of industries "affected with the public interest."

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1. For an elaboration on the "public utility concept," see Lovejoy, *Business Regulation: The Need for a Public Utility Concept*, 3 So. Tex. L.J. 292 (1958).

For those industries falling in the public utility category, this nation has rejected the alternative forms of control. Antitrust type regulation is designed to preserve or restore competition. Public ownership is generally reserved for those activities that are socially desirable and necessary but which offer little or no profit as incentive for private enterprise. Since public utility functions are usually performed most efficiently by a monopoly, antitrust remedies that force competition in such an area result in higher costs to society. The public interest is best served if the utility firm is allowed to remain a monopoly but is regulated in considerable detail as to profits that can be earned and prices that can be charged. Public ownership has not generally been used in this country because most utility activities are profitable and, thus, are appealing to private investors.²

Federal public utility legislation for the gas industry came in 1938 with the passage of the Natural Gas Act.³ This Act was one of several regulatory measures that grew out of the Federal Trade Commission's seven-year investigation of the public utility industry. The FTC urged Congress to adopt "a Federal regulatory law . . . applicable to interstate natural gas pipe lines which transport gas for ultimate sale to and use by the public. . . ."⁴ In recommending this legislation, the FTC pointed out that "Any proposed Federal legislation should be premised, in part at least, on the fact that natural gas is a valuable, but limited, natural resource in nation-wide demand, which is produced only in certain states and limited areas, and the conservation, production, transportation, and distribution of which, therefore, under proper control and regulation, are matters charged with high national public interest."⁵

The FTC felt that conservation, under the U. S. Constitution, had to be left in the hands of the states, but it did recommend the formation of interstate compacts as well as the passage of Federal laws to assist the states in enforcement of state conservation laws. These ideas were not universally held, however, as is evidenced by a House of Representatives Report on one of the early natural gas regulatory bills. Here it was clearly stated that:

When a gas well is connected with an interstate gas pipe line, that connection places the entire gas field feeding through the well in interstate commerce. Any uncontrolled well or well that is left open so the gas may flow into the air rapidly decreases the pressure in the gas field; and thereby lessens . . . the supply of gas. . . . Wells that are thus left open to blow the gas into the air constitute a burden on interstate commerce and should be closed by the authority of Congress. The prevention of waste and the conservation of the natural pressure of gas are regulation of interstate commerce in natural gas. . . . If the States in

2. There are some important exceptions to this, such as municipal water distribution and sewage disposal services.

3. 52 Stat. 821 (1938).

4. Fed. Trade Comm'n, Report on Utility Corporations, S. Doc. No. 92, 70th Cong., 1st Sess., pt. 84-A, 616 (1936).

5. Id. at 611.

which the deposits of natural gas are located will properly conserve and protect these deposits, it will not be necessary for the Federal Government to exercise its authority in that direction.⁶

Congress, however, rejected this latter view and passed the Natural Gas Act, a law which appeared to have all the earmarks of a conventional public utility law. Section 1 (a) sets out the necessity for regulation by stating that "as disclosed in the reports of the Federal Trade Commission . . . , it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest."⁷

It is apparent from this statement and from the remainder of the Act, as well as from the hearings and debates, that Congress gave no special thought to the problem of making this legislation fit with or complement other Federal and state regulations which deal directly or indirectly with this or with competing energy resources.

The "public interest" concept considered in the Act is primarily an interest in "just and reasonable" rates and charges and in adequate service. While Section 7 (e), which deals with certification of facilities, requires that "the proposed service, sale, operation, construction, extension, or acquisition . . . is or will be required by the present or future public convenience and necessity . . .," the Act has been construed narrowly and, for the most part, by looking only at present or near-future effects of FPC decisions. The "public" seems to be only the current gas consuming group, or expectant customers waiting for service. Present and potential users of other fuels, gas producers, other fuel producers, and potential gas customers, present and future, appear to get little or no attention. The Act does not require recognition of a balanced view of the public interest, although it probably permits it.⁸ The *Smith-Wimberly Report* of the 1948 Natural Gas Investigation urged a much broader view, but this recommendation has been largely ignored.⁹ It is interesting to note that conflicting interests, at different times and under different circumstances, urge a broad approach rather than a narrow one. The coal interests frequently argue that the FPC should consider the impact of a new gas pipeline on the affected part of the coal industry; and the gas producing states and gas producers often argue that the FPC should consider the impact of low field prices for gas on future exploration and drilling, as

6. Letter of Submittal by Walter M. W. Splawn, Special Counsel, dated Feb. 24, 1934, H.R. Rep. No. 827 73rd Cong., 2d Sess., pt. 2 at v. (1934).

7. 52 Stat. 821 (1938), as amended, 15 U.S.C. § 717 (1958).

8. In specific instances the FPC has looked into the impact of a particular certificate or rate adjustment on some of the interests mentioned. However, it does not have as part of its continuing policy broad welfare criteria which might serve as a framework for the Commission's actions.

9. FPS Smith-Wimberly Rep., Natural Gas Investigation, Docket No. G-580, pt. VII (1948).

well as on state tax revenues. In summary, then, the FPC has rarely attempted to explore, in any exhaustive manner, the ramifications of its policies or actions on the nation as a whole.¹⁰ The failure of the FPC to take a total view has probably led to a different allocation of resources than would have occurred otherwise. In all likelihood, a better over-all allocation could be achieved, if the Commission could use a broader public interest concept and would develop techniques and information to implement this policy.

II. CONSERVATION REGULATION OF NATURAL GAS

The control by government of natural resource utilization and exploitation in the broad sense is relatively new in this country and is entirely lacking in some areas of the economy. The strong emphasis on "*laissez-faire*" or "individualism" in the economic sphere of U.S. society, plus a rather unique development of our legal institutions, has resulted in private ownership and use of natural resources.¹¹ In its extreme form, this philosophy of individualism has advocated a complete absence of governmental control in the resources field, regardless of the social consequences. Since the 1880's and 1890's, this attitude has changed, and the change has been reflected in restrictive legislation at the state and Federal levels which has been, for the most part, upheld by the courts.

J. M. Clark has pinpointed this need for conservation quite accurately. He points out that:

Conservation is a public concern because private incentives tend to stimulate socially improvident utilization, inflicting diffused costs on future generations.

* * * *

Conservation does limit, or burden, current production; vetoing some things that a free-market economy would do. And conservationists can make mistakes. But to abandon all conservation would be a worse mistake, and the pressure of business interests toward limitation of conservation policies needs to be resisted. Reasonable conservation policies leave plenty of scope for the operation of free private enterprise. They present no threat to its essential soundness.¹²

The criteria or motives for government intervention in resource utilization have been clearly pointed out by Anthony Scott. He divides these motives into three groups:

10. Needless to say, there are those who question the desirability or legality of a "super agency" with such sweeping interests and powers. This is not the question at hand; the fact is that the FPC thus far has not pushed very hard in this direction.

11. See Clark, *Social Control of Business* (2d ed. 1939), for an extended discussion of the role of "individualism" or *laissez-faire* in the evolution of public control.

12. Clark, *Economic Institutions and Human Welfare* 141-43 (1957).

In the first place, the conservationist believes that the maximum social benefit is not achieved by each individual's maximizing his private benefit, because there are certain social benefits to be derived from conservation which are not appreciable to the individual business. . . .

Secondly, the conservationist argues that the laissez-faire theory of resource use is inapplicable. The conservationist may accept the assertion that the maximum benefit for the greatest number will emerge from the profit-maximizing efforts of entrepreneurs in *perfect competition*, but argue that it should not be carried over to a real world in which there are ubiquitous elements of ignorance, risk, and monopoly. . . .

The third motive for state intervention is perhaps unique to the conservation question. It was explained earlier that the individual business will manage natural resources in the light of the going rate of interest. The final conservationist objection to individual management is that the going rate of interest, as determined by the market, is "myopic," or shortsighted, and is not the best rate of interest from a "social" point of view. The correct social rate of interest would be lower than the market rate at present determined, and would induce more owners to conserve their resources than is now the case. (Emphasis in the original.)¹³

Unfortunately, economic analysis offers very little help in solving the troublesome problems that surround natural resource exploitation in the American institutional setting. The approach most economists have taken to conservation is similar to that taken by Scott, namely, that it is a problem of time rate of use of natural resources.¹⁴ Recently, several economists have questioned this narrow interpretation of conservation and have advocated a broader, social and institutional approach.¹⁵ For example, Professor Mason comments as follows:

I conclude, then, that although there are many so-called conservation problems that are better considered in other analytical categories, and many assertions of need for conservation that dissolve under scrutiny, there remains a set of conservation issues both real and serious. An analysis of the conditions under which the price system does not assure an effective comparison of present and future costs and benefits, and of various types of public action designed to prevent or rectify these failures, is an important part of the political economy of natural resource use.¹⁶

13. Scott, *Natural Resources: The Economics of Conservation* 57 (1955).

14. This is especially true in the writings of S. V. Ciriacy-Wantrup, Harold Hotelling, John Ise, and others, as well as Scott.

15. Scott can be included in this latter group, in part. He points out that there are a number of factors which may possibly deflect the workings of the system based on the social rate of interest. See particularly Scott, *op. cit. supra* note 7, chs. 8-9.

16. Mason, *The Political Economy of Resource Use*, in *Perspectives on Conservation* 185 (Jarrett ed. 1958).

Harold J. Barnett broadens even more the conservation concept and the problems to be solved. He makes his point in the following way:

But part of conservation doctrine, and the *gestalt* in which time rate of use appeared, go quite far beyond the time rate problem. To characterize conservation in this way . . . has two defects. It credits conservation with contributions made earlier and more systematically by Malthus, Ricardo, and Jevons, among others. And it fails to credit conservation with an important and partly successful revolution in social ideas and applied political economy.

* * * *

Of course, the rules [of waste and wise use] are at variance with economic common sense and understanding based on laissez-faire premises. But this is the essence of the matter—conservation doctrine did, in significant degree, reject laissez-faire principles; it questions the quality, even more than the mechanics, of modern civilization. This is why the intelligent men among them could plead for their view of “wise use” and avoidance of waste, to the mystification of later economists.¹⁷

The upshot of this entire discussion seems to be that some of the most basic assumptions used in conventional economic analysis must be discarded as being inappropriate and, in fact, misleading in the area of conservation. Political economy rather than economics in the narrow sense must be employed.

Despite the pitfalls and lack of sophistication of economic analysis, these general conservationist arguments have been successfully impressed upon the public (although not in this precise language) in some resource fields. The result is the incorporation of these ideas in state legislation and administrative regulations so as to place certain restrictions on the exploitation or use of natural resources.

The laws and regulations with which this paper is particularly concerned deal with the conservation of natural gas. The Federal Government has left conservation regulation to the states except in the case of Federal or Indian lands.¹⁸ Most major gas producing states have rather detailed laws providing for conservation regulation of natural gas and for the establishment of regulatory commissions to administer these laws.

The Texas law providing for gas conservation sets down, in a nutshell, the rationale of this type of control.

17. Barnett, *Malthusianism and Conservation, Resources for the Future, Inc.*, Mar. 1959, p. 30. See also Herfindahl, *What is Conservation?*, *Mineral Economics*, 1961, for a similar explanation of conservation doctrine.

18. Some people argue that the Federal Constitution implies that the Federal Government *must* leave this function to the states. This Constitutional question will not be argued here. The discussion below implies that in an *economic* sense, the Federal Government does affect state conservation regulation profoundly.

In recognition of past, present, and imminent evils occurring in the *production and use* of natural gas, as a result of waste in the production and use thereof in the absence of correlative opportunities of owners of gas in a common reservoir to produce and use the same, this law is enacted for the protection of public and private interests against such evils by prohibiting waste and compelling ratable production. (Emphasis added.)¹⁹

While policy declarations of this sort are usually not explicitly stated in conservation laws, there is implicit in most of them the general requisite to prevent waste so as to protect public and private interests.

Most state gas conservation laws can be boiled down into two major mandates to the state commissions involved. These are: (1) to prevent the waste of natural gas; and (2) to protect the correlative rights of ownership interests in a given field by forestalling and preventing drainage and by requiring "ratable" taking of gas from wells in a field. The first objective, that of waste prevention, can easily be interpreted as an attempt to "economize." Protection of correlative rights, on the other hand, is not so clearly related to economic criteria. However, it can be argued that without ratable taking and prevention of drainage there would be waste, since unnecessary competitive drilling and production would result.

The Kansas statutes conform to this same general pattern,²⁰ and are spelled out in detail by rules and regulations of the Kansas Corporation Commission.²¹ To implement the legislative mandate of preventing waste and protecting correlative rights, the Kansas Commission has developed a set of conservation tools. They can be grouped generally into the following things: (1) proration, which includes determination of the proper state allowable and the allocation of allowed state production among fields and among wells in a given field; (2) well-spacing, which is basically the establishment of minimum size drilling units;²² (3) establishment of minimum prices for gas at the wellhead; and (4) a variety of rather technical prescriptions relating to the drilling, casing, producing, and abandoning of wells, salt water disposal, reservoir repressuring and flooding, underground storage, pipeline laying, metering, and delivery, processing of gas for removal of fluids, sulfur, carbon dioxide or other undesirable components.

If it can be granted that conservation regulation in the public interest is desirable, is it possible to determine precisely what is meant by the term "public interest" when used in this context? Despite the fairly obvious truth found in the statement by the Federal Trade Commission to the effect that gas conservation and production are matters charged with high national public interest, most

19. Tex. Rev. Civ. Stat. art. 6008 (1948).

20. Kan. Gen. Stat. Ann. §§ 55-701 to 702 (1949), and § 55-703 (Supp. 1959).

21. State Corp. Comm'n of Kan. R. 82-2-200 through 82-2-218 (Topeka 1958).

22. Establishment of minimum size production units is required in some states also.

state conservation agencies have construed public interest to mean *state* interest rather than *national* interest.²³ It is even more obvious here than in the case of the Federal Natural Gas Act that there appears to be little or no attempt to integrate state gas conservation regulation with Federal regulations or policies concerned with other fuels. Even more amazing is the fact that there is often no apparent consistency between state gas regulation and state conservation regulation of closely related fuels such as crude oil and natural gas liquids.

Consumer cost considerations are rarely included in a state conservation agency's concept of the public interest;²⁴ yet such costs are of paramount importance in any appraisal of maximum social welfare. This is true for consumers at the state level as well as those at the national level. State conservation bodies too often appear to be concerned solely with the question of equitable treatment of ownership interests in gas production, to the exclusion of the rest of the public. More attention to the broader public interest would certainly put conservation regulation on a firmer footing.

III. AREAS OF CONFLICT BETWEEN THE TWO TYPES OF REGULATION

The preceding argument that both the Federal public utility regulation found in the Natural Gas Act and state gas conservation regulation lack balance, *vis-a-vis* a well rounded concept of the public interest, is further complicated by the fact that these two types of regulation conflict with each other. This conflict has become particularly noticeable in recent years with the extension of FPC jurisdiction to natural gas producers who sell in interstate commerce. The now famous 1954 *Phillips* decision by the U.S. Supreme Court²⁵ effectively put gas producers in the public utility category, although this type of activity does not meet many of the economic tests of public utility status.²⁶ Extension of the limits of FPC jurisdiction has continued since 1954, so that there seems to be little question that Federal control applies the instant gas moves from its original location to begin an interstate journey.²⁷

23. It, of course, can be and is argued that maximization of state interest will, in the long-run, also maximize national interests.

24. There is a rather unique section of the Texas oil conservation law which states that: "It is further provided that in the administration of this Act the Commission shall, at all times, take into consideration and protect the rights and interests of the purchasing and consuming public of crude oil, and all of its products. . . ." Tex. Rev. Civ. Stat. art. 6049d (1948).

25. *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

26. Noticeably lacking is the test of "natural monopoly," usually characterized by decreasing costs, excess profits, and the absence of close substitutes.

27. See the following cases for discussion of the jurisdictional extension beyond the limits set in the *Phillips* decision: *Continental Oil Co. v. FPC*, 266 F.2d 208 (5th Cir.), cert. denied 361 U.S. 827 (1959); *Continental Oil Co. v. FPC*, 247 F.2d 904 (5th Cir. 1957); *Deep South Oil Co. v. FPC*, 247 F.2d 882 (5th Cir. 1957); *Humble Oil & Ref. Co. v. FPC*, 247 F.2d 903 (3rd Cir. 1957), cert. denied 355 U.S. 930 (1958); *J. M. Huber Corp. v. FPC*, 236 F.2d 550 (3rd Cir. 1956), cert. denied 352 U.S. 971 (1957); *FPC v. J. M. Huber Corp.*, 133 F. Supp. 479 (D.N.J. 1955).

It is not necessary to await the further expansion of FPC jurisdiction to find a clash of state gas conservation laws and Federal public utility laws. In two specific instances these laws have conflicted, and in one case the Federal statute has been given precedence over the state statute.²⁸ The second case is currently in the courts.²⁹ In addition, there are some other aspects of the two sets of laws which apparently conflict, but which have not, as yet, been resolved by the courts. The two areas where judicial pronouncements exist are (1) state minimum well-head pricing, and (2) state determination of production allowables.

The first instance of a state setting a minimum well-head price occurred in the Oklahoma portion of the Guymon-Hugoton Field in 1946, when the rapidly expanding market for gas drove prices for new gas reserves far above the prices established in earlier long-term contracts.³⁰ This move was contested by two companies purchasing gas in the Hugoton Field, but the Oklahoma and U.S. Supreme Courts upheld, in both instances, the constitutionality of such state regulation.³¹ In *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, the Court stated that:

The Due Process and Equal Protection issues raised by appellant are virtually without substance. It is now undeniable that a state may adopt reasonable regulation to prevent economic and physical waste of natural gas.

* * * *

It is now well settled that a state may regulate matters of local concern over which Federal authority has not been exercised, even though the regulation has some impact on interstate commerce. . . . The only requirements consistently recognized have been that the regulation not discriminate against or place an embargo on interstate commerce, that it safeguard an obvious state interest, and that the local interest at stake outweigh whatever national interests there might be. . . .³²

It is important to note, however, that the Court specifically stated that "Whether the Gas Act authorizes the Power Commission to set field prices on sales by independent producers, or leaves that function to the states, is not before this Court."³³

In 1949 the Kansas Commission established a minimum price for gas pro-

28. *Natural Gas Pipe Line Co. v. Panoma Corp.*, 349 U.S. 44 (1955).

29. *Colorado Interstate Gas Co. v. State Corp. Comm'n*, Nos. 41,515-56, 41,55-56, Sup. Ct. Kan., 1960.

30. *Oklahoma Corp. Comm'n Conservation Div.*, Cause CD No. 1054, Order No. 19514, Dec. 9, 1946.

31. *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 203 Okla. 35, 220 P.2d 279, aff'd, 340 U.S. 179 (1950); and *Phillips Petroleum Co. v. State*, 203 Okla. 35, 220 P.2d 279, aff'd, 340 U.S. 190 (1950).

32. 340 U.S. 179, 185-87 (1950).

33. *Id.* at 188-89.

duced in the Kansas portion of the Hugoton Field.³⁴ The order was upheld by the Kansas Supreme Court but was never taken to the U.S. Supreme Court.³⁵

This first series of cases firmly established the *constitutional* right of a state to use minimum price fixing to achieve the goals of conservation. The best statement of the conservation rationale for such control is found in the Memorandum Opinion by the KCC in its basic price-fixing order for the Hugoton Field.

Inequities and discriminations in price among the various parties of interest leads only to the logical conclusion that waste arises from differentials in price. The statute is definitely specific that this Commission shall take steps for the conservation of gas from common sources of supply and to see that inequities do not arise so as to be violative of correlative rights in the field. . . .

A cheap price placed on any commodity depreciates its usefulness. . . .

We accept the belief that the Legislature implied the competence of jurisdiction to fix the price of natural gas at the wellhead in the interest of prevention of waste and that there is implied authority in the gas conservation statute. . . .³⁶

In cases upholding the price-fixing statutes, the question of a possible conflict between state conservation laws and the Natural Gas Act never arose. It was not long, however, before cases testing the jurisdictional, as contrasted to the constitutional, question came before the courts. In the *Panoma* case, the State of Oklahoma attempted to apply its minimum wellhead price to a sale of gas after the gas had been produced, gathered, and processed to remove the liquids. Although the Oklahoma court upheld this application of the regulation,³⁷ the U.S. Supreme Court found such regulation to conflict with FPC jurisdiction under the *Phillips* case interpretation of the Natural Gas Act. The U.S. Supreme Court said:

In these cases Oklahoma has attempted to fix a minimum price to be paid for natural gas, after its production and gathering has ended, by a company which transports the gas for resale in interstate commerce. We held in *Phillips Petroleum Co. v. Wisconsin* . . . that such a sale and transportation cannot be regulated by a state but are subject to the exclusive regulations of the Federal Power Commission. The *Phillips* case, therefore, controls this one.³⁸

34. State Corp. Comm'n of Kan., Conservation Div. Interim Order, Docket No. 35, 154-C (C-1868), Feb. 18, 1949.

35. *Kansas-Nebraska Natural Gas Co. v. State Corp. Comm'n*, 169 Kan. 722, 222 P.2d 704 (1950).

36. State Corp. Comm'n of Kan., Conservation Div. Docket No. 35, 154-C (C-1868), Feb. 23, 1949.

37. *Natural Gas Pipe Line. v. Panoma Corp.*, 271 P.2d 354 (Okla. 1954), rev'd per curiam, 349 U.S. 44 (1955).

38. 349 U.S. at 44-45.

In Kansas, a similar case was brought by the Cities Service Gas Company, but this time it involved dry gas which was destined for interstate commerce and which was sold at the wellhead rather than at the tail gate of a processing plant. Again, a State Supreme Court upheld the state regulation,³⁹ and again the U.S. Supreme Court reversed the state court.⁴⁰ The *per curiam* decision by the Court gave no explanation except to cite the *Phillips* and *Panoma* cases. The *Cities Service* case was remanded to the state courts where the minimum price regulation was vacated *ab initio*. In other words, the Court found that the Kansas Commission never had jurisdiction to enter its original order. This was held to be a Federal matter, even though the Federal Government had never exercised jurisdiction: ". . . the state of Kansas had no jurisdiction to regulate the price of natural gas as it came out of the gas well since that price would affect interstate commerce and the jurisdiction of the Federal Power Commission."⁴¹

While the Court was obviously correct in its assessment of the effect of state price regulation on interstate commerce, such reasoning neglects any consideration of the purpose of conservation regulation. The Court could be paraphrased as saying that even though the occurrence of waste is obvious, the prevention of this waste burdens interstate commerce and therefore is unlawful. Never is the question asked—are the broad public benefits that accrue from regulation under the Natural Gas Act greater or lesser than the public benefits that accrue from conservation regulation.

The second area in which state conservation law and Federal public utility law appears to conflict is that of gas proration. The legal battles over the constitutionality of proration were fought many years ago and were resolved in favor of the individual state's right to regulate the production of a natural resource to prevent its waste.⁴² In interpreting the early oil proration statutes the courts looked particularly for possible conflict between state regulation and the Commerce Clause in the Federal Constitution. In the *Champlin* case the U.S. Supreme Court stated that:

Plaintiff contends that the [Oklahoma] Act and proration order operate to burden interstate commerce in crude oil and its products in violation of the commerce clause. It is clear that the regulations prescribed and authorized by the Act and the proration established by the Commission apply 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

39. *Cities Service Gas Co. v. State Corp. Comm'n*, 180 Kan. 454, 304 P.2d 528 (1956).

40. *Cities Service Gas Co. v. State Corp. Comm'n*, 355 U.S. 391 (1958)

41. *Cities Service Gas Co. v. State Corp. Comm'n*, 184 Kan. 540, 543, 337 P.2d 640, 643 (1959).

42. See e.g., *Champlin Ref. Co. v. Corp. Comm'n*, 286 U.S. 210 (1943) (upholding the basic oil proration statute of Oklahoma).

though the product obtained is intended to be and in fact is immediately shipped in such commerce.⁴³

Later, in 1940, the U.S. Supreme Court stated that:

We have held that a state has constitutional power to regulate production of oil and gas so as to prevent waste and to secure equitable apportionment among landholders of the migratory gas and oil underlying their land, fairly distributing among them the costs of production and of the apportionment.⁴⁴

With specific reference to gas proration, the Court has said:

We assume that the prohibition of any wasteful conduct, whether primarily in behalf of other owners of gas in the common reservoir, or because of the public interests involved, is consistent with the Constitution of Texas and that of the United States, and that to prevent waste production may be prorated. (Footnote omitted.) We assume, also, that the State may constitutionally prorate production in order to prevent undue drainage of gas from the reserves of well owners lacking pipe line connections. . . . and the fact that plaintiffs' gas is to be sold in interstate commerce would not preclude such exercise of the State's power.⁴⁵

The question of state jurisdiction in setting proration orders appears from these and other decisions to be settled for natural gas. With this precedent firmly established, the Kansas Corporation Commission promulgated the "Basic Proration Order for the Hugoton Gas Field,"⁴⁶ which stated that, at the time, there existed production in excess of market demand. The order also provided machinery with which the Commission could determine market demand and prorate it equitably. From 1944 through May, 1956, the Commission took semi-annual "nominations" (proposed purchases) from gas transmission companies in the field, and accepted the total figure as the "demand" for Kansas Hugoton gas. The "demand" was prorated equitably by formula among all the wells in the field.

In 1956 the Kansas Commission felt that the old method of proration prevented any pipeline from increasing its purchases unless a majority of the pipelines acted in concert. The Commission maintained that as a result, the "market demand" for the Kansas portion of the Hugoton Field had not grown as rapidly as might have been possible, and any one company could not increase purchases unilaterally. Finally, the Commission claimed that the Oklahoma portion of the Field was being produced more rapidly than the Kansas portion

43. *Id.* at 235.

44. *Hunter Co. v. McHugh*, 320 U.S. 222, 227 (1943).

45. *Thompson v. Consol. Gas Util. Corp.*, 300 U.S. 55, 76-77 (1937).

46. *State Corp. Comm'n of Kan.*, Conservation Div., No. C-164, Order No. 44-3-21, as amended by order dated Oct. 13, 1948.

which created a pressure differential and caused a drainage of gas from Kansas to Oklahoma. The Commission decided to abandon its old method of estimating "market demand" (which was based primarily on "nominations") and chose to rely on its own estimates rather than on those of the pipeline purchasers. The result was a series of monthly proration orders which exceeded the monthly needs of most pipelines in the field and of the collective group of lines. The Commission reasoned that market demand should include more than pipeline nominations.

In its Report and Order effective February 1, 1958, the Commission started determining the market demand by considering nominations, the rate of increase in total consumer markets of the pipeline companies compared to the rate of increase in their takes from the Kansas Hugoton, the takes from other sources of supply, and other factors.⁴⁷

Two pipelines challenged the validity of the order of the Commission, and a Kansas District Court set aside the order on the grounds that the amount of gas prorated was in excess of market demand.⁴⁸ The companies argued that such proration regulation places a burden on interstate commerce, since pipelines which are forced to purchase more gas in one state must, of necessity, curtail purchases in other states. Certainly national interests are present here, since such regulation has repercussions on other states' policies, on prices bid and asked for uncommitted reserves, and on decisions of producers where and when to explore and drill. However, as in the case of minimum price regulation, the courts never get to the truly important and fundamental question of whether the utility regulation path or the conservation regulation path costs society the least. There is never even an attempt to weigh the alternatives or to propose some compromise or blending of the two.

Both the minimum price and proration conflicts illustrate a lack of single purpose, cooperation, and mutual understanding, as well as a lack of general appreciation of what the "public interest" actually is when we are speaking of fuels policy. To argue blindly for either Federal omniscience and omnipotence or for inalienable "states' rights" in this area is to miss the point completely.

The unique hidden costs of these conflicts seem to lie in the unnecessarily burdensome contradictions in policy which increase uncertainties on the part of producers and consumers alike, and which influence expectations and plans of both groups. For example, a gas producer who is uncertain about the future of sales he might make in interstate commerce might well sell in a less favorable but more certain intrastate market. The result is misallocation of resources due primarily to uncertain political factors rather than to economic factors. This is

47. Brief for Appellant, p. 17, *Colorado Interstate Gas Co. v. State Corp. Comm'n*, Nos. 41,515-56 and 41,555-56, Sup. Ct. Kan., 1960.

48. The case has been appealed to the Kansas Supreme Court. *Colorado Interstate Gas Co. v. State Corp. Comm'n*, supra note 47.

irrational, from an economic standpoint, and wasteful. Another example might be the potential industrial consumer who, because of uncertainties, uses a more costly or less suitable fuel than gas. Once again the economic consequence for society is resource misallocation and the inevitable social waste.

IV. CONCLUSION

This brief analysis shows that public utility regulation under the Natural Gas Act is narrow, myopic, and seriously lacking in a broad, consistent public interest concept. Equally unsatisfactory from this standpoint are the state gas conservation regulations which are, at best, partial and provincial in seeking to maximize social benefits. The wastes occurring in both these areas are compounded by lack of complimentary and, in fact, by direct conflict between the two. The public, in general, suffers since it must ultimately pay for faulty policy in any area, and the public in this case is made up of producers and consumers of gas, tax payers, buyers and sellers of competitive fuels, producers and consumers of products in which energy is a cost component; or, in other words, everyone.

In a world where natural resources and national economic growth rates are of great public concern, it is imperative that the United States eliminate the expensive luxury of an inconsistent, illogical, and wasteful fuels policy. This does not mean that all regulation should be turned over to the Federal Government or to some "super" fuels agency, nor does it mean that the free market mechanism should be permitted to carry us wherever it will. It does mean that the fuels policy of the United States as it exists today must be carefully set down and examined to discover what gaps need filling, what overlapping can be eliminated, and what inconsistencies can be removed. Only if the problem areas can be delineated, can they be attacked and solved.