

THE REGULATION OF NATURAL GAS

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Today natural gas is a new giant among our nation's resources. Always of enormous potential, it has risen from relative obscurity to a position of vital importance. A few years ago a driller searched only for oil, and when the well turned out to be a "gasser," it was either capped or the gas permitted to blow into the air.¹ Casinghead gas,² produced with oil, was piped away from the well and flared. In those years there was little or no market for natural gas. It was almost worthless—an unwanted stepchild in the oil industry.

As knowledge of natural gas grew, its many uses and possibilities were realized. The mixtures of hydrocarbons found in natural gas³ were like magic in the hands of the chemists who transformed them into thousands of different products.⁴ The petroleum engineers discovered its value in maintaining pressure in the oil reservoir, and in secondary recovery methods.⁵ Demand for its use by industry and the housewife developed gradually, but since World War II demand has erupted into phenomenal proportions. Production, in order to fulfill this demand, has shown a comparable increase in Texas as demonstrated by the chart⁶ on following page. Now only two states, Vermont and Nevada, lack gas facilities, present or proposed. Gas pipeline mileage has increased so rapidly that it exceeds that of the railroads.⁷ Of the total 8.018 trillion cubic feet of net production marketed in the United States in 1952, Texas produced 4.304 trillion cubic feet, or 53.7 per cent, of which 2,006,463,802 M.C.F. was exported from Texas.⁸

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¹ ATTORNEY GENERAL OF TEXAS, *TEXAS GAS CONSERVATION LAWS AND OIL AND GAS REGULATIONS* (TEXAS MID-CONTINENT OIL AND GAS ASS'N, DALLAS, 1946); STEWART E. BUCKLEY, *PETROLEUM CONSERVATION* (1951).

² JOHN R. STOCKTON, RICHARD C. HENSHAW, JR., AND RICHARD W. GRAVES, *ECONOMICS OF NATURAL GAS IN TEXAS* 2, 5 (1952). The term "casinghead gas" had its beginning in the very early days. Wells which had ceased to flow were (and still are in many cases) pumped through a string of pipe, smaller in diameter than the well casing, called tubing. A device was developed, which rested on the top of the casing, to support the tubing and close in the annular space between the casing and tubing. Gas would rise up in the annular space and might cause fires if it was not confined. This device was called a "casinghead." Concern by the operators that the gas pressure on the casinghead might be detrimental to the productivity of the well caused them to pipe the gas a short distance away from the well and burn it there in a flare.

³ Thompson, *Natural Gas Conservation*, *American Gas Jour.*, May, 1953, p. 47.

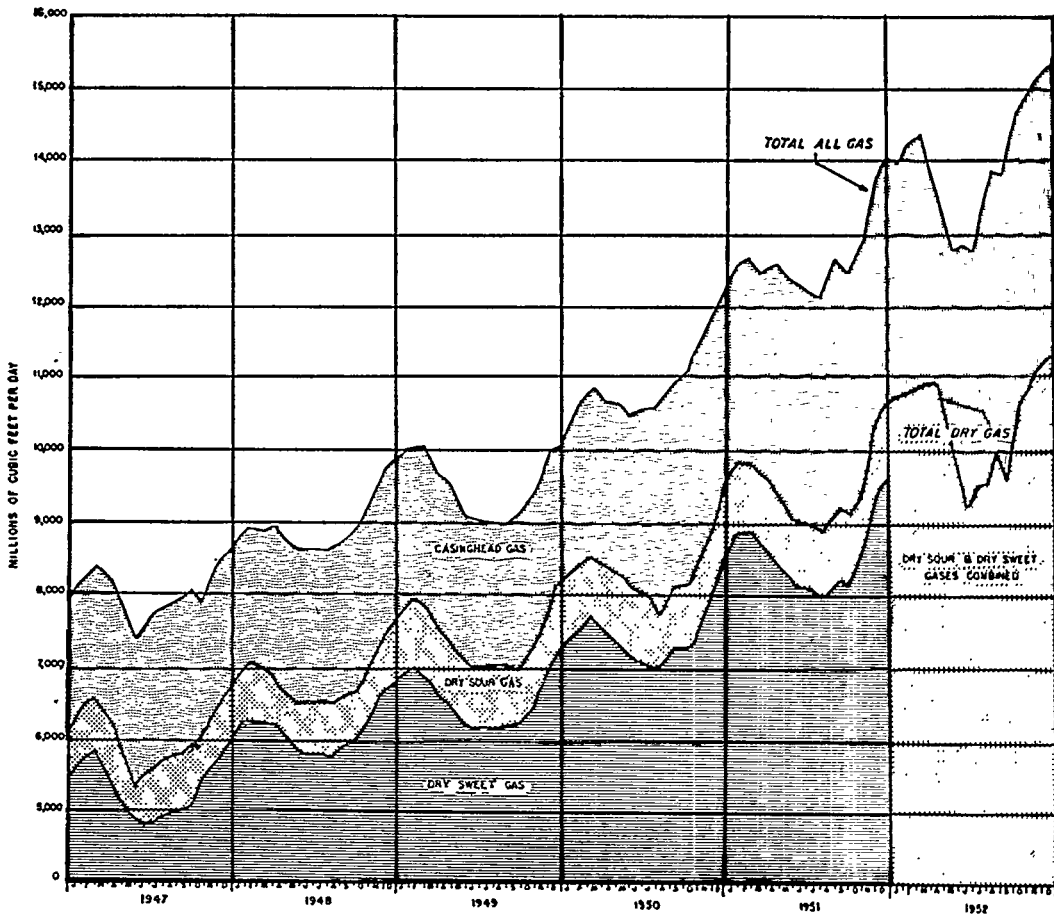
⁴ STOCKTON, HENSHAW, AND GRAVES, *op. cit. supra* note 2, at 14 (1952).

⁵ BUCKLEY, *op. cit. supra* note 1; STOCKTON, HENSHAW AND GRAVES, *op. cit. supra* note 2, at 22-23.

⁶ ANN. REPORT OF THE OIL AND GAS DIVISION, RAILROAD COMMISSION OF TEXAS 28 (1952).

⁷ United Press Report, July 4, 1953.

⁸ ANN. REP. OF THE OIL AND GAS DIVISION, RAILROAD COMMISSION OF TEXAS (1952).



NATURAL GAS PRODUCTION IN TEXAS, 1947-1952

But the real story behind the rise of this new resource giant is found in the development of its regulation and control by the states through their conservation statutes and regulatory agencies. Without the foresight, courage, and wisdom of the men who have served on these regulatory bodies, the natural gas industry would not occupy the position it does today. The nation owes a great debt to these men of conservation.

DEVELOPMENT OF REGULATION OF NATURAL GAS IN TEXAS

A. Prevention of Waste and Adjustment of Correlative Rights

The earliest discovery of natural gas in Texas was in 1865 in the Nacogdoches oil field, but it was not until the turn of the century that the first use of natural gas was made by piping it into the city of Corsicana from a nearby oil and gas field. Ten years passed before any real use of the gas was put into effect. In 1910, the Lone Star Gas Company inaugurated service to Dallas and Fort Worth from the Petrolia field.⁹

⁹ STOCKTON, HENSHAW AND GRAVES, *op. cit. supra* note 2, at 4.

In the meantime, in 1899, the first statutes were passed by the legislature for the regulation of production and use of natural gas.¹⁰ The statutes proved adequate until the discovery of the great Panhandle field in 1918.¹¹ This vast and complex field created many new problems, which resulted in a great struggle in legislation and litigation out of which was forged the foundation undergirding our present conservation policies and practices.

Knowledge of the Panhandle field developed gradually. Eight years passed before its magnitude was known.¹² Between 1929 and 1933 development was curtailed because of the depression, but since 1933 the field has experienced a rapid growth.

The location of the Panhandle field was a handicap. Industry and population were remote and the demand was almost entirely local. But the large volumes of gas found there soon attracted the carbon black industry,¹³ which began using enormous quantities of the gas. In 1930 extensive plants were constructed for the purpose of extracting the gasoline content from gas produced by gas wells. The residue, comprising 23/24 of the gas, had very little market and consequently was flared or blown into the air.

To meet this situation, the legislature in 1931 passed an Act¹⁴ which touched off the first suit by such an operator to enjoin the enforcement of the statutes.¹⁵ The suit was brought in a federal district court, which upheld the validity of the statutes. Obviously basing its decision upon the power to prevent waste, the court held:¹⁶

We are not in doubt that both upon considerations of securing and preserving the correlative rights of persons in property, though owned by them, of the shifting and fugacious kind which oil and gas is, and upon considerations of conserving the natural resources of the state, ample power exists in the Legislature to prevent the wasteful utilization of oil and gas, and to regulate and control their production and use in such reasonable way as to bring about their conservation, and to prevent their dissipation by waste. We therefore reject all of plaintiff's contentions against the statutes founded upon legislative want of power, and address ourselves to a consideration of the question whether the Legislature has clearly and in a reasonable way undertaken to exercise that power. We think it has.

This was a significant victory for the Railroad Commission of Texas. However, following the decision, the Commission, because of the conditions of the field, began issuance of stripping permits.

Meanwhile, there was begun in 1926 the construction of pipelines out of the Panhandle field. By 1931 Panhandle gas was being transported as far as Indianapolis,

¹⁰ Gen. Laws Texas 1899, 26th Legis., c. 49, p. 68.

¹¹ ATTORNEY GENERAL OF TEXAS, TEXAS GAS CONSERVATION LAWS AND OIL AND GAS REGULATIONS, *op. cit. supra* note 1.

¹² *Ibid.* The field is approximately 124 miles in length, with an average width of approximately 20 miles. It lies in the counties of Hartley, Moore, Hutchinson, Potter, Carson, Gray, and Wheeler. The oil producing area is about 90 miles in length and is on the northeast flank of the structure.

¹³ STOCKTON, HENSHAW, AND GRAVES, *op. cit. supra* note 2, at 4.

¹⁴ Tex. Acts 1931, 42d Legis., 1st called sess., c. 26, p. 46.

¹⁵ F. C. Henderson v. Railroad Comm'n of Texas, 56 F. 2d 218 (W. D. Tex. 1932), *appeal dismissed*, 287 U. S. 672 (1952).

¹⁶ 56 F. 2d at 221.

Indiana. These pipeline companies owned many wells in the field and it was from these wells that they took the gas for transportation. Owners of wells which had no market immediately felt the effect of this taking because of drainage. The conflict between these operators and the pipeline companies rose to such a fever that in 1931 the legislature enacted a law known as the Common Purchase Act.¹⁷ This Act was designed to protect the operators who had no market for the sale of their gas.

Immediately these operators without a market demanded that the pipeline companies take their gas as required by the new Act. The pipeline companies refused to comply and filed suit in a federal district court seeking an injunction against the Commission, the Attorney General and the Governor.¹⁸ The issue clearly was one of correlative rights. But the federal court decided that the Act was invalid and that the requirements of the Act would be a taking of property for public use without just compensation and a violation of the Fourteenth Amendment to the Constitution. On the issue of correlative rights, the court said:¹⁹

The equitable principle of correlative rights or ratable taking of gas from a common pool is sought to be applied through compulsory purchase.

Following this decision, the Railroad Commission retaliated with an order which had for its purpose the closing in or shutting down of all wells owned by the pipeline companies until the other wells in the field could obtain a market. Again the pipeline companies filed suit in a federal district court²⁰ and the court, having substantially the same facts before it as in the prior case, once more decided with the pipeline companies. As the court construed the statute, the Commission was only authorized to limit production to prevent physical waste. However, the opinion said:²¹

We have not had occasion to consider whether the existence of these rules of property would work a limitation upon the legislative power to control production, not in order to prevent waste of the State's resources, but to protect the mutual and correlative rights of owners against undue takings from a common source of supply. We find no occasion to consider it now; it does not arise in this case.

Prior to the handing down of this decision, the legislature, apparently recognizing the serious difficulties being experienced by the Railroad Commission, passed another Act²² which granted to the Commission power to determine the allowable production from a common source of supply, based upon the "reasonable market demand which can be produced without waste," and further permitted the Commission to allocate the allowable production among the producers on a reasonable

¹⁷ Tex. Acts, 1931, 42nd Legis., 1st called sess., c. 28, p. 58; Art. 6049a, §8a.

¹⁸ *Texoma Natural Gas Co. v. Railroad Commission of Texas*, and three other cases, 59 F. 2d 750 (W. D. Tex. 1932).

¹⁹ *Id.* at 753.

²⁰ *Texoma Natural Gas Co. v. Terrell*, and *Cities Service Gas Co. v. Terrell*, 2 F. Supp. 168 (W. D. Tex. 1932).

²¹ *Id.* at 170.

²² Tex. Acts 1932, 42nd Legis., 4th called sess., c. 2.

basis. The Commission, acting under its new authority, promulgated an order on December 30, 1932,²³ finding that the reasonable market demand for gas in the Panhandle field was 300,000,000 cubic feet of gas daily. In allocating an amount of this gas to an operator, the Commission used units of 160 acres, upon which a well had been completed, and allowed one-half of its quota to each unit or fractional unit in the proportion that the open flow capacity of the well on the unit or fraction thereof bore to the total of the open flow capacity of all units and fractions thereof, and the other one-half under an algebraic formula.

The pipeline companies again filed suit in a federal district court,²⁴ and obtained another decision in their favor. The court held that the order had for its purpose the compelling of producers with markets to purchase gas from producers without markets. The state contended that the legislature in passing the Act intended to establish the doctrine of correlative rights in Texas, and that the order was sustainable because it bore a reasonable relation to the prevention of waste. The court could not bring itself to the point of recognizing any intent on the part of the legislature to change the rule of property in Texas,²⁵ although it was quite obvious by this time that both the legislature and the Commission were struggling with all their power to establish the correlative rights doctrine. The court's reasoning during this period was manifestly based upon actual or physical waste and it saw no relationship between this issue and that of correlative rights.

In further support of its position, the state cited the case of *Champlin Refining Company v. Corporation Commission of Oklahoma*.²⁶ This decision, written by Mr. Justice Butler, apparently was directly in point for the state's contentions, but the federal district court distinguished the cases on the grounds that (1) the property laws in Texas and Oklahoma were different; (2) the order in the *Champlin* case involved oil and not gas; and (3) the *Champlin* decision was clearly based on physical waste.

Meanwhile, the practice of stripping natural gas had increased. More and more such permits were issued to the operators of gasoline plants. The result was that more than 1 billion cubic feet of gas was being blown or flared into the air daily.

Other operators in the field, who believed that such practice caused migration of gas from their land to the stripping operators, filed suit in a federal district court praying for an injunction against this type of operation.²⁷ An injunction was denied by the federal district judge, but on appeal the circuit court reversed and remanded the case.²⁸

²³ ATTORNEY GENERAL OF TEXAS, TEXAS GAS CONSERVATION LAWS AND OIL AND GAS REGULATIONS, *op. cit. supra* note 1.

²⁴ Canadian River Gas Co. v. Terrell and companion cases, *supra* note 20.

²⁵ Because of the fugacious nature of oil and gas, early decisions applied the laws governing the capture of wild animals. Little was actually known at the time about the physical characteristics of oil and gas. STOCKTON, HENSHAW, AND GRAVES, *op. cit. supra* note 2, at 213.

²⁶ 286 U. S. 210 (1932).

²⁷ Sneed v. Phillips Petroleum Company and two other cases (N. D. Tex.) (opinion unreported). See also Danciger Oil and Refining Co. v. Smith, 4 F. Supp. 236 (N. D. Tex. 1933).

²⁸ Sneed v. Phillips Petroleum Co., 76 F. 2d 785 (5th Cir. 1935). The reversal was on a minor point not material here.

Looking back at this period from our present-day vantage point, it is apparent that the Railroad Commission of Texas was laboring under almost insurmountable obstacles. Unquestionably, the venting of such enormous quantities of gas from the stripping operations was a frightful waste. Too, because of the lack of power to adjust correlative rights, other serious waste through drainage was occurring. Faced with this situation, the legislature, in 1935, enacted a comprehensive statute.²⁹ Its purpose was to prevent waste and to provide all producers in the Panhandle field with the right to produce and market their fair share of recoverable gas. The Act gave broad powers to the Commission for the carrying out of these aims.

Included in the 1935 Act was a provision classifying gas as sweet or sour and specifying the use to be made of each kind of gas. It further authorized the Commission to zone the fields, if this was necessary to carry out the purposes of the Act. In compliance with the statute, the Railroad Commission, on December 10, 1935, placed the entire Panhandle field under a comprehensive plan of regulation and control. The order divided the field into two zones, the Eastern and Western. Since sour gas only was found in the Western part of the field, the dividing line was placed between the sweet and sour gas areas.

Suits contesting this order were filed in a federal district court.³⁰ Both the order and the statutes were attacked. Directly put in issue was the principle of correlative rights. A three-judge federal court again ruled against the Railroad Commission and held that the statute did not grant to the Commission the power to adjust correlative rights. It was suggested by Judge Hutcheson that the case be appealed. This was done, and the Supreme Court, through Mr. Justice Brandeis, affirmed the lower court.³¹ Though the Commission suffered another setback in the federal courts, it is significant that Mr. Justice Brandeis in the course of the opinion said:³²

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.

Here was clear recognition of the principle for which the state had been fighting for many years.

Through this opening wedge the Railroad Commission issued orders classifying certain wells as sweet gas wells and prohibiting the taking of the gas therefrom for the manufacture of gasoline with the residue being used in the manufacture of carbon black. This gave rise to still another suit³³ which had for its purpose the striking down of these orders. A federal district court refused to grant plaintiffs the relief prayed for, and a direct appeal was taken to the Supreme Court, which affirmed the lower court and expressly held that the legislature could validly regulate the production and use of natural gas.³⁴

²⁹ Tex. Acts, 1935, 44th Legis.; REV. CIV. STAT. c. 120, p. 318.

³⁰ Texas Panhandle Gas Co. v. Thompson, 12 F. Supp. 462 (W. D. Tex. 1935); Consolidated Gas Utilities Co. v. Thompson, 14 F. Supp. 318 (W. D. Tex. 1936).

³¹ Thompson v. Consolidated Gas Utilities Corp., 300 U. S. 55 (1937).

³² *Id.* at 76-77.

³³ Henderson Co. v. Thompson, 12 F. Supp. 519 (W. D. Tex. 1936).

³⁴ Henderson Co. v. Thompson, 300 U. S. 258 (1937).

After losing this suit, the operators, knowing that the 1935 Act contained no restrictions on the use of sour gas, resorted to the use of sour gas for the manufacture of carbon black. Then the legislature passed a statute³⁵ restricting the total daily volume of sour gas which could be withdrawn from a reservoir containing both sweet and sour gas to 750,000,000 cubic feet. At the same time, authority was granted the Commission to prorate the withdrawals of such gas.

Pursuant to this Act, the Commission entered an order promulgating the proration formula for the volume of gas that could be produced from sour gas wells. The affected operators again brought suit in the federal courts for an injunction to restrain enforcement of this order.³⁶ A federal three-judge court followed the *Consolidated* case and refused to grant an injunction.

The Commission was now on firm ground. Two decisions of the Supreme Court of the United States followed in 1940 and in 1943, respectively, which materially strengthened the position of the Texas legislature and Railroad Commission. In the case of *Railroad Commission of Texas v. Rowan-Nichols Oil Co.*,³⁷ Mr. Justice Frankfurter, in upholding the Commission's orders promulgating a formula for allocation of allowable oil production, said:³⁸

Certainly so far as the federal courts are concerned the evolution of these formulas belongs to the Commission and not to the judiciary. Except where the jurisdiction rests, as it does not here, on diversity of citizenship, the only question open to a federal tribunal is whether the state action complained of has transgressed whatever restrictions the vague contours of the Due Process Clause may place upon the exercise of the state's regulatory power. A controversy like this always calls for fresh reminder that courts must not substitute their notions of expediency and fairness for those which have guided the agencies to whom the formulation and execution of policy have been entrusted. General as these considerations may be, they are decisive of the present case. . . . Certainly in a domain of knowledge still shifting and growing, and in a field where judgment is therefore necessarily beset by the necessity of inferences bordering on conjecture even for those learned in the art, it would be presumptuous for courts, on the basis of conflicting expert testimony, to deem the view of the administrative tribunal, acting under legislative authority, offensive to the Fourteenth Amendment.

Though this decision upheld an oil proration order, it revealed a whole new concept by the federal judiciary of the state's conservation powers and regulatory measures put into effect through the Railroad Commission. The new concept became more entrenched in the case of *Burford v. Sun Oil Company*,³⁹ decided in 1943, wherein Mr. Justice Black said:⁴⁰

The very "confusion" which the Texas legislature and Supreme Court feared might result from review by many state courts of the Railroad Commission's orders has resulted from the exercise of federal equity jurisdiction. As a practical matter, the federal courts

³⁵ Tex. Acts 1937, 45th Legis.; REV. CIV. STAT. c. 367, p. 746.

³⁶ *Henderson v. Terrell*, 24 F. Supp. 147 (W. D. Tex. 1938).

³⁷ 310 U. S. 573 (1940).

³⁸ *Id.* at 580-582.

³⁹ 319 U. S. 315 (1943).

⁴⁰ *Id.* at 327, 330-334.

can make small contribution to the well organized system of regulation and review which the Texas statutes provide. Texas courts can give fully as great relief, including temporary restraining orders, as the federal courts. Delay, *misunderstanding of local law, and needless federal conflict with the state policy*, are the inevitable product of this double system of review. . . . The Railroad Commission has had to adjust itself to the permutations of the law as seen by the federal courts. . . . The instant case raised a number of problems of no general significance on which a federal court can only try to ascertain state law. . . .

These questions of regulation of the industry by the state administrative agency, whether involving gas or oil prorationing programs . . . so clearly involve basic problems of Texas policy that equitable discretion should be exercised to give the Texas courts the first opportunity to consider them. . . . Conflicts in the interpretation of state law, dangerous to the success of state policies, are almost certain to result from the intervention of the lower federal courts.⁴¹

While these cases were being considered in the federal courts, much litigation had arisen in the state courts. These cases resulted in decisions which brought the Railroad Commission of Texas into a new realm of authority. The most significant of these cases was *Corzelius v. Harrell*.⁴² The dispute between Corzelius and Harrell arose over the uses each was making of gas produced in the same reservoir. Harrell owned 94.8 per cent of the production in the field while Corzelius owned only 4.1 per cent of the production in the field. Corzelius sold gas which his wells produced for lighting and heating purposes to the city of Houston. Harrell operated a recycling plant. Each claimed undue drainage caused by the use that the other made of his produced gas. On the application of Harrell, the Commission issued an order which limited withdrawals from the field not to exceed 20 M.M.C.F. daily. Harrell filed suit to set aside the order. No issue of waste was made, but the issue of "adjustment of correlative rights" was directly put in issue. The judgment was for Harrell in the trial court, and this judgment was affirmed by the Court of Civil Appeals, the order of the Commission being set aside. The case was finally decided by the Supreme Court of Texas. Mr. Justice Sharp, in upholding the order of the Railroad Commission, reversed the lower courts and said:⁴³

Subsections (a) and (b) of Section 10 of Article 6008 are not dependent on each other. They are coordinate, and each has its own independent standing in this law. Unquestionably, we think that Sec. 10 of Art. 6008 authorizes the Railroad Commission to prorate and regulate the daily gas well production from each common reservoir, in order to prevent waste and adjust correlative rights as provided for in such Subsections (a) and (b).

Thus ended the first great phase in the development of regulation of natural gas in Texas. In achieving a comprehensive program of conservation, including the authority to adjust correlative rights, the Railroad Commission made for itself a splendid record. There evolved out of this long struggle experience which pointed

⁴¹ Compare exemption provision Natural Gas Act, *infra* page 336 and Federal Power Commission v. Panhandle Eastern Pipeline Company, *infra* page 337.

⁴² 143 Tex. 509, 186 S. W. 2d 961 (1945).

⁴³ 143 Tex. at 521-522, 186 S. W. 2d at 968.

the way toward a better understanding of the problems presented by conservation. It was not until 1947 that any new developments occurred in the regulation of natural gas.

THE FLARE GAS CASES

It is evident that great waste of natural gas had occurred in the Panhandle field. This was largely because the markets had not been developed to the point where the gas could be utilized. Discovery of other oil and gas fields throughout the state, including the great East Texas field in 1930,⁴⁴ had increased to staggering proportions by the time of World War II. Consequently, the production of casinghead gas increased as the development of oil fields became more prolific.

Everywhere over the state casinghead gas was generally flared or vented into the air, causing waste on a vast scale. Some of this gas, however, was put to useful purposes, such as returning it to the reservoir for pressure maintenance and to effect secondary recovery of oil.⁴⁵ The Railroad Commission had long had in mind ways to prevent this great waste of casinghead gas, but World War II interfered with those plans. The war made tremendous demands on oil production and caused serious shortages of materials such as pipe, thereby preventing any serious approach to the problem.

With the war over and demand for natural gas increasing daily, the Commission, in 1947, took its first bold step toward eliminating the flaring of casinghead gas. By an order to be effective April 1, 1947, the Commission prohibited the producing of either oil or gas from all wells in the Seeligson field in southwest Texas until casinghead gas could be used for the following purposes: (a) light or fuel; (b) efficient chemical manufacturing other than the manufacture of carbon black; (c) bona fide introduction of gas into oil or gas-bearing horizon in order to maintain or increase the rock pressure, or otherwise increase the ultimate recovery of oil or gas; and (d) the extraction of natural gasoline when the residue gas is returned to the horizon from which it has produced. The resulting suit brought by Shell Oil Company and others was ultimately decided by the Supreme Court of Texas.⁴⁶

The trial court granted a temporary injunction holding that the Commission was without authority to enter such an order. The Supreme Court held that the trial court was in error in invalidating the order of the Commission, but upheld the granting of a temporary injunction until the merits of the case could be decided. The court expressly found that the Commission had such authority, stating:⁴⁷

The conclusions necessarily follow that the Commission has both the authority and the responsibility of prescribing fair and reasonable rules to prevent the waste of casinghead gas whenever, under the circumstances presented, it appears that a preventable waste of this natural resource either is occurring or is reasonably imminent, and that in this undertaking the Commission's acts are well within the perimeter of its delegated powers.

⁴⁴ STOCKTON, HENSHAW AND GRAVES, *op. cit. supra* note 2, at 4.

⁴⁵ See note 5 *supra*.

⁴⁶ Railroad Commission v. Shell Oil Co., 146 Tex. 286, 206 S. W. 2d 235 (1947). See also Weber, *Huge Gas Conservation Project Now in Initial Operation Stage*, Oil and Gas Journal, July 8, 1948, p. 60.

⁴⁷ 146 Tex. at 296, 206 S. W. 2d at 241-242.

Brown v. Humble Oil & Ref. Co., 126 Tex. 296, 83 S.W. 2d 935, 99 A. L. R. 1107; *Corzelius v. Harrell*, 143 Tex. 509, 186 S.W. 2d 961.

It was a significant victory for the Commission and laid the groundwork for one of the Commission's most dramatic moves in 1949 when it issued orders closing down 16 gas-flaring oil fields. The operators in these fields immediately filed suit to restrain the enforcement of these orders. The suit brought by Sterling Oil and Refining Company and others who were operators in the Heyser field was tried first.⁴⁸

The trial court entered a judgment declaring the Commission's order invalid and issued an injunction enjoining its enforcement. The case was appealed directly to the Supreme Court of Texas by the Railroad Commission and, in an opinion by Mr. Justice Sharp, the court reversed the trial court and upheld the power and authority of the Commission to enter the order. The court said:⁴⁹

It is quite clear that the Railroad Commission, in the exercise of its duty as prescribed by the statutes, was trying to prevent waste in the flaring of gas. The Railroad Commission is not required to establish a rule that is absolutely perfect. Its members were dealing with a complex problem concerning the Heyser Field, and the Commission's order must be considered from a reasonable and practical standpoint, and it is sufficient if it treats all interested parties justly and impartially. The actions and rulings of the Railroad Commission in attempting to accomplish such results "will not be disturbed by the courts unless such rules or orders are clearly illegal, unreasonable, or arbitrary." *Corzelius v. Harrell*, 143 Tex. 509, 186 S.W. 2d 961, 967, and cases cited; *Railroad Commission of Texas v. Shell Oil Co., Inc.*, 146 Tex. 286, 206 S. W. 2d 235.

With the validating of these orders by the Supreme Court of Texas, the Commission had achieved a great milestone in conservation. Billions of cubic feet of casinghead being daily flared were diverted to beneficial use.⁵⁰ Other cases, which were tried subsequently, reached the same conclusions.⁵¹ Today it is a rare sight indeed to see any flaring of casinghead gas. The result of this has been to conserve one of the nation's greatest resources by using it for many beneficial purposes.⁵²

THE FEDERAL THREAT TO STATE REGULATION

The increased demand for natural gas has brought with it a rise in price.⁵³ State regulatory bodies in Oklahoma and Kansas have exercised their waste pre-

⁴⁸ *Railroad Commission v. Sterling Oil and Refining Co.*, 218 S. W. 2d 415 (Tex. Sup. Ct. 1949).

⁴⁹ *Id.* at 420.

⁵⁰ Since the 1949 decision in the *Sterling* case, the total reported production of casinghead gas has increased from 771 billion cubic feet to 1,403 billion cubic feet in 1952. ANN. REPORT OF THE OIL AND GAS DIVISION, THE RAILROAD COMMISSION OF TEXAS (1952). Moreover, the Commission has adopted a policy of running casinghead gas in ahead of gas-well gas, thereby relieving to this extent the strain on gas-well gas reserves.

⁵¹ *Railroad Commission of Texas v. Flower Bluff Oil Corp.*, 219 S. W. 2d 506 (Tex. Civ. App. 1949); *Humble Oil and Refining Co. v. Railroad Comm'n*, 148 Tex. 228, 223 S. W. 2d 785 (1949); *Railroad Commission of Texas v. Rowan Oil Co.*, 259 S. W. 2d 173 (1953). Though the order in the *Rowan* case was invalidated, the Commissioner's powers to stop flaring of gas by shutting in oil fields was not lessened. The Commission's order included non-flarers as well as flarers, which rendered the order void.

⁵² See note 50 *supra*.

⁵³ JOHN C. JACOBS, PROBLEMS INCIDENT TO THE MARKETING OF GAS (SOUTHWESTERN LEGAL INSTITUTE, 1954).

vention powers by setting a minimum price for sales of gas at the wellhead. The Oklahoma orders have been upheld.⁵⁴ The increase in price has created a greater incentive among independent producers not only to find more gas but also to step up their activities in the gathering and processing of natural gas.

The industry itself is functionally composed of production and gathering, transportation, and distribution. Production includes leasing, exploration, and operation of the wells. Gathering consists of bringing the gas from the wells to a central point such as a processing plant and the preparation or processing of the gas for transmission and consumption. Transportation is the moving of the gas through transmission lines which connect to the outlet of the gathering or processing facilities in the field of production. Distribution is the moving (usually at low pressures) to the ultimate consumer of the gas which has been transported.⁵⁵ The price received by a producer, gatherer, or processor is a very vital part of those functions.⁵⁶ With these preliminary statements in mind, let us consider federal regulation and how its threat to state regulation developed.

A. Federal Regulation and Decisions Under the Natural Gas Act

In 1938, Congress passed the Natural Gas Act.⁵⁷ This legislation actually came about as a result of a decision of the Supreme Court of the United States in *Missouri v. Kansas Natural Gas Company*.⁵⁸ In that case, Missouri sought to prevent an increase in price of gas sold to local distributors by the Kansas Natural Gas Company which had transported the gas from another state. The Supreme Court of the United States held that Missouri was not so empowered because of the commerce clause.

Several years after this decision, the Federal Trade Commission in 1936 investigated the entire industry and made a report to Congress.⁵⁹ Extensive hearings were held before committees of Congress and it was made clear that any proposed federal regulation must not interfere with local state functions, either at the producing and gathering, or distribution end. In the testimony before the committees, Mr. Dozier A. DeVane, then Solicitor for the Federal Power Commission, made it explicit that the proposed legislation was not intended to regulate the field rates or prices charged by independent producers and gatherers.⁶⁰

When the Act was finally passed, it contained an exemption or jurisdictional sec-

⁵⁴ *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U. S. 179 (1950).

⁵⁵ FINAL REPORT OF THE FEDERAL TRADE COMMISSION TO SENATE OF THE UNITED STATES PURSUANT TO S. RES. 83, 70th Cong., 1st Sess. Pt. 84-A, 70th Cong., 1st Sess. 640 (SEN. DOC. 92). Also Comment, *Federal Price Control of Natural Gas Sold to Interstate Pipelines*, 59 YALE L. J. 1468 (1950).

⁵⁶ Hines H. Baker, *Natural Gas for the Future*, an address delivered before the American Gas Association, St. Louis, Mo., Oct. 28, 1953. See Judge Clark's dissenting opinion, *State of Wisconsin v. Federal Power Comm'n*, 205 F. 2d 706, 713 (D. C. Cir. 1953), *cert. granted*, 346 U. S. 934 (1954).

⁵⁷ 52 STAT. 821 (1938), as amended, 56 STAT. 83 (1942), 15 U. S. C. §717 (Supp. 1952).

⁵⁸ 265 U. S. 298 (1924).

⁵⁹ FEDERAL TRADE COMMISSION REPORT, *op. cit. supra* note 55.

⁶⁰ Testimony of Dozier A. DeVane, in *Hearings before a Subcommittee of the House Committee on Interstate and Foreign Commerce on H. R. 11662*, 74th Cong., 2d Sess. 28, 34, 42-43 (1936). Note reliance of the Supreme Court of the United States on Mr. DeVane's testimony in *Federal Power Commission v. Panhandle Eastern Pipeline Co.*, 337 U. S. 498, 505 (1949).

tion which clearly is in full accord with the evidence presented before the committees. Section 1(b) of the Act provides:

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

The declared purpose of the Seventy-Fifth Congress when it passed the Act was "to occupy the field in which the Supreme Court has held that the states may not act." In the beginning, no one questioned this construction of the Act.

The Federal Power Commission itself in 1940 first considered the question of its jurisdiction over sales made by a producer and gatherer.⁶¹ The Commission expressly held that it had no jurisdiction of such sales. In eight subsequent cases the Commission consistently held that it had no jurisdiction over independent producers' and gatherers' sales of natural gas for resale in interstate commerce, because of the exemption of production and gathering.⁶² This is not to say that the Commission members themselves were unanimously of this opinion. Indeed, from time to time various Commission members strenuously argued that the Commission had such jurisdiction.

In 1947 the Supreme Court of the United States in *Interstate Natural Gas Company v. Federal Power Commission*,⁶³ held that the Federal Power Commission had jurisdiction over Interstate's sales. The company was admittedly a "natural gas company" by reason of its interstate transmission, but it argued that its field prices came within the production and gathering exemption of the Act and were not subject to federal regulation. In affirming the Court of Appeals for the Fifth Circuit, the Supreme Court used language which led many to believe that the Court had held that all sales in interstate commerce for resale by producers and gatherers, independent or not, were subject to the Commission's regulation. Upon close study of the opinion, however, there seems no basis for such a construction. Indeed, the Court plainly stated that no such question was presented or passed upon.⁶⁴ Moreover, in perfect consistency with its prior decisions, the Court laid down the following rule:⁶⁵

The purpose of that restriction was, rather, to preserve in the States powers of regulation in the areas in which the States are constitutionally competent to act. Thus, the House Committee report states: "The bill takes no authority from State commissions, and is

⁶¹ *Columbian Fuel Corp.*, 2 F. P. C. 200 (1940).

⁶² *Fin-Ker Oil and Gas Production Co.*, 6 F. P. C. 92 (1947); *Tennessee Gas and Transmission Co. and The Chicago Corp.*, 6 F. P. C. 98 (1947); *Kansas-Nebraska Natural Gas Co.*, 6 F. P. C. 664 (1947); *R. J. and D. E. Whelan*, 6 F. P. C. 672 (1947); *Hassie Hunt Trust*, 6 F. P. C. 835 (1947); *Sinclair Prairie Oil Co.*, 6 F. P. C. 1059 (1947); *La Gloria Corp.*, 7 F. P. C. 349 (1948); *The Superior Oil Co.*, 7 F. P. C. 627 (1948).

⁶³ 331 U. S. 682 (1947).

⁶⁴ *Id.* at 690 n. 18, 691.

⁶⁵ *Id.* at 690.

so drawn as to complement and in no manner usurp State regulatory authority. . . .” Clearly, among the powers thus reserved to the States is the power to regulate the physical production and gathering of natural gas in the interests of conservation or of any other consideration of legitimate local concern. It was the intention of Congress to give the States full freedom in these matters. Thus, where sales though technically consummated in interstate commerce, are made during the course of production and gathering and are so closely connected with the local incidents of that process as to render rate regulation by the Federal Power Commission inconsistent or a substantial interference with the exercise by the State of its regulatory functions, the jurisdiction of the Federal Power Commission does not attach.

This would seem to foreclose any attempt to show that the *Interstate* decision put a cloak of federal jurisdiction over field sales of independent producers and gatherers. But the champions of federal jurisdiction continued their fight, in spite of another decision two years later by the Supreme Court of the United States. In *Federal Power Commission v. Panhandle Eastern Pipe Line Company*,⁶⁶ the Court again followed its consistent construction of the Act, saying:⁶⁷

The legislative history of this Act is replete with evidence of the care taken by Congress to keep the power over the production and gathering of gas within the states. This probably occurred because the state legislatures, in the interests of conservation, had delegated broad and elaborate power to their regulatory bodies over all aspects of producing gas. The Natural Gas Act was designed to supplement state power and to produce a harmonious and comprehensive regulation of the industry. Neither state nor federal regulatory body was to encroach upon the jurisdiction of the other. Congress enacted this Act after full consideration of the problems of production and distribution. It considered the state interests as well as the national interest. It had both producers and consumers in mind. Legislative adjustments were made to reconcile the conflicting views.

B. The *Phillips* Case

The controversy advanced to the point where the Federal Power Commission issued an order dated October 28, 1948⁶⁸ directing that an investigation be held to determine (1) whether Phillips Petroleum Company was a “natural gas company” within the meaning of the Natural Gas Act, and if so, (2) whether any of its rates subject to the jurisdiction of the Commission were unjust or unreasonable. This was the opening gun of those who sought federal jurisdiction over independent producers’ and gatherers’ field sales.

Hearings in the *Phillips* case began on April 3, 1951, and continued to May 23, 1951. Intervenors in the proceedings included the producing states of New Mexico, Oklahoma, Texas, Kansas, Arkansas, Louisiana, and Mississippi, all protesting the attempted federal regulation on the ground that such jurisdiction would conflict with the states’ regulatory and conservation powers. Intervening also were the State of Wisconsin, the City of Detroit, Michigan, the City of Kansas City, Missouri, the City of Milwaukee, Wisconsin, and the County of Wayne, Michigan, each contending for federal jurisdiction. The record made at the hearing consisted of more

⁶⁶ 337 U. S. 498 (1949).

⁶⁷ *Id.* at 509-513.

⁶⁸ Docket No. G-1148.

than 10,000 pages. The Commission, on motion of Phillips and the producing states, confined the hearing to the question of whether it had jurisdiction of Phillips' sales of natural gas to five interstate pipeline companies reporting to the Federal Power Commissions as natural gas companies.

After oral argument before it in Washington, the Commission by a four-to-one majority held that Phillips was not subject to its jurisdiction.⁶⁹ The opinion was predicated primarily on two grounds, the first being:⁷⁰

We find that its [Phillips] operations, so far as relevant, consist of production and gathering, or incidents of or activities related to these functions thus requiring their inclusion within the Act's exemption.

The second:⁷¹

In varying degrees, the evidence clearly shows that our regulation of sales made in the process of production and gathering would, by its very nature, be inconsistent or constitute a substantial interference with such regulation of producers and gatherers by Oklahoma, Texas, and New Mexico. To cite one example, there is a direct relation between price and conservation, an important concern in the regulation of each of the states.

Commissioner Draper wrote a separate concurring opinion based solely on the conflict question. Commissioner Buchanan dissented.

Thereafter, the State of Wisconsin and others appealed from the order of the Commission to the Court of Appeals for the District of Columbia Circuit and on May 22, 1953, that court (with one judge dissenting) reversed the Federal Power Commission and held Phillips to be a "natural gas company" subject to rate regulation by the Commission.⁷² Petitions for writ of certiorari were duly filed with the Supreme Court by the Federal Power Commission, the States of Texas, Oklahoma, and New Mexico, and Phillips. On November 30, 1953, the Supreme Court denied all three petitions.⁷³ Petitions for rehearing were then filed and on January 18, 1954, the Court set aside its previous orders and granted the petitions for certiorari.⁷⁴ The case is now pending before the Court, but as of this date has not been set for argument.

Needless to say, the Court of Appeals' decision reversing the Commission was a severe shock to the producing states and the entire natural gas industry. It accentuated the fears of the producing states that their established conservation and regulatory powers were on the threshold of being enveloped by federal jurisdiction. The opinion treated the Commission's findings on the conflict question as "un-supportable" and "immaterial," thus overriding the entire evidence of conflict presented by the states. The court said:⁷⁵

But the validity or invalidity of the Commission's conclusion that Phillips is not a "natural-gas company" does not turn upon the evaluation of testimony or upon any facts

⁶⁹ 10 F. P. C. 246 (1951).

⁷⁰ *Id.* at 277.

⁷¹ *Id.* at 279.

⁷² *Wisconsin v. Federal Power Comm'n*, 205 F. 2d 706 (D. C. Cir. 1953).

⁷³ 346 U. S. 896 (1953).

⁷⁴ 346 U. S. 934 (1954).

⁷⁵ 205 F. 2d at 711.

peculiar to this case. It turns upon the generic question whether the exemption "production or gathering" in Section 1(b) of the Natural Gas Act covers interstate sales of gas by the corporation that produced and gathered it.

The court further stated with reference to the language in the *Interstate* case regarding conflict with state authority:⁷⁶

The Supreme Court said in the *Interstate Natural Gas* case: "*Where sales, though technically consummated in Interstate Commerce, are made during the course of production and gathering and are so closely connected with the local incidents of that process as to render rate regulation by the Federal Power Commission inconsistent or a substantial interference with the exercise by the State of its regulatory functions, the jurisdiction of the Federal Power Commission does not attach.*" By replacing the Supreme Court's "and" with "or" the Commission reverses the sense.

Thus by peculiar emphasis on the single word "or" and an impractical twist of the term "made during the course," the Court of Appeals apparently misconstrued not only the Supreme Court's language in the *Interstate* case, but also the exemption in the Natural Gas Act itself. The Act uses the word "or" in exempting "production or gathering." There is no apparent logic as to why the Court of Appeals permitted its decision to turn upon the use by the Federal Power Commission of the word "or" instead of "and" in its findings.

Only one construction can be made of the above-quoted part of the opinion, and that is that an interstate sale of a producer and gatherer is subject to regulation if consummated by delivery as the last step in gathering even if conflict between federal regulation and state regulatory authority is shown, and that in order to obtain the benefit of the rule laid down in the *Interstate* case, a sale must be made before, rather than simultaneously with, the completion of gathering. One could escape federal jurisdiction under such a rule only by making a sale followed by more gathering. In view of the fact that a greater part of all gas gathered by independents is sold at the end of the process, the Court of Appeals' opinion is not based on a realistic or practical interpretation of the Supreme Court's *Interstate* language.

It is difficult to understand, too, the treatment which the Court of Appeals accorded the decision by the Supreme Court of the United States in *Cities Service Gas Company v. Peerless Oil & Gas Company*.⁷⁷ In that case the Supreme Court approved the State of Oklahoma's orders fixing a minimum price on the sales of gas made at the wellhead in the Guymon-Hugaton field in Oklahoma. The opponents of the order urged that the sales were made in interstate commerce and therefore beyond the state's power to regulate. The Supreme Court, answering this contention, held:⁷⁸

We recognize that there is also a strong national interest in natural gas problems. But it is far from clear that on balance such interest is harmed by the state regulations under attack here.

⁷⁶ *Ibid.*

⁷⁷ 340 U. S. 179 (1950).

⁷⁸ *Id.* at 187.

In addition, the Court went on to say that a legitimate local interest was involved and that the wellhead price of gas was only a small fraction of the ultimate consumer prices.⁷⁹

But the Court of Appeals decided that the *Cities Service* case was "irrelevant." The court sought to distinguish it from the *Phillips* case on the ground that the Oklahoma order involved only sales at the wellhead, whereas Phillips' sales were made after production and gathering had ceased and processing had intervened. The court recognized that Cities Service's sales were made at the end of production, but said⁸⁰ that such sales were "obviously made during the course of production and gathering. . . ." Apparently overlooked was the fact that in a companion case decided the same day,⁸¹ the Supreme Court held that Oklahoma's power was not limited where the first sale occurred at the conclusion of gathering. This conclusion of the Court of Appeals would lead to a peculiar application of the Natural Gas Act in that the interstate sale of a producer at the wellhead at the end of production would be exempt, but the interstate sale of a gatherer at the end of processing would be subject to the Act.

One of the underlying principles upon which the Commission based its orders in the *Phillips* case is the relationship of price to conservation. Concerning that relationship the Commission found:⁸²

. . . there is a direct relation between price and conservation, an important concern in the regulation of each of the states. Even though a producer be allowed a reasonable return on actual legitimate investment, our fixing of maximum rates for his sales would run counter to State conservation efforts, through the fixing of minimum wellhead prices or otherwise, to insure maximum recovery of gas prior to abandonment of the well. For the higher the profit, the longer it is economical to operate the well. And to the extent that the producer could obtain a profit higher than that permissible under our maximum-price regulation, the longer abandonment would be postponed. Similarly, the higher the price paid to the producer and gatherer, the easier it becomes for the State to discourage by regulation the flaring of gas and to encourage the gathering and marketing of such gas. This is particularly true as to casinghead gas.

Since a state has the power to set the minimum price on sales made at the wellhead, inevitable conflict would result if the Federal Power Commission assumed jurisdiction by setting a maximum price over these same sales. The States of Oklahoma and Kansas would be directly affected.

In the case of Texas, however, the policy is to permit free competition to control the price. The Railroad Commission of Texas has refused to set a minimum price for sales of gas in the field, and the legislature has failed to pass a minimum price bill, although several such bills have been introduced during recent sessions. If the

⁷⁹ *Cities Service* case, 340 U. S. at 187. See also Hines H. Baker, *Natural Gas for the Future*, address delivered before the American Gas Association, St. Louis, Mo., Oct. 28, 1953, chart, p. 12, and see U. S. DEP'T OF INTERIOR, BUREAU OF MINES, MINERAL INDUSTRY SURVEYS, MINERAL MARKET REP. NO. MMS2229 (Nov. 9, 1953).

⁸⁰ 205 F. 2d 706, 710 n. 9 (D. C. Cir. 1953).

⁸¹ *Phillips Petroleum Co. v. Oklahoma*, 340 U. S. 190 (1950).

⁸² *Re Phillips Petroleum Co.*, 10 F. P. C. 246, 279 (1951).

Federal Power Commission fixed a maximum price for field sales in Texas, the conflict with Texas' conservation policies would be no less than in the case of Oklahoma.

Naturally, the recent grant of certiorari in the *Phillips* case offers much encouragement. It is hoped that the long struggle to end the threat of federal interference with state conservation and regulatory powers will be set at rest. In any event, the states will not give up the fight to protect their regulatory powers over conservation which are so necessary to the welfare of both the state and the entire nation.