Volume 20 | Number 1

Fall 1984

A New Dimension in the Ratable Taking of Natural Gas in Oklahoma: Enrolled House Bill 1221

Rick D. Chamberlain

A NEW DIMENSION IN THE RATABLE TAKING OF NATURAL GAS IN OKLAHOMA: ENROLLED HOUSE BILL 1221

I. INTRODUCTION

In May of 1983 Governor George Nigh signed into law a bill which adds a new dimension to the production and sale of natural gas in Oklahoma. Enrolled House Bill 1221[1] introduces fundamental changes in the rights and duties of mineral owners, producers, operators and purchasers with regard to the ratable taking of natural gas. Due to the magnitude of these changes, challenges to the legislation's validity are likely. This Comment will examine House Bill 1221 (hereinafter H.B. 1221 or the Act) in light of the challenges that may be raised and will assess the likelihood of their success.

II. THE NEED FOR RATABLE TAKING OF NATURAL GAS

The concept of real property ownership at common law was embodied in the maxim *cujus est solum ejus est usque ad coelum et ad infernos* which means "whose is the land, his is also that which is above and below it."[2] Under this concept, which is commonly known as the *ad coelum* doctrine, a landowner owned not only the surface of his land but everything above and below it as well. Thus, one who held title to a parcel of land also held title to any minerals lying beneath the land.[3] While this doctrine served the needs of the judiciary in dealing with minerals having a fixed situs (e.g., coal), it was inadequate for dealing with migratory minerals such as oil and natural gas.[4] Because of their migratory characteristics, oil and gas could be drained from under one parcel of land by a well drilled on an adjacent parcel.[5] Who would be considered the owner of the oil and gas at any given time? Would it be the landowner from under whose property the oil and gas was drained

1. 1983 Okla. Sess. Laws ch. 77 (codified at OKLA. STAT. tit. 52, §§ 541-47 (Supp. 1983)).
2. Brandes v. Mitterling, 67 Ariz. 349, —, 196 P.2d 464, 467 (1948); *see also* Edwards v. Lee's Adm'r, 265 Ky. 418, —, 96 S.W.2d 1028, 1029 (1936), —; Edwards v. Sims, 232 Ky. 791, —, 24 S.W.2d 619, 620 (1929); Toth v. Bigelow, 1 N.J. 379, —, 64 A.2d 62, 64 (1949).
3. *See, e.g.*, *Toth*, 64 A.2d at 64.
4. *See* 1 W. SUMMERS, THE LAW OF OIL AND GAS § 4 (1954) (general discussion of the physical attributes of oil and gas in the reservoir).
5. *Id.*

or the adjacent landowner whose labor and capital investment actually brought the minerals to the surface where they could be put to beneficial use?

A workable solution to this dilemma was eventually devised by analogizing to the law surrounding animals *ferae naturae*.[6] A property owner acquired no property rights in wild animals on his property unless and until he actually reduced them to possession by capturing them.[7] Similarly, a property owner acquired no property rights in minerals *ferae naturae* underlying his property until he reduced them to his possession.[8] The intuitive appeal of the analogy and its application are illustrated by the following excerpt:

> [O]il, and still more strongly gas, may be classed by themselves, if the analogy be not too fanciful, as minerals *ferae naturae*. In common with animals, and unlike other minerals, they have the power and the tendency to escape without the volition of the owner . . . . They belong to the owner of land, and are part of it, so long as they are on or in it, and are subject to his control; but when they escape, and go into another's control, the title of the former owner is gone. Possession of the land, therefore, is not necessarily possession of the gas. If an adjoining, or even a distant, owner drills his own land, and taps your gas, so that it comes into his well and under his control, it is no longer yours but his. And equally so as between lessor and lessee . . . , the one who controls the gas—has it in his grasp, so to speak—is the one who has possession in the legal as well as in the ordinary sense of the word.[9]

Thus, under the *rule of capture* a landowner acquired title to oil and gas produced from wells on his land even if part of the oil had migrated from adjacent tracts.[10] The rule of capture has been widely adopted

---

6. "Of a wild nature or disposition. Animals which are by nature wild are so designated, by way of distinction from such as are naturally tame, the latter being called '*domitae naturae*.'" BLACK'S LAW DICTIONARY 747 (5th ed. 1979).

7. *See, e.g.*, Fleet v. Hegeman, 14 Wend. 42, 46 (N.Y. Sup. Ct. 1837) (oysters planted in a bed by an individual not animals *ferae naturae*).

8. Westmoreland & Cambria Natural Gas Co. v. De Witt, 180 Pa. 235, —, 18 A. 724, 725 (1889).

9. *Id.*

10. *Id.*; Brown v. Spilman, 155 U.S. 665, 669-70 (1894); Hammonds v. Central Ky. Natural Gas Co., 255 Ky. 685, —, 75 S.W.2d 204, 205 (1934); Champlin Ref. Co. v. Corporation Comm'n, 286 U.S. 210, 233 (1931); *see also* 1 E. KUNTZ, LAW OF OIL AND GAS §§ 4.1-4.2 (1962) (hereinafter cited as KUNTZ); 1 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 204.4 (1983) (hereinafter cited as WILLIAMS & MEYERS); Pierce, *Coordinated Reservoir Development—An Alternative to the Rule of Capture for the Ownership and Development of Oil and Gas—Part I*, 4 J. ENERGY L. & POL'Y 1, 27-33 (1983) (hereinafter cited as Pierce, *Coordinated Reservoir Development*). There are three ownership theories currently being utilized in the United States, of which the rule of capture is an integral part. However, the rule of capture operates essentially the same regardless of the applicable ownership theory. Under the *non-ownership theory*, oil and gas in place is owned by no

and remains the law today in many jurisdictions,[11] including Oklahoma.[12]

Unfortunately, the rule of capture also had unforeseen and undesirable consequences. While the rule had the desirable effect of encouraging development of oil and gas reserves, it did so at the expense of economic and physical waste.[13] Since one overlying landowner could legally reduce an entire reservoir to his possession, the only viable remedy available to adjacent landowners was to drill wells of their own and attempt to "capture" as much oil and gas as possible.[14] As a result, many more wells were drilled than necessary to efficiently develop producing formations.[15] The cost of these unnecessary wells resulted in higher production costs which were ultimately passed on to consumers in the form of higher prices.[16] In addition to excessive drilling costs, the rush to produce often resulted in supplies of oil and gas far in excess of market demand.[17] This surplus caused prices to fall so that those who invested in the oil and gas fields, as well as royalty owners, actually got fewer dollars and less oil and gas than if the fields had been scientifically developed.[18] Since excess natural gas could not be stored it was often simply vented into the atmosphere, rapidly exhausting underground reservoir energy.[19] For example, in the Glenn Pool oil field alone it was estimated that 50,000,000,000 cubic feet of natural

---

one. Only when the minerals are reduced to possession does ownership attach. The *ownership in place* theory treats oil and gas as a part of the land itself and vests ownership with the landowner while the minerals are on or under the land, or otherwise subject to the landowner's control. Finally, the *qualified ownership* theory vests title to oil and gas in the landowner while remaining in or on his land. However, his ownership is subject to divestment should the minerals migrate to another tract of land. Oklahoma has apparently adopted the qualified ownership theory. Rich v. Doneghey, 71 Okla. 204, 206-7, 177 P.86, 89-90 (1918); *see also* 1 WILLIAMS & MEYERS, *supra* note 10, at §§ 203.1-203.4 for an explanation of the various ownership theories.

11. *See, e.g.*, Succession of Rugg, 339 So. 2d 519, *cert. denied*, 341 So. 2d 897 (La. App. 1976); Wronski v. Sun Oil Co., 89 Mich. App. 11, 279 N.W.2d 564 (1979); Masonite Corp. v. State Oil & Gas Bd., 240 So.2d 446 (Miss. 1970); Baumgartner v. Gulf Oil Corp., 184 Neb. 384, 168 N.W.2d 510 (1969); Halbouty v. Railroad Comm'n, 163 Tex. 417, 357 S.W.2d 364, *cert. denied*, 371 U.S. 888 (1962).

12. Frost v. Ponca City, 541 P.2d 1321 (Okla. 1975).

13. *See, e.g.*, Hague v. Wheeler, 157 Pa. 324, 27 A. 714 (1893); *see also* 1 WILLIAMS & MEYERS, *supra* note 10, at § 204.6; Pierce, *Coordinated Reservoir Development*, *supra* note 10 at 4, 56.

14. Barnard v. Monongahela Natural Gas Co., 216 Pa. 362, —, 65 A. 801, 802 (1907).

15. J. CLARK, THE OIL CENTURY 97-99 (1958).

16. *Id.*

17. *Id.*

18. *Id.*; *see also* AMERICAN BAR ASSOCIATION, SECTION OF MINERAL LAW, CONSERVATION OF OIL & GAS, A LEGAL HISTORY, 1948, 7-15 (1949) (general discussion of reservoir energies and the engineering basis for conservation).

19. CLARK, *supra* note 15, at 149.

gas were wasted by 1912.[20] While excess oil could be stored, production often exceeded available storage facilities.[21] Producers with no market or storage facilities were forced to store their production in gullies, creeks, and earthern reservoirs until demand increased or until storage tanks could be built.[22] Evaporation, seepage and run-off took a heavy toll.[23]

Various attempts have been made to mitigate the undesirable effects of the rule of capture. One such attempt is the judicially created doctrine of correlative rights.[24] This doctrine essentially provides that in the process of reducing oil or gas to his possession, an overlying landowner may not violate the correlative rights of other overlying landowners.[25] One commentator has identified these correlative rights as:

1) "the right against waste of extracted substances,"
2) the right "against spoilage of the common source of supply" (i.e., the reservoir),
3) the right "against malicious depletion of the common source of supply, and"
4) "the right to a fair opportunity to extract oil or gas."[26]

A landowner who either purposefully or negligently violates one of these correlative rights may be liable in damages to other landowners in the common source of supply.[27]

In addition to judicial efforts to tame the rule of capture, many state legislatures have enacted conservation measures intended to protect correlative rights and to maximize recovery of available resource deposits.[28] At a minimum, such legislation expressly defines and prohibits waste of natural resources.[29] However, many states go further

20. *Id.*
21. *Id.* at 153.
22. *Id.* at 153-54.
23. *Id.* at 155-56.
24. *See, e.g.*, Ohio Oil Co. v. Indiana, 177 U.S. 190, 209-11 (1900); Manufacturers' Gas & Oil Co. v. Indiana Natural Gas & Oil Co., 155 Ind. 461, 57 N.E. 912, 915 (1900); *see generally*, 1 Kuntz, *supra* note 10, at §§ 4.3-4.7; Pierce, *Coordinated Reservoir Development*, *supra* note 10, at 50-55.
25. *See, e.g.*, *Manufacturer's Gas & Oil Co.*, 57 N.E. 912 at 915; Louisville Gas Co. v. Kentucky Heating Co., 132 Ky. 435, —, 111 S.W. 374, 376 (1908); Louisville Gas Co. v. Kentucky Heating Co., 117 Ky. 71, —, 77 S.W. 368, 369-70 (1903).
26. 1 KUNTZ, *supra* note 10, at § 4.3.
27. *Louisville Gas Co.*, 111 S.W. at 376.
28. *E.g.*, KAN. STAT. ANN. §§ 55-102, 55-103, 55-108, 55-121, 55-601, 55-602, 55-603, 55-610, 55-612, 55-701, 55-702, 55-703, 55-703a (1983).
29. *E.g.*, CAL. PUB. RES. CODE §§ 3300, 3500, 3501 (West 1972); KAN. STAT. ANN. §§ 55-108, 55-121, 55-601, 55-602, 55-701, 55-702 (1983); OKLA. STAT. tit. 52, §§ 86.2, 86.3, 236, 237, 238, 271,

and attempt to conserve available resources by regulating use,[30] production[31] and sale.[32] One such regulatory measure, the one with which this Comment is concerned, requires the ratable taking of natural gas by producers and purchasers from a common source of supply.[33] Such regulations typically require production from the common source of supply to be in accordance with some prescribed formula or allocation[34] and require purchasers to take from such producers without discrimination as to price or amount.[35] Ratable taking restrictions prevent one producer from fulfilling his sales contracts at the expense of other producers in the field.

III. RATABLE TAKING OF GAS IN OKLAHOMA PRIOR TO H.B. 1221

As one of the pioneers in conservation legislation, Oklahoma has enacted several provisions dealing directly or indirectly with the ratable taking of natural gas,[36] many of which remain in force today.[37] Initially, while in its natural state, the natural gas belongs to the overlying

273 (1981); TEX. NAT. RES. CODE ANN. §§ 85.045, 85.046, 86.011, 86.012, 86.082, 86.083, 91.015 (Vernon 1978).

30. *E.g.*, KAN. STAT. ANN. §§ 55-102, 55-103, 55-108 (1983); OKLA. STAT. tit. 52, §§ 293, 295, 302 (1981); TEX. NAT. RES. CODE ANN. §§ 86.011, 86.181-86.185, 87.131, 87.132, 87.171, 87.172, 91.017, 91.018 (Vernon 1978).

31. *E.g.*, CAL. PUB. RES. CODE §§ 3301, 3450, 3451, 3630, 3640, 3645 & 3652 (West 1972); KAN. STAT. ANN. §§ 55-603, 55-703, 55-703a, 55-1301 to 55-1315 (1983); OKLA. STAT. tit. 52, §§ 87.1, 232, 239, 272, 274 & 287.1-287.15 (1981); TEX. NAT. RES. CODE ANN. §§ 85.053-85.055, 86.011, 86.081-86.097 & 87.051-87.054 (Vernon 1978).

32. *E.g.*, KAN. STAT. ANN. §§ 55-610, 55-612, 55-1401 to 55-1423 (1983); OKLA. STAT. tit. 52, §§ 23, 54, 240 & 272 (1981); TEX. NAT. RES. CODE ANN. §§ 85.041, 85.048 & 87.133 (Vernon 1978).

33. *See, e.g.*, OKLA. STAT. tit. 52, §§ 23, 232, 233, 239 & 240 (1981); *see generally* 5 KUNTZ, *supra* note 10, at § 75.3. "[R]atable taking is defined as the proportion which the natural flow of gas from the wells of one producer bears to the amount of the natural flow from the wells of the other owners producing from the same common source of supply or common reservoir." Republic Natural Gas Co. v. State, 198 Okla. 350, 354-55, 180 P.2d 1009, 1013-14 (1947) (construing OKLA. STAT. tit. 52, §§ 232, 233 (1947)).

34. *See, e.g.*, OKLA. STAT. tit. 52, § 232 (1981) which provides:

> Any owner or oil and gas lessee of the surface, having the right to drill for gas shall have the right to sink a well to the natural gas underneath the same and to take gas therefrom until the gas under such surface is exhausted; in case other parties having the right to drill into the common reservoir of gas drill a well or wells into the same, then the amount of gas each owner may take therefrom shall be proportionate to the natural flow of his well or wells to the natural flow of the well or wells of such other owners of the same common source of supply of gas, such natural flow to be determined by any standard measurement at the beginning of each calendar month; provided that not more than fifty percent (50%) of the natural flow of any well shall be taken unless, for good cause shown and upon notice and hearing, the Corporation Commission may, by proper order, permit the taking of a greater amount.

35. *See, e.g.*, OKLA. STAT. tit. 52, §§ 23, 232, 233, 239, 240 (1981).

36. *Id.*

37. *Id.*

landowner or lessee.[38] Once production begins, however, the rule of capture prevails subject to certain limitations.[39] Natural gas may not be produced in a manner constituting waste[40] as defined in two different provisions. In 1915 the term included the "escape of natural gas in commercial quantities into open air, the intentional drowning with water of a gas stratum capable of producing gas in commercial quantities, underground waste, the permitting of any natural gas well to wastefully burn and the wasteful utilization of such gas."[41] In 1947 the definition was expanded to include "the production of gas in such quantities or in such manner as unreasonably to reduce reservoir pressure or unreasonably to diminish the quantity of oil or gas that might be recovered from a common source of supply" as well as "the unnecessary depletion or inefficient utilization of gas energy contained within a common source of supply."[42] Wasteful production is further limited in Oklahoma by the Oklahoma Corporation Commission's power to promulgate rules and regulations.[43]

In addition to prohibitions against wasteful production practices, producers in Oklahoma face restrictions on the volume of gas which they can legally produce. A producer may take only an "amount of gas . . . proportionate to the natural flow of his well or wells to the natural flow of the well or wells of . . . other owners of the same common source of supply of gas."[44] Furthermore, when the amount of gas available from a common source of supply exceeds the market demand for such gas, producers may only take "such proportion of the natural gas that may be marketed without waste, as the natural flow of the well or wells owned or controlled by any such person, firm or corporation bears to the total natural flow of such common source of supply."[45]

---

38. *Id.* § 231.

39. The law of capture remains viable in Oklahoma within certain limits as illustrated by the following comment from the Oklahoma Supreme Court:

> [U]nder the "law of capture" which obtains in Oklahoma, a landowner does not own migratory substances underlying his land, but has an exclusive right to drill for, produce, or otherwise gain possession of such substances, subject only to restrictions and regulations pursuant to police power. [Citations omitted]. A landowner does not acquire title, or absolute ownership of the migratory substances, until the substances are reduced to actual possession by being brought to the surface and then controlled. [Citations omitted].

Frost v. Ponca City, 541 P.2d 1321, 1323 (Okla. 1975).

40. OKLA. STAT. tit. 52, § 236 (1981).

41. *Id.* § 237.

42. *Id.* § 86.3.

43. *Id.*

44. *Id.* § 232.

45. *Id.* § 239.

Any producer taking more than his proportionate share will be subject to civil[46] and criminal[47] sanctions.

Purchasers of Oklahoma natural gas also face numerous conservation regulations. Any party taking gas from a gas field must, with certain narrow exceptions, take ratably from each owner in proportion to that owner's interest in the field and at a price agreed upon by the parties.[48] If the parties are unable to agree on a price, one will be fixed by the Oklahoma Corporation Commission.[49] Pipelines operating within the state are deemed to be common carriers and are therefore unable to discriminate in the transportation of natural gas.[50] In addition, such pipelines and any other parties purchasing gas within the state are deemed to be common purchasers.[51] As such, they are required to purchase all natural gas within reach of their pipeline without discrimination as to the producer of the gas.[52] However, if the common purchaser is unable to purchase all gas offered for sale, it must take ratably from each producer and may not discriminate as to price or amount.[53]

IV. General Provisions of H.B. 1221

H.B. 1221 was signed into law on May 3, 1983, and became effective immediately due to its emergency status.[54] Its stated purpose is "to protect the rights and correlative rights of all interest owners of natural gas wells . . . and to afford all such owners an equal opportunity to extract their fair share of gas and to sell and be paid in proportion to

46. OKLA. STAT. tit. 52, § 234 (1981) provides:

> Any person, firm or corporation, taking more than his or its proportionate share of . . . gas, in violation of the provisions of this act, [footnote omitted] shall be liable to any adjoining well owner for all damages sustained thereby and subject to a penalty for each violation not to exceed five hundred dollars ($500.00), and each day such violation is continued shall be a separate offense.

47. OKLA. STAT. tit. 52, § 235 (1981) provides:

> Any person or agent of a corporation, who takes gas, or aids or abets in the taking of gas, except as herein provided, either directly or indirectly, as an individual, officer, agent, or employee of any corporation, shall be guilty of grand larceny, and, upon conviction thereof, shall be sentenced to the penitentiary not to exceed five (5) years.

48. *Id.* § 233.

49. *Id.*

50. *Id.* § 24. Pipelines may not transport the natural gas of one producer and refuse to transport that of another producer.

51. *Id.* §§ 23, 240.

52. *Id.*

53. *But see, e.g.*, Northern Natural Gas Co. v. Corporation Comm'n of Kan., 372 U.S. 84, 94, *reh'g denied* 372 U.S. 960 (1963) (state conservation measures aimed at interstate purchasers, as opposed to producers, were preempted by the federal Natural Gas Act).

54. *See supra* note 1.

their interest therein."[55] Furthermore, the Act is intended "to protect such owners against discrimination in purchases in favor of one owner against another."[56]

Section Two of the Act[57] is probably the most controversial provision. This section provides that when a well is placed into production, each owner is entitled to share ratably in the revenues generated by the sale of production.[58] This provision goes a step beyond existing ratable take statutes which only require that each owner be allowed to extract his fair share of gas from the well[59] and suggests the creation of some type of cotenancy property interest in the proceeds generated by a well's production. This suggestion is supported by other provisions within the Act as discussed below. Of course the exact nature of the property interest created will depend largely upon judicial interpretation of the Act and regulations promulgated thereunder.

Prior to the date of the first production, the operator of the unit area must offer each owner in the well an election whereby the operator will seek to market that owner's ratable share of production or any designated portion thereof.[60] If the owner so elects, the operator must attempt to market the owner's share at the best price and terms available in the area but not at a price and terms less favorable than those received by the operator.[61] The electing owner is not bound to accept any offer procured by the operator but the owner's failure to reject an offer within 30 days is deemed to be an acceptance thereof.[62] If no offer is forthcoming within 120 days from the date of election the owner may rescind the election in writing.[63] The election is not mandatory but is merely an option available to the owner, and if the option is not exercised, the operator is under no duty to market the owner's share.[64] The owner retains the right to separately dispose of his share of production or to receive it in kind whether or not the election is made,[65] although if the election is made and an offer accepted this right will likely cease.

If an electing owner receives a contract for sale of only his portion

55. OKLA. STAT. tit. 52, § 541 (Supp. 1983).
56. *Id.*
57. *Id.* § 542.
58. *Id.* § 542(A).
59. *Id.* §§ 232, 233 (1981).
60. *Id.* § 542(B) (Supp. 1983).
61. *Id.*
62. *Id.*
63. *Id.*
64. *Id.* § 542(C).
65. *Id.* § 542(D).

of production, Section Three provides that the other electing owners not under contract are entitled, but not compelled, to share ratably in the revenue from the contract "to the extent of their net revenue interest."[66] The electing owner receiving the sales contract must give written notice to all other net revenue owners without contracts so that they may decide whether or not to deliver their share of production for sale.[67] The quoted language further implies that under H.B. 1221, not only do mineral owners in a well have ownership rights in the gas produced from the well, but also in the revenue generated from the sale of that gas.

Section Four of the Act[68] provides that a well's lawful daily production is owned by all owners in proportion to their interest in the well regardless of which owner actually produces the gas.[69] An owner producing and selling gas separately from other owners must account to those owners and compensate them for their proportionate share of the gas.[70] Section Five requires that distribution of revenues from the sale of production be made pursuant to title 52, section 540 of the Oklahoma Statutes and that an owner receiving revenues directly from a purchaser must forward the same to the party responsible for distribution under section 540.[71]

Section Six operates as a disclaimer of sorts by specifying exactly what H.B. 1221 is not intended to do. It is not to be construed as 1) setting or restricting the price, terms or conditions for the sale of production; 2) requiring a purchaser to connect to a well he is not already obligated to connect to; or 3) altering the legal definitions of common purchaser or common carrier.[72]

Under Section Seven, the Oklahoma Corporation Commission is empowered to promulgate rules and regulations for implementing H.B. 1221 and enforcement of penalties for violating its provisions.[73] However, owners are not precluded from suing one another in state district courts and the courts may administer existing legal remedies including the award of treble damages and attorneys' fees.[74]

---

66. *Id.* § 543(A).
67. *Id.* § 543(B).
68. *Id.* § 544.
69. *Id.*
70. *Id.*
71. *Id.* § 545.
72. *Id.* § 546.
73. *Id.* § 547.
74. *Id.*

Finally, Section Eight provides that the provisions of the Act are severable so that a judicial determination that any part is void does not affect the other parts.[75]

V. CONSTITUTIONALITY OF H.B. 1221

As with most ratable take statutes enacted in Oklahoma, the validity of H.B. 1221 will undoubtedly be challenged.[76] The following sections examine the validity of the Act in light of the challenges which are likely to be raised.

A. *Federal Preemption*

One potential challenge is that state authority to regulate or affect an interstate pipeline's purchase of natural gas has been preempted by the Natural Gas Act of 1938 (NGA)[77] and the Natural Gas Policy Act of 1978 (NGPA)[78] and is within the exclusive jurisdiction of the Federal Energy Regulatory Commission (hereinafter FERC), successor to the Federal Power Commission (hereinafter FPC).[79] The complexity of these two federal acts and their interrelationship with one another precludes a simple resolution of the challenge. Furthermore, the fact that the NGPA does not completely abrogate the NGA but, rather, modifies and supplements it necessitates an examination of both acts.

1. Natural Gas Act

The jurisdiction of the FPC under the NGA extends to "[1] the transportation of natural gas in interstate commerce, [2] to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and [3] to natural-gas companies engaged in such transportation or sale."[80] However, the FPC has no authority over "[1] any other transportation or sale of natural gas or [2] . . . the local distribution of natural gas or [3] . . . the facilities used for such distribution or [4] . . . production or

75. *Id.* § 541 (1983 Okla. Sess. Laws ch. 77, § 8 provides for severability as noted after § 541).
76. *See, e.g.*, Cities Service Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179 (1950) (Oklahoma Corporation Commission order directing pipeline operator to connect its pipeline to a gas well and to take gas from that well ratably with other wells in the gas field upheld against due process, equal protection and federal preemption challenges).
77. 15 U.S.C. §§ 717-717w (1982).
78. *Id.* §§ 3301-3432.
79. *See, e.g.*, Natural Gas Pipeline Co. v. Corporation Comm'n, 349 U.S. 44 (1955) (per curiam).
80. 15 U.S.C. § 717(b) (1982).

gathering of natural gas."[81] At first glance it would appear that H.B. 1221's regulation only of producers and operators would place it within the "production or gathering" exception to the FPC's jurisdiction. However, in *Phillips Petroleum Co. v. Wisconsin*,[82] the Supreme Court extended the jurisdiction of the FPC to mere producers. The Court held that an independent natural gas producer which sold gas to an interstate pipeline for interstate transportation and resale was a natural gas company within the meaning of the NGA and that the sale, therefore, was not exempted from FPC jurisdiction by the "production or gathering exception."[83] The Court looked to the legislative history of the NGA and found "a congressional intent to give the . . . [FPC] . . . jurisdiction over the rates of all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company."[84] This language represented a significant expansion of the scope of the FPC's jurisdiction beyond what had been previously believed.

Two subsequent per curiam opinions overturned an attempt by the Oklahoma Corporation Commission to fix a minimum price for the sale of gas to an interstate pipeline.[85] Citing *Phillips* as controlling, the Court held that "such a sale and transportation cannot be regulated by a State but are subject to the *exclusive* regulation of the Federal Power Commission."[86] While both *Phillips* and the later per curiam opinions deal specifically with state economic regulation of wholesales to interstate pipelines, the language used, particularly in the latter opinions, can be read to preempt any state regulation of such wholesales, presumably including conservation measures. Such a reading would suggest that H.B. 1221 is indeed federally preempted, at least insofar as it regulates producer sales to interstate pipelines.

In *Northern Natural Gas Co. v. Corporation Commission of Kansas*,[87] the Supreme Court expressly extended FPC jurisdiction to state ratable take orders affecting sales to interstate pipelines. The Court

81. *Id.*
82. 347 U.S. 672 (1954).
83. *Id.* at 677.
84. *Id.* at 682. For an excellent discussion of *Phillips*, its impact and the subsequent expansion of FPC jurisdiction *see* 1 AMERICAN GAS ASSOCIATION, REGULATION OF THE GAS INDUSTRY §§ 20.01-20.04 (1983).
85. Natural Gas Pipeline Co. v. Panoma Corp., 349 U.S. 44 (1955) (per curiam) (decided together with Natural Gas Pipeline Co. v. Corp. Comm'n, 349 U.S. 44 (1955).
86. *Id.* (emphasis added).
87. 372 U.S. 84, *reh'g denied* 372 U.S. 960 (1963).

indicated that "[t]he federal regulatory scheme leaves no room either for *direct* state regulation of the prices of interstate wholesales of natural gas, [citations omitted], or for state regulations which would *indirectly* achieve the same result."[88] The ratable take orders were found to constitute invalid state price regulation, which directly affected "the ability of the Federal Power Commission to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation, which was an objective of the Natural Gas Act."[89] However, *Northern Natural Gas* cannot be read as invalidating all state conservation measures affecting interstate wholesales of natural gas. The Court expressly recognized "a significant distinction, . . . between conservation measures aimed directly at interstate purchasers and wholesalers for resale, and those aimed at producers and production. The former cannot be sustained when they threaten . . . the achievement of the comprehensive scheme of federal regulation."[90] Therefore, the implication of *Phillips* and *Northern Natural Gas* is that state conservation measures aimed directly at producers and production will be sustained unless they threaten the uniformity of federal regulation by indirectly affecting the prices of interstate wholesales of natural gas.

When viewed in this context the validity of H.B. 1221 is questionable. While the Act is not aimed directly at interstate purchasers and does not directly regulate the prices of interstate wholesales, it affects such purchasers and purchases indirectly. For example, assume that each owner in a well has elected to have the operator of the unit area market his share of production under Section Two of H.B. 1221.[91] The operator is under a duty to market such production "at the best price and terms available in the area . . . [but] . . . in no event upon a price and terms less than that received by the operator."[92] Thus, the state effectively creates a minimum price below which the production cannot be sold—the price and terms received by the operator. If the potential customers of the operator are interstate pipelines, there is arguably an indirect state regulation of wholesale gas prices as prohibited by *Phillips*[93] and *Northern Natural Gas*.[94] While Section Six of the Act pro-

88. *Id.* at 91 (emphasis added).
89. *Id.* at 91-92.
90. *Id.* at 94.
91. OKLA. STAT. tit. 52, § 542(B) (Supp. 1983).
92. *Id.*
93. 347 U.S. at 672.
94. 372 U.S. at 84.

vides that it is not to be construed as fixing a price for sales of natural gas,[95] such a construction would be strained under the foregoing facts. If each owner in a given well elects to have its share of production marketed by the operator, and if the express language of Section Two[96] is given effect (i.e., operator prohibited from selling at a lower price than he receives), Section Six would clearly be violated since the price received by the operator for his own share of production is the effective minimum price below which the remainder of the well's production cannot be sold.

The conflict between the two sections could be avoided by construing Section Two[97] as requiring only that the operator make a "best effort" or a "reasonable effort" to market the production of electing owners at a price no less than that which he receives. While such a construction would likely alleviate the apparent conflict between Section Two[98] and Section Six[99] of the Act, as well as avoiding preemption problems with the NGA, it would also serve to render H.B. 1221 ineffective. It is doubtful whether purchasers would be willing to purchase the owner's share of production at the same price paid to the operator if such production could be purchased for less after the operator had made a reasonable attempt to market the production at a higher price.

Therefore, on the basis of the provisions of the NGA and interpretive judicial decisions, it can be argued that H.B. 1221 represents a potential state invasion of the FPC's exclusive jurisdiction under the NGA. While the potential invasion may be avoided in part by judicial construction, such a construction might render the Act ineffective.

2. Natural Gas Policy Act

Section 3431 of the NGPA[100] sets forth its coordination with the NGA. In general, FERC jurisdiction under the NGPA no longer extends to "first sales" of gas "not committed or dedicated to interstate commerce as of November 8, 1978."[101] Also excluded from FERC jurisdiction are "first sales" or gas "committed or dedicated to interstate commerce as of November 8, 1978," which is "high cost natural gas,"

95. Okla. Stat. tit. 52, § 546 (Supp. 1983).
96. *Id.* § 542 (B).
97. *Id.*
98. *Id.*
99. *Id.* § 546.
100. 15 U.S.C. §§ 3301-3432 (1982).
101. *Id.* § 3431(a)(1)(A).

"new natural gas" or "natural gas produced from any new, onshore production well."[102] All other sales and transportation previously within the jurisdiction of the FPC remain under FERC jurisdiction.[103]

A first sale is defined as any sale to 1) an interstate pipeline, 2) an intrastate pipeline, 3) a local distribution company, 4) a party for their own use or 5) any sale prior to such a sale.[104] However, a sale by an interstate pipeline, an intrastate pipeline or a local distribution company does not qualify as a first sale unless the gas sold was also produced by the selling party "or any affiliate thereof."[105] Thus, it can be inferred from the foregoing that a sale by an interstate pipeline, an intrastate pipeline, a local distribution company, or any affiliate thereof, of gas not produced by such party to any other party would not constitute a first sale and would remain within the jurisdiction of the FERC.

One of the problems raised by the provisions of H.B. 1221 is the status of the unit area operator in the scheme of the NGPA while engaged in marketing the production of electing owners. For example, assume that the unit area operator is a large integrated petroleum company which owns mineral interests in the gas field and also owns and operates the interstate pipeline which carries gas from the field to interstate markets. Sales by the company, or an affiliate thereof, of gas which it produced would be a first sale under the NGPA and, therefore, exempt from FERC jurisdiction.[106] However, if we assume further that all of the owners within a unit area elect to have the operator market their shares of production under Section Two[107] of H.B. 1221, a potential problem arises.

It appears from the provisions of the NGPA that such sales do not constitute first sales since they are sales by an interstate pipeline, intrastate pipeline, or local distribution company, or an affiliate thereof of gas not produced by such party.[108] If the sales are not first sales, they would remain subject to FERC jurisdiction since they are not expressly removed therefrom.[109] However, such sales are also subject to indirect state price regulation under Section Two[110] of H.B. 1221 as discussed

102. *Id.* § 3431(a)(1)(B)(i), (ii) & (iii).
103. *Id.*
104. *Id.* § 3301(21)(A)(i), (ii), (iii) & (iv).
105. *Id.* § 3301(21)(B).
106. *Id.*
107. Okla. Stat. tit. 52, § 542(B) (Supp. 1983).
108. 15 U.S.C. § 3301(21)(B) (1982).
109. *Id.* § 3431(a)(1).
110. Okla. Stat. tit. 52, § 542(B) (Supp. 1983).

above in connection with the NGA (i.e., the operator cannot sell electing owner's production at a price less than he receives).

Thus, H.B. 1221 constitutes a potential invasion of FERC's exclusive jurisdiction and would be void, at least insofar as presented by the facts above. The ultimate determination of the validity of H.B. 1221 will depend upon judicial interpretation of both the NGPA and H.B. 1221. However, it appears from the foregoing analysis that there are sufficient potential conflicts between the two acts to warrant close scrutiny by Oklahoma courts.

B. *Commerce Clause*

Another issue closely related to federal preemption is whether H.B. 1221 constitutes a state infringement upon the exclusive power of Congress to regulate interstate commerce under the commerce clause of the Constitution.[111] Clearly, the Act does not discriminate against interstate commerce on its face, thereby avoiding the strict scrutiny standard of review applied by the Supreme Court in such cases.[112] Rather, H.B. 1221 merely affects interstate commerce by its applicability to all sales of natural gas by Oklahoma producers, including those sales to interstate pipelines which are destined for out of state markets.[113]

As such, H.B. 1221 need only meet the general requirements set forth by the Supreme Court in *Pike v. Bruce Church*.[114] *Pike* essentially sets forth a two-step commerce clause analysis. The initial inquiry is whether the state legislation or regulation promotes a "legitimate local public interest."[115] If not, the legislation will be struck down as a violation of the commerce clause. However, if the legislation promotes a legitimate local interest, the second step of the analysis requires that the local interest be balanced against the burden imposed on interstate commerce.[116] If the effects of the state legislation "on interstate commerce are only incidental, it will be upheld unless the bur-

---

111. U.S. CONST. art. I, § 8, cl. 1 & 2 provides that "The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes. . . ."

112. Hughes v. Oklahoma, 441 U.S. 323 (1979).

113. Although H.B. 1221 does not expressly provide that it applies to sales to interstate pipelines, neither does it expressly exclude such sales. Thus, an inference can be made that the Act applies to *all* sales of natural gas by Oklahoma producers, at least until there is contrary judicial determination.

114. 397 U.S. 137 (1970).

115. *Id.* at 142.

116. *Id.*

den imposed on such commerce is clearly excessive in relation to the putative local benefits."[117] Thus, it appears that state legislation which excessively burdens interstate commerce to the detriment of legitimate local interests will be struck down.

In applying the foregoing analysis to H.B. 1221, it may be argued that conservation of natural resources is a legitimate local interest. In upholding a state's constitutional right to impose ratable taking by regulating the purchase of natural gas,[118] the Supreme Court in *Cities Services Gas Co. v. Peerless Oil & Gas Co.*[119] found a clear legitimate local interest in the conservation of natural gas. The Court explained that "[a] state is justifiably concerned with preventing rapid and uneconomic dissipation of one of its chief natural resources."[120] Thus, H.B. 1221 clearly satisfies the first prong of the *Pike* commerce clause analysis.

The second prong of the analysis requires that Oklahoma's interest in conserving natural gas be weighed against the impact of H.B. 1221 on interstate commerce. As discussed above in the context of federal preemption, Section Two of the Act[121] effectively sets a minimum price (i.e., the price received by the unit area operator) below which the production of electing owners may not be sold. This minimum price apparently applies to all sales, including those to interstate markets. Thus, H.B. 1221 may potentially impact interstate commerce, although the extent of such impact will depend upon judicial interpretation of Section Two of the Act and the facts of the particular case.

The Supreme Court in *Kassel v. Consolidated Freightways Corp.*[122] stated that "a State's power to regulate commerce is never greater than in matters traditionally of local concern."[123] Conservation of natural resources has been determined to be such a matter of traditional local concern.[124] Thus, there are factors to be considered on either end of

117. *Id.*
118. The Court in Northern Natural Gas Co. v. Corporation Comm'n of Kansas, 372 U.S. 84 (1963), distinguished Cities Service Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179 (1950) and Phillips Petroleum Co. v. Oklahoma, 340 U.S. 190 (1950) on the following basis: "In those cases we were dealing with constitutional questions and not the construction of the Natural Gas Act." 372 U.S. at 91 n.10. The implication is that a state may have a constitutional right to regulate conservation of state resources; however, that right may be preempted by federal legislation.
119. 340 U.S. 179 (1950).
120. *Id.* at 187.
121. OKLA. STAT. tit. 52, § 542(B) (Supp. 1983).
122. 450 U.S. 662 (1981).
123. *Id.* at 670.
124. Cities Service Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179, 187 (1950).

the commerce clause balance—the potential impact of H.B. 1221 on interstate commerce vs. Oklahoma's interest in conserving natural gas. While it is impossible to accurately predict how the courts will strike the balance between these competing interests, it can safely be said that H.B. 1221 represents a potential state infringement on Congress' exclusive power to regulate interstate commerce.

C. *Contract Clause*

H.B. 1221 will likely be challenged as an impairment of existing natural gas sales contracts in violation of the contract clause of the Constitution.[125] The leading case in this area is *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*,[126] wherein the Supreme Court set forth a three-part analysis for determining whether a state law impairs existing contracts.[127] The initial inquiry is "whether the state law has, in fact, operated as a *substantial impairment* of a contractual relationship."[128] If there is in fact substantial impairment, "the State, in justification, must have a significant and legitimate public purpose behind the regulation, such as the remedying of a broad and social or economic problem."[129] If both of these requirements are met, the regulation will be upheld so long as "the adjustment of 'the rights and responsibilities of contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation's] adoption.' "[130]

It is doubtful whether H.B. 1221 constitutes a substantial impairment of natural gas sales contracts in light of the Court's application of the above mentioned test to the facts in *Energy Reserves*.[131] The issue in *Energy Reserves* was whether a state statute, regulating the price of natural gas, impaired the plaintiff's sales contract with the defendant.[132] The Court held that it did not, finding it "[s]ignificant . . . that the parties . . . [were] . . . operating in a heavily regulated indus-

---

125. U.S. CONST. art. I, § 10, cl. 1 provides that "No State shall . . . pass any . . . Law impairing the Obligation of Contracts. . . ."

126. 459 U.S. 400 (1983).

127. *Id.* at 410-13 (citing United States Trust Co. v. New Jersey, 431 U.S. 1 (1977) and Allied Structural Steel Co. v. Spannaus, 438 U.S. 234 (1978)).

128. 459 U.S. at 411 (emphasis added).

129. *Id.* at 411-12.

130. *Id.*

131. *See supra* note 126; *see also* Note, *Legislative Impairment of Natural Gas Contracts: Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 19 TULSA L.J. 384 (1984) for an analysis of the *Energy Reserves* decision.

132. 459 U.S. 400 at 410.

try."[133] The Court found that "[p]rice regulation existed [in the natural gas industry at the time the contracts were entered into] and it was foreseeable as the type of law that would alter contract obligations" so that the seller's "reasonable expectations" were not impaired by the Kansas regulation.[134]

If this rationale is applied in cases questioning the validity of H.B. 1221, it can be argued that the Act affects parties operating in the same "heavily regulated industry."[135] Furthermore, ratable take statutes applying to both producers[136] and purchasers[137] were in effect in Oklahoma at the time many existing natural gas contracts were entered into. It was foreseeable that such regulation would continue to exist, and perhaps even increase, in the future. Thus, it is doubtful that H.B. 1221 impairs the "reasonable expectations" of parties to existing natural gas sales contracts, with the possible exception of contracts signed prior to enactment of ratable take statutes.

Even if H.B 1221 was found to substantially impair existing sales contracts, the state should have no difficulty in justifying the Act as having a "significant and legitimate public purpose."[138] As discussed above in connection with the commerce clause analysis, the Supreme Court has recognized conservation of natural resources as a substantial local interest.[139] Furthermore, there is nothing in the language of H.B. 1221 which appears to be unreasonable or inappropriate to that local purpose. Therefore, it is unlikely that H.B. 1221 will be struck down as violative of the contract clause.

D. *Due Process and Equal Protection*

Current Oklahoma ratable take statutes have been attacked as a taking of private property without due process of the law, as well as a denial of equal protection in violation of the Fourteenth Amendment.[140] The same challenges may also be made to H.B. 1221. The success of such challenges, however, appears unlikely in light of the almost complete deference given state legislatures by the Supreme

133. *Id.* at 413.
134. *Id.* at 416.
135. *Id.* at 413.
136. *E.g.*, OKLA. STAT. tit. 52, §§ 232, 239 (1981).
137. *Id.* §§ 23, 233, 240.
138. *Energy Reserves*, 459 U.S. at 411.
139. Cities Service Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179, 187 (1950).
140. *See, e.g.*, Phillips Petroleum Co. v. Oklahoma, 340 U.S. 190 (1950).

Court in *Cities Service Gas Co. v. Peerless Oil & Gas Co.*[141] The Court characterized Cities' due process and equal protection challenges to Oklahoma's then existing ratable take provisions[142] as "virtually without substance."[143] Stating that it is "undeniable that a state may adopt reasonable regulations to prevent economic and physical waste of natural gas,"[144] the Court required only that such regulations be "substantially related to a legitimate end sought to be attained."[145] In applying this standard, the Court looked only to the evidence before the Corporation Commission at the time the contested order was issued and, finding the evidence sufficient, upheld the order.[146] The Court refused to examine the propriety of the order and stated that "[i]t is no concern of ours that other regulatory devices might be more appropriate, or that less extensive means might suffice. Such matters are the province of the legislature and the commission."[147]

Thus, to withstand due process and equal protection challenges, H.B. 1221 need only be found reasonable and "substantially related to a legitimate end."[148] It would not be enough for one challenging the legislation to show that "some other regulatory device might be more appropriate"[149] or that "less extensive means might suffice."[150] Rather, it would have to be shown that H.B. 1221 was unreasonable or that it was not substantially related to legitimate ends.[151] Clearly, the ends sought to be achieved by H.B. 1221 are legitimate. They are the same ends sought by the ratable take statutes challenged and upheld in *Peerless*, namely conservation of natural gas and protection of correlative rights.[152] It would be difficult to argue that the means employed by H.B. 1221 are not substantially related to these ends since compliance with the Act would almost certainly result in the accomplishment of the desired goal. Finally, the reasonableness of H.B. 1221 is largely a question of fact and, as such, difficult to predict. It is clear that the party

141. 340 U.S. 179 (1950).
142. OKLA. STAT. tit. 52, §§ 23-25, 231-233, 239, 240 (1941).
143. 340 U.S. at 185.
144. *Id.*
145. *Id.* at 186 (citing Nebbia v. New York, 291 U.S. 502 (1934)).
146. *Peerless*, 340 U.S. at 186.
147. *Id.*
148. *Id.* at 185.
149. *Id.* at 186.
150. *Id.*
151. *Id.* at 185, 186.
152. OKLA. STAT. tit. 52, § 541 (Supp. 1983).

challenging the reasonableness of H.B. 1221 based on due process and equal protection arguments bears a heavy burden of proof.

VI. CONCLUSION

As shown in the foregoing analysis, H.B. 1221 is a valid exercise of Oklahoma's police power only if it is construed so as to avoid potential infringements on federal regulatory power. However, several caveats to this conclusion are in order. First, the Court does not always follow its own precedent.[153] Occasionally the Court will take a new direction in a certain matter due to the emergence of new public policies, personnel changes within the Court, etc.[154] Such a shift in direction is by no means inconceivable should the Court examine H.B. 1221.

Secondly, much of the analysis within this Comment is, of necessity, largely subjective due to the nebulous nature of the legal principles involved. For example, how intrusive must a statutory provision be before it substantially impairs an existing contract? When does a statute's effect on interstate commerce become more than merely incidental? Reasonable men may differ in their answers to such questions.

Thirdly, it must be remembered that, even if H.B. 1221 alone does not violate the Constitution, individual regulations promulgated by the Corporation Commission under authority of the Act may do so. Having not been promulgated at the time of this writing, a discussion of such regulations would be inappropriate.

Finally, it is always risky to predict the future. Legislation which appears innocuous on paper will occasionally have unforeseen consequences in the context of real life. This is particularly true when dealing with an industry as complex and pervasive as the natural gas industry. Nevertheless, it is hoped that despite these caveats, this Comment has highlighted some of the changes brought about by H.B. 1221 and exposed some of the surrounding uncertainties.

Rick D. Chamberlain

153. *See, e.g.*, Brown v. Board of Education of Topeka, 347 U.S. 483 (1954) (the Court abandoned the "separate but equal" doctrine announced in Plessy v. Ferguson, 163 U.S. 537 (1896)).
154. *See, e.g.*, *Brown*, 347 U.S. at 492.