Preemption Survives Deregulation of Natural Gas: Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi

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PREEMPTION SURVIVES DEREGULATION OF NATURAL GAS: *TRANSCONTINENTAL GAS PIPE LINE CORP. v. STATE OIL AND GAS BOARD OF MISSISSIPPI*

I. Introduction

In early 1986, the Supreme Court of the United States once again affirmed its position that the Natural Gas Act preempts state authority to require interstate pipeline carriers to purchase natural gas ratably from a common pool. That case, *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi*,[1] (*Transco*) resumed a line of cases which determined state regulation of the natural gas transportation industry to be preempted by federal law.[2] This Note examines *Transco* and the rationale underlying the case.

The *Transco* decision may be the last in a series of cases finding preemption. The majority received only five votes, one of which was that of the recently retired Chief Justice Warren Burger. With the appointment of Antonin Scalia to the Court, the dissenters may be able to command the majority; in which case, ratable-take rules would be valid as they would not, according to the dissenting view, frustrate any pertinent federal policies. But, for the time being, *Transco* stands for the proposition that state ratable-take rules are preempted by the Natural Gas Act (NGA), as amended by the Natural Gas Policy Act (NGPA).

II. Statement of the Case

A. *Facts*

During a period of natural gas shortage, Transco, an interstate pipeline distribution company, entered into thirty-five long term take-or-pay contracts with operators who were producing natural gas from a common gas pool in southern Mississippi.[3] Transco contracted with three

1. 106 S. Ct. 709 (1986).
2. *See infra* notes 41-50 and accompanying text.
3. *Transco*, 106 S. Ct. at 712. According to the Mississippi Supreme Court, six wells were complete and producing in the Harper Sand gas pool as of September, 1982, the same time as Transco's hearing before the Mississippi State Oil and Gas Board. Getty operated three of those wells; Tomlinson operated one well; and Florida Exploration operated two wells. Transcontinental Gas Pipeline Corp. v. State Oil & Gas Bd., 457 So. 2d 1298, 1307 (Miss. 1984), *rev'd*, 106 S. Ct. 709

operators to obtain gas from this pool, known as the Harper Sand gas pool.[4] Those operators were Getty Oil Company, Florida Exploration Company, and Tomlinson Interests, Inc.[5] Each contract contained a take-or-pay provision.[6] Under its contract with Getty and with Tomlinson, Transco had to buy only those two company's shares of the gas produced from their wells.[7] But, Transco's contract with Florida Exploration obligated it to take all the gas from Florida Exploration's wells even if the gas belonged to another owner of the common pool.[8] Thus, with a period of increasing demand, Transco bound itself to buy gas out of the Harper Sand pool from only these three operators.

Because of the high demand for gas, Transco began to buy shares of production from smaller owners but did not bind itself to any long term supply contracts with these smaller owners and producers.[9] One owner, Coastal Exploration, Inc., was the company which started the Transco litigation by filing a complaint with the State Oil and Gas Board of Mississippi seeking enforcement of the state's ratable-taking rule.[10] But, by 1982, the demand for natural gas lessened, and Transco found itself in the precarious position of having more gas than it could sell.[11] Therefore, in May of 1982, Transco stopped purchasing gas from owners with whom it had no long term contract.[12] Coastal then sought to ratify Getty's contract and thus bind Transco to purchase Coastal's gas.[13] In refusing to purchase the gas, Transco posited a counteroffer with two alternatives.[14] Either Coastal could sell gas to Transco at a price consid-

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(1986). Originally, the area was thought to be comprised of two separate fields—the Greens Creek Field and the East Morgantown Field—both in Marion County, Mississippi. Later discoveries by Getty of gas in between those two fields confirmed that both were contiguous and that the Harper Sand gas pool underlay parts of both. *Id.*

4. *Transco*, 106 S. Ct. at 712.
5. *Id.*
6. *Id.* A take-or-pay provision is a contractual obligation to purchase a certain amount of gas or in lieu of that to pay for gas not purchased. H. WILLIAMS & C. MEYERS, MANUAL OF OIL AND GAS TERMS 882 (6th ed. 1984). The reason for the inclusion of a take-or-pay provision in a contract lies in the cyclical demand for natural gas. Natural gas is a seasonal product to the extent that a purchaser uses the gas for heating needs. A purchaser may normally claim the gas which he has paid for at a later date by making up the difference between the purchase price under the take-or-pay clause and the current market value. *See generally* Pierce, *Natural Gas Regulation, Deregulation, and Contracts*, 68 VA. L. REV. 63 (1982). Professor Pierce discusses succinctly various contractual provisions used in the natural gas industry, including take-or-pay clauses. *Id.* at 77-81.
7. *Transco*, 106 S. Ct. at 711.
8. *Id.*
9. *Id.*
10. *Id.* at 711-12.
11. *Id.* at 712.
12. *Id.*
13. *Id.*
14. *Id.*

erably lower than that of the other contracts, or Coastal could use Transco's pipeline to transport gas to purchasers, the sales of which Coastal would arrange on its own.[15] Coastal refused both alternatives.[16]

During the same time, Getty and Tomlinson reduced production from their wells, so that they were only pumping an amount equal to their own ownership interest.[17] Thus, the reduction meant that the operators would not produce any of Coastal's interest in the common pool unless Coastal arranged a sale of that gas on its own.[18] Facing the immediate prospect of losing revenue and the long term prospect of depletion of the pool and increased recovery costs, Coastal pursued legal action.[19]

B. *Procedural History*

Coastal sought to force Transco to take the gas from the pool ratably. On July 29, 1982, Coastal filed its petition with the State Oil and Gas Board of Mississippi.[20] That petition sought to invoke Mississippi's statewide Rule 48, a ratable-taking rule.[21] Enforcement of the rule would require Transco to purchase gas in proportion to the various owners' shares in the common pool.

Coastal's complaint led to a hearing before the Board in September of 1982. At the hearing, Transco claimed that Rule 48 was invalid and that the Board did not have jurisdiction over the subject matter.[22] Among various constitutional arguments, Transco argued that federal law preempts the states' abilities to force an interstate pipeline carrier to

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15. *Id.*

16. *Id.* Fifty-five other owners and producers at the Harper Sand pool did sign agreements with Transco which were essentially like Transco's contract with Getty except for a lower purchase price and the requirement of nominating one seller's representative for each well. *Transco*, 457 So. 2d at 1309.

17. *Transco*, 106 S. Ct. at 712.

18. *Transco*, 457 So. 2d at 1309.

19. *Transco*, 106 S. Ct. at 712. Coastal's immediate problem, lost revenue, resulted simply from not having its ownership share of gas pumped out of the pool. The long term problems resulted from geological factors. Within the pool, gas tends to flow toward producing wells because the pressure at those points is less than nonproducing points. Thus, Coastal's interest tends to seep away, and other producers may be able to siphon off that gas. Moreover, the total reduction in pressure from depletion of the pool by other operators renders the remainder of the gas more difficult to recover, hence more costly to recover, thereby decreasing the value of Coastal's ownership interest. *Id.*

20. *Id.* Another party, the Fairchilds, who were owners in one of the Getty wells, joined in Coastal's petition. *Transco*, 457 So. 2d at 1311.

21. Rule 48 reads: "Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, or producers shall purchase without discrimination in favor of one owner, operator, or producer against another in the same source of supply." *Transco*, 106 S. Ct. at 712.

22. *Transco*, 457 So. 2d at 1311.

purchase gas ratably.[23] After a three-day hearing, the Board issued an order requiring Transco to comply with Rule 48.[24]

Transco appealed the ruling to the Circuit Court of the First Judicial District of Hinds County, Mississippi.[25] That court held that neither the NGA nor the NGPA preempted the Board's authority and that the order was congruent with the commerce clause of the United States Constitution.[26]

Beleaguered, Transco then appealed to the Supreme Court of Mississippi. In that court, Transco raised the same constitutional issues as it had before, including the contention that federal law preempted the area.[27] In considering the preemption argument, the Mississippi court reasoned that the NGPA's removal of jurisdiction from the Federal Energy Regulatory Commission (the FERC) over high cost gas, such as that produced from the Harper Sand Pool, revealed congressional intent to withdraw its preemption of the area.[28] Because federal law no longer preempted the area, Mississippi's State Oil and Gas Board was free to promulgate rules that required ratable-taking. The state court also considered Transco's argument that federal law implicitly preempted regulation of ratable-taking.[29] According to this argument, a decision by Congress to leave an area unregulated (or to deregulate) is tantamount to affirmative regulation;[30] thus, the federal law, although not explicit, would nonetheless preempt state regulation. According to the court's analysis of the NGPA, Congress did not implicitly prohibit state regula-

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23. *Id.*

24. *Transco,* 106 S. Ct. at 712-13. Order No. 409-82 from the Gas Board made the following direction to Transco:

> "[F]orthwith to comply with Statewide Rule 48 of the State Oil and Gas Board of Mississippi in its purchases of gas from the said Harper Sand Gas Pool in Greens Creek and East Morgantown Fields and . . . ratably take and purchase gas without discrimination in favor of one owner, operator or producer against another in the said common source of [sic] pool; and, specifically, in the event it so chooses and elects to take and purchase gas produced from the said common pool, Transco shall ratably take and purchase without discrimination in favor of the operators Getty and Tomlinson against Coastal, the Fairchilds, and Inexco."

Id. at 713 n.1 (citation omitted).

25. *Id.* at 713.

26. *Id.*

27. *Id.*

28. *Id.*

29. *Transco,* 106 S. Ct. at 713.

30. *Id.* The Mississippi Supreme Court relied on the following language from Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n: " 'a federal decision to forgo regulation in a given area may imply an authoritative federal determination that the area is best left *un*regulated, and in that event would have as much pre-emptive force as a decision *to* regulate.' " *Transco,* 457 So. 2d at 1317 (quoting Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n, 461 U.S. 375, 384 (1983)).

tion of deregulated gas at the wellhead.[31] In that light, statewide Rule 48 was valid; therefore, the Board could legitimately order Transco to take ratably. Thus, the court rejected all of Transco's arguments and let the Board's decision stand.[32] Transco then appealed to the United States Supreme Court.[33]

C. *Issues*

In deciding *Transco*, the Supreme Court faced two challenges to Mississippi's ratable-taking rule: (1) whether the NGA and the NGPA, as it amended the original Act, prohibited states from promulgating rules to regulate the proportion in which a purchaser buys natural gas from the owners of a common pool;[34] and (2) whether Mississippi's Rule 48 intruded impermissibly into the federal government's power under the commerce clause. Because the Court resolved *Transco* on the issue of preemption, it did not address the issue of the rule's constitutionality under the commerce clause.[35]

Resolution of the preemption issue involves a two-step analysis. The first step is to decide whether a previous case, *Northern Natural Gas Co. v. Kansas Corp. Commission*,[36] controls the resolution of this case. The second step is bifurcated. If *Northern Natural* controls and if the action taken by the Mississippi State Oil and Gas Board falls within the parameters of that case, then federal law preempts that action. If *Northern Natural* controls but the action of the Board does not fall within its

31. *Transco*, 457 So. 2d at 1318. The state court noted that its holding applied only to "high-cost" natural gas, i.e. gas lying in pools at a depth of more than 15,000 feet, gas over which the FERC no longer has jurisdiction to set the price at the wellhead. *Id.; see* 15 U.S.C. § 3431(a)(1)(B)(i) (1982).

32. The Mississippi Supreme Court also considered challenges to Rule 48 under the commerce clause, the void-for-vagueness doctrine, and the due process principle of taking without just compensation. The court rejected each of these arguments. Transco also raised numerous state claims which the court also rejected. However, the court did hold that the Board could not force Transco to pay non-contract owners the same price as it paid to contract owners. *Transco*, 457 So. 2d at 1318-25. Because the United States Supreme Court resolved the case on the ground of federal preemption, it did not address the other issues. Therefore, this Note concentrates on the preemption claim.

33. *Transco*, 457 So. 2d 1298 (Miss. 1984), *cert. granted*, 105 S. Ct. 1840 (1985).

34. The preemption argument stems from the supremacy clause of the United States Constitution. That clause reads:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. CONST. art. VI, cl. 2.

35. *Transco*, 106 S. Ct. at 718.

36. 372 U.S. 84 (1963).

parameters, then federal law does not preempt action to require ratable-taking. On the other hand, if *Northern Natural* does not control, then federal law does not preempt the area at all. Importantly, the Court cast its entire analysis in terms of the applicability of *Northern Natural*. That case itself posed numerous factors to consider in resolution of the preemption issue. One can categorize these factors as three broad considerations:[37] (1) whether "Mississippi's ratable take rule invades the exclusive sphere of the NGA"; (2) whether that ratable-take rule contravenes congressional intent—as reflected in the NGPA—of deregulating the price of high-cost natural gas at the wellhead; and, (3) whether that ratable-take rule impermissibly impinges upon the federal scheme relating to natural gas, a scheme which gradually institutes a free-market policy.[38]

III. LAW PRIOR TO THE CASE

Prior to 1938, the law concerning the regulation of natural gas development and sale was in flux. In the early part of this century, many states attempted to exercise direct control over production and sale of natural gas. But, in 1924, the Supreme Court reached a landmark decision which turned the whole area upside down. In *Missouri v. Kansas Natural Gas Co.*, the Court held that, under the commerce clause, states could not constitutionally regulate wholesale prices of gas which entered interstate commerce.[39] Against that backdrop, Congress enacted the NGA in 1938.[40]

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37. *Transco,* 106 S. Ct. at 718 (Rehnquist, J., dissenting).

38. *Id.*

39. 265 U.S. 298 (1924). Although the majority in *Transco* did not reach the commerce clause issue raised by the appellant Transco, the decision in *Kansas Natural* illustrates the concept of the negative commerce clause. In other words, because the Constitution granted specifically to Congress the power to regulate interstate commerce, the commerce clause inherently forbids any state action which is unduly burdensome or discriminatory upon interstate commerce, even if Congress does not regulate the subject matter with which a particular state law is concerned. *Id.* at 307. The reasons supporting the negative commerce clause involve the unity of the nation economically and the federal government's role as a unifying force. *See* H. P. Hood & Sons v. Du Mond, 336 U.S. 525, 537 (1949).

40. 15 U.S.C. § 717 (1982). Section 1(b) of the Act sets out its scope:

> The provisions of this [Act] shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for 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.

Id. § 717(b). The Act defines a natural gas company as one "engaged in the transportation of natural gas in interstate commerce" or one selling gas in interstate commerce for resale. *Id.* § 717a(6).

The purpose of the NGA was to stake the federal claim in the whole area of natural gas regula-

In response to the Court's ruling and in response to a belief that consumers needed protection against pricing policies of the natural gas companies, Congress set forth a comprehensive scheme to control natural gas prices. Section 1(a) of the NGA reveals Congress' intent:

> [I]t is declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.[41]

The Act sought to exercise the federal government's regulatory monopoly over the interstate gas market in order to close up the perceived regulatory gap.[42] By stepping in, Congress could attempt to correct the perceived harm done to the distribution network as well as to the end user, the consumer.[43]

To implement the policies of the NGA, Congress established the Federal Power Commission. Congress vested that Commission with exclusive jurisdiction over the transport and sale of natural gas in interstate commerce.[44] According to the Commission's initial interpretation of the Act's coverage, its authority extended to end-of-line sales but not to first sales to interstate pipeline carriers.[45] However, in 1954, the Court extended coverage of the NGA to local first sales, although still excluding production and gathering.[46]

In upholding the exclusivity of the Commission's jurisdiction, the

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tion in interstate commerce. *See infra* note 45; *see* Exxon Corp. v. Eagerton, 462 U.S. 176, 184 (1983) (cited in *Transco,* 106 S. Ct. at 720 (Rehnquist, J. dissenting)).

Finally, under the NGA, states were left with the authority to regulate the production and gathering of natural gas, activities of local distribution companies, and intrastate sales and transportation. 15 U.S.C. § 717(c) (1982).

41. 15 U.S.C. § 717(a) (1982); *see supra* note 43 for the scope of the Act.

42. H.R. Rep. No. 709, 75th Cong., 1st Sess. 1-2 (1937). "The basic purpose of the present legislation is to occupy this field [sales in interstate commerce not considered local yet not subject to state regulation] in which the Supreme Court has held that the States may not act." *Id.*; *see also* S. Rep. No. 1162, 75th Cong., 1st Sess. 1-2 (1937).

43. A report of the Federal Trade Commission influenced Congress' decision to regulate. Pierce, *supra* note 6, at 65. Section 1(a) of the Act refers explicitly to reports of the Federal Trade Commission. 15 U.S.C. § 717(a) (1982).

44. *Northern Natural,* 372 U.S. at 89. Sections 4(b) and 5(a) of the NGA sets out the Commission's duties. 15 U.S.C. § 717c(b), d(a) (1982). In order to ensure an adequate supply of natural gas nationwide at just and reasonable prices, the Commission was to prevent gas companies from granting anyone an undue preference or treating anyone with undue prejudice and to prevent unreasonably disparate prices between different localities or classes of service. 15 U.S.C. § 717c(b) (1982). The Act granted the Commission authority to adjust rates based on these factors in cases subject to its rate-making authority and to investigate and determine costs of production and transportation in cases not subject to its rate-making authority. 15 U.S.C. § 717d(a) & (b) (1982).

45. *Transco,* 106 S. Ct. at 721 (Rehnquist, J., dissenting).

46. *Id.* (citing Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672, 677-78 (1954)).

Court held in *Northern Natural* that the NGA preempted state ratable-take regulations as applied to interstate pipeline carriers. The rationale behind that decision was that these regulations indirectly affected price and thus intruded upon the exclusive domain of the NGA.[47]

In the years between *Northern Natural* and 1978, however, the conditions in the natural gas distribution industry deteriorated. The detailed federal regulatory scheme, which was supposed to ensure an adequate supply of gas at a low price, had in reality contributed to interstate gas shortages.[48] The immediate cause was the artificial price ceiling imposed on the industry by the NGA. In response to the critical shortage of natural gas, Congress passed the Emergency Natural Gas Act of 1977 (ENGA).[49] Under the ENGA, the President could declare an emergency and force the distribution of natural gas exempting the distributor from the NGA's coverage. President Carter, after imposing a two-month state of emergency,[50] urged Congress to enact comprehensive legislation to deal with the nation's energy needs.[51] After considerable debate, Congress chose to pursue a policy different from that embodied in the NGA. That policy entailed gradual deregulation of the industry through gradual removal of price restrictions and ceilings as well as elimination of the distinction between interstate and intrastate markets. To that end Congress enacted the Natural Gas Policy Act of 1978.[52]

The NGPA incorporated into the NGA the scheme of gradual deregulation. The statute divides natural gas into three main categories.[53] The first of those categories, the one relevant in *Transco*, is high-cost natural gas.[54] The other two categories are new gas,[55] and old gas.[56]

47. *Northern Natural*, 372 U.S. at 92.

48. *See* Pierce, *supra* note 6, at 69.

49. Emergency Natural Gas Act, Pub. L. No. 95-2, 91 Stat. 4-10 (1977).

50. *See* Proclamation No. 4485, 42 Fed. Reg. 6789 (1977).

51. 123 CONG. REC. 11482 (1977).

52. Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3351 (1978) (codified at 15 U.S.C. §§ 3301-3432 (1982 & West Supp. 1986)).

53. *See infra* notes 54-57. *See* Pierce, *supra* note 6, at 87-89.

54. NGPA § 107, 15 U.S.C. § 3317 (1982).

55. NGPA §§ 102, 103, 15 U.S.C. §§ 3312, 3313 (1982). "New natural gas" includes that produced from a new lease on the Outer Continental Shelf, gas from a new well more than 2.5 miles from the nearest marker well or gas from such a well one thousand feet below the deepest level of each marker well within 2.5 miles, gas from onshore wells produced in commercial quantities after, but not before April 20, 1977, unless that gas could have been produced in commercial quantities, was the offshoot of an old well, or was withheld. 15 U.S.C. § 3312 (1982). Section 103 of the Act sets out the pricing policy for new gas. 15 U.S.C. § 3313 (1982).

56. 15 U.S.C. §§ 3314-16, 3318-19 (1982). The category denominated "old natural gas" includes numerous subcategories. Section 104 of the Act sets ceiling prices for natural gas dedicated to interstate commerce, i.e. that gas under contract for distribution before November 8, 1978. 15 U.S.C. § 3314 (1982). Section 105 of the Act prescribes the maximum price for gas sold under an

High-cost gas includes gas produced from wells below 15,000 feet deep on which drilling began on or after February 19, 1977 (as in this case) from geopressured brine, from coal seams, and from Devonian shale.[57] The FERC implemented deregulation of high-cost natural gas in 1979.

Many states took the passage of the NGPA as a green light to expand the scope of their own ratable-take regulations,[58] or to revive old rules already on the books.[59] Mississippi had merely suspended enforcement of its ratable-take rule before 1978.[60] The Supreme Court of Mississippi stated: "[p]rior to 1978 this state's authority to enforce Rule 48 requiring ratable taking had been effectively suspended—preempted, if you will, and any orders [to take ratably] . . . would have been wholly unenforceable."[61] That court's decision that the NGPA altered the preemption of state authority led directly to the Supreme Court's current reaffirmation of the preemption doctrine.

IV. Decision of the Case

A. *Majority Opinion*

The *Transco* case, which squarely held that the NGA (as amended by the NGPA) preempts state authority to regulate ratable-taking,[62] will have strong precedential value in the years to come. The decision itself, however, commanded only a 5-4 majority.[63] Justice Blackmun delivered the Court's opinion in which Justices Burger, Brennan, White, and Marshall joined.[64] Justice Rehnquist wrote a vigorous dissenting opinion in which Justices Powell, Stevens, and O'Connor joined.[65] Despite the lack

existing contract but not dedicated or committed for shipment into interstate commerce before November 8, 1978. 15 U.S.C. § 3315 (1982). Section 106 of the Act sets forth ceiling prices both for interstate and for intrastate rollover contracts. 15 U.S.C. § 3316 (1982). Section 108 of the Act applies to the first sale of gas from stripper wells. Stripper well natural gas is that which is "nonassociated," i.e., not produced in conjunction with crude oil. 15 U.S.C. § 3318 (1982). Section 109 of the Act serves as the catch-all provision. 15 U.S.C. § 3319 (1982).

57. 15 U.S.C. § 3317(c) (1982). The statute also authorizes the Commission to classify gas, the production of which involves "extraordinary risks or costs," as high-cost natural gas. 15 U.S.C. § 3317(c)(2) (1982).

58. *See infra* notes 125-27 and accompanying text.

59. The Mississippi ratable-take rule, was promulgated by that state's Oil and Gas Board on Nov. 19, 1951.

60. *Transco*, 457 So. 2d at 1314.

61. *Id.*

62. *Transco*, 106 S. Ct. at 718.

63. *Id.* at 711.

64. *Id.*

65. *Id.*

of a strong majority, the decision rests soundly upon *Northern Natural*; thus, overcoming this strong precedent would be difficult.

According to the Court, resolution of the case depended upon whether, in revising the NGA to provide for market determination of supply, demand, and thus price of natural gas, Congress intended to give to the states the very same regulatory power which it had taken away from the FERC.[66] The Court, holding that Congress had no such intention, stated concisely the rationale for its conclusion. To begin with, in other parts of the NGA, Congress provided explicit regulatory power for the states.[67] However, the statute which took away the FERC's power to regulate high-cost natural gas[68] on its first sale[69] contained no comparable grant of authority to the states. Moreover, Congress' denial of jurisdiction to the FERC over the intricate structure of wellhead pricing of high-cost natural gas does not necessarily evince an intent to abandon that area but rather evinces an intent to implement a different policy, namely a gradual return of free-market dynamics.[70]

Despite this relatively straightforward and concise analysis, the Court found necessary a multi-tiered approach in which the balance of the majority's opinion examines *Transco's* issues only through the looking-glass of *Northern Natural*. The first step in the Court's analysis was to examine the applicability of *Northern Natural*.[71] If *Northern Natural* applied, the Court concluded that preemption would be clear.[72] In turn, deciding whether this prior case controlled hinged upon the altered characteristics of the federal regulatory scheme as embodied in the NGA (as amended by the NGPA).[73] Those principles provided the basis for the decision in *Northern Natural*.[74]

In *Northern Natural*, the Court considered the analogous issue of whether Kansas could issue a ratable-take order in light of the comprehensive regulatory scheme embodied in the NGA.[75] Similar to Transco's

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66. *Id.* at 717.
67. *Id.* The Court cites two exemplary provisions. *See* 15 U.S.C. §§ 3413(c), 3432(a) (1982).
68. *See* 15 U.S.C. § 3317(c)(1) (1982).
69. *See* 15 U.S.C. § 3431(a)(1)(B)(i)-(ii) (1982).
70. *Transco*, 106 S. Ct. at 717.
71. *Id.* at 714.
72. *Id.*
73. *Id.*
74. *Id.*
75. Northern Natural Gas Co. v. State Corp. Comm'n, 372 U.S. 84, 91 (1963). The reader should keep in mind that this case was decided wholly under the NGA, before Congress decided on deregulation. The policy of deregulation did not manifest itself until 1978, fifteen years after *Northern Natural*. *See Transco*, 106 S. Ct. at 716.

arrangements, Northern Natural Gas Company entered a contract with Republic Natural Gas Company to buy all the gas Republic produced from its Hugoton field.[76] Additionally, Northern entered contracts with other producers. These contracts obligated Northern to buy gas only if Republic could not produce the amount Northern required.[77] Up to 1958, Northern took ratably from all producers.[78] But beginning in 1958, Northern's demand for gas slackened; thus, production slackened which caused drainage toward Republic's wells.[79] As a result, the Kansas Corporation Commission ordered Northern to take ratably.[80]

B. *Arguments Advanced in* Northern Natural

1. The Production—Gathering Distinction

Section 1(b) of the NGA states that the Act does not apply to the production nor to the gathering of natural gas.[81] Kansas attempted to argue that this distinction removed the NGA's regulatory restrictions from its order.[82] Kansas further argued that the sole purpose of its order was to protect correlative rights of other producers.[83] The *Northern Natural* Court rejected this argument. According to that Court, the terms "production" and "gathering" meant narrowly the act of drawing gas from the earth and preparing it for distribution.[84] Because the Kansas order applied to a purchaser, not a producer, the order came under the coverage of the Act.[85] Thus, the production-gathering argument had no merit.

2. Ratable-take Rules as Conflicting with Federal Policy

The linchpin of rejecting the production-gathering argument entailed the comprehensiveness of the federal regulatory scheme. That comprehensiveness reached "all wholesales of natural gas in interstate

76. *Transco,* 106 S. Ct. at 714.
77. *Id.*
78. *Id.*
79. *Id.* at 715.
80. *Id.* The Kansas Corporation Commission had previously issued an order requiring producers operating in the Hugoton field to produce ratably. *Id.*
81. 15 U.S.C. § 717(b) (1982).
82. *Id.*
83. *Transco,* 106 S. Ct. at 715.
84. *Id.*
85. *Id.* Of course, a state may adopt reasonable regulations aimed at preventing waste of the natural resource—both physical and economic waste. Cities Serv. Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179, 185 (1950). However, ratable-taking regulations represent an impermissible intrusion into federal interstate concerns. *Transco,* 106 S. Ct. at 715.

commerce."[86] The uniformity of the regulatory scheme involved several key factors: (1) because a ratable-take order aims directly at purchasers who transact in interstate commerce, the order interferes with federal regulation;[87] (2) this interference would result in the purchasers having to calculate and balance "the output of thousands of natural gas wells within the [s]tate...";[88] and (3) readjustments in purchasing patterns could do damage to federal regulatory activities which seek to oversee the intricate cost relationship between first purchase and wholesale distribution.[89] As the result of this reasoning, ratable-take orders become impermissible because they alter a purchaser's otherwise unburdened decision-making process, which alteration could ultimately lead to higher prices for consumers.[90] This result would conflict directly with the overall federal policy of ensuring low prices for consumer use.[91]

C. *Relevant Changes in the Natural Gas Act*

The analysis in *Northern Natural,* although altered in superficial ways by amendments contained in the NGPA of 1978, remains sound. Most of the policies underlying the NGPA are the same as those underlying the NGA at the time of the decision of *Northern Natural.*[92] The most significant change comes in the form of the method by which Congress intended its policies to carry forth.[93] The new method—denominated as deregulation—emphasizes the marketplace. Instead of having FERC set prices and control supply and demand, the NGPA envisions gradual introduction of market dynamics as the factor influencing price.[94] Most importantly, instead of abandoning the area, Congress chose to pursue a policy of deregulation—an affirmative decision not to regulate.

D. *Application to* Transco *Facts*

With *Northern Natural* firmly placed in its proper perspective, the Court had a relatively easy task finding the ratable-take order imposed

86. *Transco,* 106 S. Ct. at 715 (quoting Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672, 682 (1954)).
87. *Northern Natural,* 372 U.S. at 91-92.
88. *Id.* at 92.
89. *Id.*
90. *Id.*; *see Transco,* 106 S. Ct. at 716.
91. *Northern Natural,* 372 U.S. at 92.
92. *Transco,* 106 S. Ct. at 716.
93. *Id.*
94. *Id.*

on Transco to be invalid on preemption grounds. Nothing in the NGPA, according to the Court, manifested congressional intent to abdicate its powers over the regulation of natural gas in interstate commerce.[95] To the contrary, Congress simply chose to leave the cost of high-cost natural gas unregulated. The FERC's jurisdiction, although curtailed, still encompassed two aspects of high-cost natural gas.[96] First of all, FERC may still regulate sales after the first sale.[97] Secondly, FERC has authority to examine pass-through[98] costs to find any excesses that result from fraud, abuse, or other similar causes.[99] Yet, despite this diminishment in FERC's authority, Congress made no mention of giving states that authority. That omission was purposeful. High-cost natural gas comprised one area subject to early deregulation[100] for the purpose of implementing the new market-oriented policy.

Simply because FERC could no longer control the price of the gas, did not mean that Mississippi could reach out to control that price itself.[101] The broad scheme of deregulation aimed at allowing market pricing prevailed throughout the NGPA. Thus, Mississippi's regulating ratable-taking tended to violate this spirit.[102] Specifically, the ratable-take order would disrupt the uniformity of the federal regulatory scheme.[103] The varied regulations of different states would force the interstate pipeline operator such as Transco into a quandry of balancing the requirements of those varied regulations.[104] Moreover, the state ratable-take rules would probably increase the ultimate price of the natural gas. Because most interstate pipeline carriers have entered into take-or-pay contracts which commit them to buy gas in excess of demand, that

95. *Id.*; *see Transco*, 106 S. Ct. at 717 (citing Northern Natural Gas Co. v. State Corp. Comm'n, 372 U.S. 84, 91 (1963)).

96. *See generally* Williams, *Federal Preemption of State Conservation Laws after the Natural Gas Policy Act: A Preliminary Look*, 56 U. COLO. L. REV. 521, 528-29 (1985). Professor Williams suggests four ways in which the federal regulatory policy impinges directly upon wellhead sales. The first way involves the price ceilings imposed. The second way involves FERC's "non-price" jurisdiction over various wellhead sales. The third way entails FERC's power to scrutinize pass-through costs. And, the fourth way relates to FERC's monitoring and regulation of the transportation of gas in interstate commerce. *Id.*

97. The very language of the classification provisions in the NGPA demonstrates that the NGA's pricing regulatory scheme still applies to sales after the first sale. *See, e.g.*, 15 U.S.C. § 3317(a) (1982).

98. "Pass-through" costs are simply those which the purchaser/transporter of gas passes along the chain of distribution to the consumer. Unless challenged, this pass-through is automatic.

99. 15 U.S.C. § 3431(c)(2) (1982); *see also*, supra, note 98.

100. *See* 15 U.S.C. § 3331(b) (1982).

101. *Transco*, 106 S. Ct. at 717.

102. *Id.*

103. *Id.* at 717.

104. *Id.*

pipeline would be forced to buy additional gas from non-contract owners.[105] As a result, the pipeline will not take gas from elsewhere, triggering those take-or-pay provisions obligating the pipeline, Transco, to buy the gas with right of later delivery.[106] This cascading effect also would result in artificially increased prices. Furthermore, the increases in price caused by the ratable-take orders could cause FERC to make unnecessary and costly investigations to see whether those automatic pass-through increases stemmed from fraud, abuse, or like grounds.[107] If FERC were to find abuse, its ruling—disallowing the pass-through—would be in direct conflict with Mississippi's order against Transco.[108] Thus, the Mississippi ratable-take rule fell under the preeminent federal regulatory scheme.

E. *Dissenting Opinion*

In attacking the majority's decision, Justices Rehnquist, Powell, Stevens, and O'Connor found that Mississippi's ratable-take rule did not invade the exclusive sphere of the Natural Gas Policy Act; did not conflict with Congress' desire, as manifested in the Natural Gas Policy Act, of letting the market control prices of high-cost natural gas at the wellhead; and did not contravene free-market policies implicit in the commerce clause.[109] Aside from the dissenters' view that the Mississippi rule is valid, the dissenters also believe that the majority, sympathetic to Transco's plight, frees it from bad deals by a misuse of the preemption doctrine.[110]

Analytically, the dissenters view the majority's reliance upon the reasoning of *Northern Natural* as misplaced.[111] Because the NGPA removed high-cost natural gas from regulatory pricing, the rule and ration-

105. *Id.*

106. *Id.*

107. *Id.* That very investigation occurred in *Transco* and posed a potential problem. FERC challenged some of Transco's cost pass-throughs on the ground of abuse. On Oct. 31, 1985, an administrative law judge ruled that Transco's purchases of gas from the Harper Sand gas pool pursuant to Mississippi's Rule 48 were prudent. FERC had requested that Transco use a least-cost purchasing strategy which would ignore Rule 48. The ALJ refused that argument, reasoning that Transco was bound to follow the Mississippi rule until the United States Supreme Court ruled otherwise. *Id.* at 717-18 n.5.

108. *Id.* at 718.

109. *Transco,* 106 S. Ct. at 718 (Rehnquist, J., dissenting).

110. *Id.*

111. *Id.* at 720. Curiously, the dissent states that the majority reverses the decision of the Mississippi Supreme Court on both preemption and commerce clause grounds. *Id.* Yet, the majority states expressly that it did not need to nor would it reach the question of whether the Mississippi ratable-take rule ran afoul of the commerce clause. *Id.* at 718.

ale of *Northern Natural* no longer apply;[112] therefore, Mississippi's ratable-take rule and others like it are consistent with the NGPA.[113] In concluding that *Northern Natural* does not govern resolution of the case, the dissent identified the real issue as whether Mississippi's ratable-take rule unduly intrudes upon or frustrates the purposes underlying the NGA as amended by the NGPA.[114]

Resolving the issue of impermissible intrusion involves the examination of two sides of the state ratable-take rule: its domestic purpose and the degree of its effect upon interstate commerce.[115] Ratable-take rules such as Mississippi's can serve two domestic policy goals. One policy emphasizes the need for conservation of a state's natural resources.[116] The other policy encourages fair dealing among those who extract and produce the natural resources.[117] According to this rationale, one should not be allowed to drain the gas that belongs to others and thereby make the removal of that gas considerably more costly or perhaps impossible. In the opinion of Justice Rehnquist, the ratable-take rule creates the incentive for joint owners to work together as a single owner.[118] In addition, as a rule which merely regulates the contractual relations between two parties, its effect on interstate commerce would be negligible.[119]

112. *Id.* at 720.

113. *Id.* According to the dissent, that consistency stems from Congress' purpose in enacting the NGPA, namely, the purpose of decontrolling the price of high-cost natural gas at the wellhead sold to interstate pipelines. *Id.* at 720-22. The dissent also expresses some doubt that the NGPA ever controlled the wellhead price of high-cost natural gas. *Id.* at 722.

Regardless, the controls on wellhead prices of high-cost gas no longer exist. Indeed, FERC's regulatory jurisdiction is concomitantly more restricted. *Id.* FERC retains merely the authority to probe for fraud, abuse, or otherwise illegitimate grounds in a distributor's raising of its prices. *Id.* at n.4; *see* 15 U.S.C. § 3431(c)(2) (1982).

114. *Transco,* 106 S. Ct. at 722. According to the dissent, a state rule which regulates or establishes property rights or contractual rights does not interfere with the purpose of decontrolling wellhead prices. Id.

115. Measuring that degree means comparing the effect of the rule and the degree to which that effect diverges from Congress' plans.

116. States possess the power to take the necessary measures to protect the scarce natural resources found within the jurisdiction of the state. *See Northern Natural,* 372 U.S. at 93. In *Northern Natural,* the Court asserted that it considers the states' power to preserve natural resources important especially in regard to natural gas. *Id.* Despite this language, the Court deemed that problem not significant in *Northern Natural. Id.* at 93-94.

117. *Transco,* 106 S. Ct. at 722-23 (Rehnquist, J., dissenting).

118. *Id.* at 723.

119. *Id.* Rehnquist makes an assumption that the rule will have no significant effect on interstate commerce. However, an interstate pipeline carrier which is forced to buy gas ratably will eventually pay more than it otherwise would pay for gas because of the various take-or-pay provisions in the long-term contracts it has entered. Also, because it will have to buy more than needed, it may well have to pass along the extra cost to end-use consumers. Under the market-theory now pervasive in the Natural Gas Act, this result seems entirely consistent with the purposes Congress had in mind. A closer examination suggests that this result would not be consistent. Congress

Furthermore, whereas Congress intended to decontrol wellhead prices and implicitly intended to prevent states from regulating those prices, it did not intend to prevent states from exercising their authority to govern property and contract rights.[120]

Rather than as a factor distorting free-market prices, Justice Rehnquist views the ratable-take rule as a factor fostering the smooth operation of the market.[121] Because the rule requires ratable-taking only from one common gas pool and not from all pools within a particular state, its interstate effect is attenuated.[122]

V. IMPACT ON OKLAHOMA

Oklahoma, like many other states, has regulated the production, sale, and distribution of natural gas within the state for many years. State statutes range from those designed to prevent waste to those designed to impose ratable taking on purchasers of natural gas.[123] Four statutes, and rules promulgated under those statutes, govern ratable-taking and ratable purchasing.[124] And, although these statutes are broad, they do not prescribe rate-making authority.[125] Early on, the Oklahoma Corporation Commission (OCC) attempted to regulate wellhead prices,

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deregulated the well-head price so that natural forces in the market-place would set prices. Congress continued the long-standing policy goal of assuring adequate supplies of natural gas at just and reasonable prices. Arguably, a state's interference is not the kind of free-market idea Congress envisioned. Moreover, a price artificially raised by the hand of state regulation arguably is not a reasonable price.

However simple the resolution of the issue may seem, it is in reality quite complicated. As Rehnquist himself points out, the legislative history of the NGPA is nearly devoid of any discussion in terms of supply and demand. *Id.* at 722 n.5. But, the very nature of the changes in the NGA point strongly toward the free hand of market theory economics.

120. *Id.* at 723 n.6.

121. *Id.* at 723. Justice Rehnquist distinguishes taxes and subsidies as having a distorting effect. *Id.*

122. *Id.* Rehnquist concedes that a rule requiring ratable-taking from all pools within a state would burden interstate commerce and interfere with the purposes of the NGPA. *Id.*

In essence, the dissenters appear to disagree not so much with the majority's analytical approach but rather with the majority's finding (implicit in the *Northern Natural* analysis) that Mississippi's Rule 48 has a substantial impact in interstate commerce and thus frustrates Congress' intent.

123. *See generally* Allison, *The Prorationing of Natural Gas in Oklahoma*, 57 U. COLO. L. REV. 169 (1986). These statutes give the Oklahoma Corporation Commission powerful and far-reaching tools. *Id.* at 169. Professor Allison divides the Commission's authority into four areas: 1) production limits designed to prevent waste; 2) rules for well spacing and forced pooling on separate tracts that overlie a common source for the purpose of discouraging "unnecessary wells, [preserving] reservoir pressure, and equitably [dividing] the economic benefits of exploiting the common source"; 3) forced unitization requirements; and, 4) restraints on producers, purchasers, and sellers to insure that each may receive a proportionate share of the benefits of the production. *Id.*

124. OKLA. STAT. tit. 52 §§ 23, 233, 239, 240 (1981).

125. *But see* OKLA. STAT. tit. 52, §§ 260.1 to -.13 (West Supp. 1984-85) (Oklahoma Natural Gas Price Protection Act), which provided limited maximum prices for intrastate gas.

but abandoned that effort after a series of federal court cases decided that the OCC's actions were invalid under the NGA.[126] Clearly then, neither direct nor indirect price controls would be permissible under the NGA. But, after the passage of the NGPA, the question remained whether the ratable taking provisions themselves were valid.[127] In regard to similar Mississippi rules and in regard to ratable-take rules in general, Transco answered that question by holding ratable take rules invalid.

Shortly thereafter, in *ANR Pipeline Co. v. Corporation Comm'n*,[128] a federal district court sitting in Oklahoma held the state's ratable take provision, denominated as a ratable purchase statute, section 240, to be unconstitutional as applied to interstate pipeline companies on grounds of preemption.[129] Plaintiff's in *ANR* sought a declaratory judgment that section 240 and Rule 1-305 promulgated thereunder were invalid because the federal regulatory scheme preempted the area. Additionally, the plaintiffs sought and obtained an injunction against the OCC.

In construing the validity of section 240,[130] the court examined Oklahoma's statute in light of *Northern Natural* and *Transco*. The key to the invalidation of the ratable take provisions stemmed from a compari-

126. *See* Natural Gas Pipeline Company v. Panoma, 349 U.S. 44 (1955); Federal Power Comm'n v. Corporation Comm'n, 362 F. Supp. 522 (W.D. Okla. 1973), *aff'd sub nom.* Corporation Comm'n v. Federal Power Comm'n, 415 U.S. 961 (1974). *See generally* Allison, *supra* note 123, at 190, n.116.

127. In regard to that question, the OCC in 1984 opined that the commerce clause of the United States Constitution did not preclude Oklahoma from enforcing the ratable-taking requirements of section 240 as applied to interstate pipelines and that the FERC's jurisdiction under the NGA as modified by the NGPA did not preempt Oklahoma from enforcing sections 230 and 240. In Re: Whether the Oklahoma Corporation Commission Has the Authority to Require Ratable Take of Natural Gas by First Purchasers Who Are Interstate Pipelines, Order No. 281, 285 (July 3, 1985)(*discussed in* Allison, *supra* note 123, at 194-97).

128. 643 F. Supp. 419 (W.D. Okla. 1986) (memorandum opinion).

129. *Id.* at 424.

130. OKLA. STAT. tit. 52, § 240 provides:

> Every person, firm, or corporation, now or hereafter engaged in the business of purchasing and selling natural gas in this state, shall be a common purchaser thereof, and shall purchase all of the natural gas which may be offered for sale, and which may reasonably be reached by its trunk lines, or gathering lines without discrimination in favor of one producer as against another, or in favor of any one source of supply as against another save as authorized by the Corportion Commission after due notice and hearing; but if any such person, firm or corporation, shall be unable to purchase all the gas so offered, then it shall purchase natural gas from each producer ratably. It shall be unlawful for any such common purchaser to discriminate between like grades and pressures of natural gas, or in favor of its own production, or of production in which it may be directly or indirectly interested, either in whole or in part, but for the purpose of prorating the natural gas to be marketed, such production shall be treated in like manner as that of any other producer or ratable proportion that such production bears to the total production available for marketing. The Corporation Commission shall have authority to make regulations for the delivery, metering and equitable purchasing and taking of all such gas and shall have authority to relieve any such common purchaser, after due notice and hearing, from the duty of purchasing gas of an inferior quality or grade.

son of the Oklahoma statute to the Mississippi rule held invalid in *Transco* and the Kansas statute held invalid in *Northern Natural.* The court concluded concisely that each provision was intended to regulate the taking of natural gas and that each had that effect.[131] The court followed the pattern of analysis laid down in *Transco,* that of applying the concerns articulated in *Northern Natural* in light of changes in the federal regulatory structure effected in the NGPA.[132] Most importantly, the court stated that, although the statute might seek to protect correlative rights and prevent waste, that statute " 'directly undermines Congress' determination that the supply, the demand, and the price of high-cost gas be determined by market forces.' "[133] Thus, under the aegis of *Transco,* one of Oklahoma's ratable-take provision fell in its entirety.

Whether *ANR* has properly defined the limits of *Transco* remains to be seen. Under the rather mechanical application of *Transco,* most of Oklahoma's laws relating to the conservation of natural gas would seem to be invalid as applied to interstate pipelines. However, the Court in *Transco* surely could not have meant such a harsh result. Under such a broad interpretation, any regulation of production or gathering could effect the ultimate price of the gas in contravention of the federal scheme of deregulation. Properly viewed, *Transco* merely invalidated provisions which directly affected the interstate purchaser. Presumably, any Oklahoma rule designed to prevent waste and targeted not at purchasers but at producers would be valid.[134]

VI. CONCLUSION

Transco is an important case in the sense that it reaffirms the federal government's preemption of natural gas regulation. However, the case suffers from two major deficiencies. First, the majority opinion is not of such clarity and lucidity as to survive in the years to come. Part of its probable demise stems from the second problem, namely, the recent ap-

131. ANR, 643 F. Supp. at 422-23.

132. *Id.* at 423.

133. *Id.* (quoting *Transco,* 106 S. Ct. at 716-17. The OCC contended that its enforcement of sections 239 and 240 in regard to production only incidentally touched upon the first sales to interstate pipeline carriers. *Id.* at 423. The OCC also asserted that its enforcement activities do not interfere with those of the FERC, because the FERC has no jurisdiction over production and gathering. Accordingly, because the FERC may only regulate the first sale by setting maximum price settings, the OCC's control over production would not interfere with federal law. *Id.*

134. *See, e.g.,* OKLA. STAT. tit. 52, § 239 (1981) (ratable production). *ANR* held only that section 240 is invalid. *ANR,* 643 F. Supp. at 424.

pointment of a new justice to the Court whose appointment could bring the dissenters in *Transco* into the majority position.

For the present, the import is clear. Any attempt by a state to enter the domain of federal regulation or deregulation will receive a hostile reception in the Supreme Court. Moreover, proving that a state regulation is sufficiently narrow to prevent intrusion upon federal legislative jurisdiction will be difficult.

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