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State Regulation Over the Construction and Operation of Intrastate Pipelines and Gathering Systems in Oklahoma

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STATE REGULATION OVER THE CONSTRUCTION AND OPERATION OF INTRASTATE PIPELINES AND GATHERING SYSTEMS IN OKLAHOMA*

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I. INTRODUCTION

Prior to 1986, most producers of natural gas sold their product to intrastate or interstate pipeline companies at or near the wellhead. Once the proper price was determined under the applicable statutes or orders of the Federal Energy Regulatory Commission (FERC) or its predecessor, the Federal Power Commission,¹ the producers simply delivered the natural gas to the local pipeline company on a monthly basis, and their primary concern was to insure that they received the proper payment for the volumes sold. Such transactions were relatively simple, and most producers saw little need to attempt to understand the business of intrastate and interstate pipelines or the regulations applicable to the sale and transportation of natural gas in intrastate or interstate commerce.

However, during the past decade, the wellhead price for natural gas has been deregulated.² Deregulation has resulted in open market type negotiations over the price of natural gas. In addition, as a result of a series of FERC orders beginning in 1985,³ most pipelines, particularly

1. Department of Energy Organization Act, § 7101, 42 U.S.C. § 7171(a) (1988). On October 1, 1977, the FERC assumed regulatory responsibilities previously held by the Federal Power Commission.

2. Natural Gas Wellhead Decontrol Act of 1989, § 3301, 15 U.S.C. § 3331 (Supp. I 1989).

3. Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 50 Fed. Reg. 42,408 (Oct. 18, 1985), F.E.R.C. Stats. & Regs., Regulations Preambles 1982-1985 ¶ 30,665 (1985) (codified as amended in scattered sections of 18 C.F.R. pts. 2, 157, 282, 375 and 381) (final rule and statement of policy), *reh'g granted in part and denied in part*, Order No. 436-A, 50 Fed. Reg. 52,217 (1985), F.E.R.C. Stats. & Regs., Regulations Preambles 1982-1985 ¶ 30,675, *reh'g granted in part*, Order No. 436-B, 51 Fed. Reg. 6,398 (1986), F.E.R.C. Stats. & Regs. ¶ 30,688, *reh'g denied*, Order No. 436-C, 51 Fed. Reg. 11,566 (1986), 34 F.E.R.C. ¶ 61,404, *reh'g denied*, Order No. 436-D, 51 Fed. Reg. 11,569 (1986), 34 F.E.R.C. ¶ 61,405, *reconsid. denied*, Order No. 436-E, 51 Fed. Reg. 11,566 (1986), 34 F.E.R.C. ¶ 61,403, *vacated and remanded for further proceedings*, *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied sub nom.* *Interstate Natural Gas Ass'n v. FERC*, 485 U.S. 1006 (1988), *readopted on an interim basis on remand*, Order No. 500, 52 Fed. Reg. 30,334 (Aug. 14, 1987), F.E.R.C. Stats. & Regs., Regulations Preambles ¶ 30,761, *extension granted*, Order No. 500-A, 52 Fed. Reg. 39,507 (Oct. 22, 1987), F.E.R.C. Stats. & Regs., Regulations Preambles ¶ 30,770, *modified*, Order No. 500-B, 52 Fed. Reg. 39,630 (Oct. 23, 1987), F.E.R.C. Stats. & Regs., Regulations Preambles ¶ 30,772, *modified further*, Order No. 500-C, 52 Fed. Reg. 48,986 (Dec. 29, 1987), F.E.R.C. Stats. & Regs., Regulations & Preambles ¶ 30,786, *modified further*, Order No. 500-D, 53 Fed. Reg. 8,439 (Mar.15, 1988), F.E.R.C. Stats. & Regs., Regulations Preambles ¶ 30,800, *reh'g denied*, Order No. 500-E, 53 Fed. Reg. 16,859 (May 12, 1988), 43 F.E.R.C. ¶ 61,234, *modified further*, Order No. 500-F, 53 Fed. Reg. 50,924 (Dec. 19, 1988), F.E.R.C. Stats. & Regs., Regulations Preambles ¶ 30,841, *reh'g denied*, Order No. 500-G, 54 Fed. Reg. 7,400 (Feb. 21, 1989), 46 F.E.R.C. ¶ 61,148, *vacated and remanded*, *American Gas Ass'n v. FERC*, 888 F.2d 136 (D.C. Cir. 1989), *readopted*, Order No. 500-H, 54 Fed. Reg. 52,344 (Dec. 21, 1989), F.E.R.C. Stats. & Regs., Regulations Preambles ¶ 30,867 (Final Rule), *reh'g granted in part and denied in part*, Order No. 500-I, 55 Fed. Reg. 6,605 (Feb. 26, 1990), F.E.R.C. Stats. & Regs., Regulations Preambles ¶ 30,880, *aff'd in part and rev'd in part sub nom.* *American Gas Ass'n v. FERC*, 912 F.2d 1496 (D.C. Cir. 1990), *cert. denied sub nom.* *Willcox v. FERC*, 111 S. Ct. 957 (1991); codified at 18 C.F.R. § 284.8(b); Order No. 636, Docket Nos. RM91-11-000 and RM87-34-

interstate pipelines, are becoming primarily transporters of natural gas instead of purchasers at the wellhead. The gas itself is now being sold and traded separately as a commodity. The change in the role of the pipeline companies from merchants to mere transporters has caused the emergence of hundreds of gas marketers who assist in buying and selling the product and making transportation arrangements.⁴

Furthermore, since the enactment of the Natural Gas Policy Act of 1978 (NGPA),⁵ intrastate pipeline companies have been permitted to transport gas that will flow in interstate commerce without becoming subject to the burdensome federal rules and regulations applicable to interstate pipelines. In reliance on the NGPA, intrastate pipeline companies have begun transporting substantial volumes of gas on behalf of interstate pipeline companies, resulting in an interconnected, national network of pipelines.

This development creates an important role for gathering systems in aggregating gas from various wells at low pressures and then delivering the gas to larger, higher pressure pipelines. "Gathering" gas involves collecting it from various wells before it is delivered into a larger, main pipeline.⁶ Although the distinction between gathering and transporting gas may appear to be relatively simple, for purposes of federal regulation the FERC and the courts have had to apply various tests in their attempt to differentiate between a gathering facility, which has traditionally been exempt from FERC regulation, and an interstate transportation facility, which is subject to FERC regulation.⁷ Although it is not the purpose of this article to address the distinction between gathering and transporting, it is important to recognize that there is a difference. Given these dramatic changes, it is now important for all members of the natural gas industry to more fully understand the existing rules, statutes, and regulations applicable to both interstate and intrastate natural gas pipelines.⁸

065 (April 8, 1992); Order No. 636-A, 57 Fed. Reg. 36,128 (Aug. 12, 1992); Order No. 636-B, Docket No. RM91-11-004 (Nov. 27, 1992).

4. See FERC Order No. 636 *supra* note 3; Robert E. Willett, *Business Strategy: Mini-Boom in Software for Marketers*, 5 NATURAL GAS 17 (June 1989) (states that gas marketers had grown from about 20 to about 250 between 1986 and 1989).

5. 15 U.S.C. §§ 3301-3432 (1988) (amended 1989).

6. See *In re Phillips Petroleum Co.*, 10 F.P.C. 246, 277 (1951), *rev'd on other grounds*, Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954).

7. See *id.*; Barnes Transp. Co., 18 F.P.C. 369 (1957); Ben Bolt Gathering Co., 26 F.P.C. 825 (1961), *aff'd*, 323 F.2d 610 (5th Cir. 1963); Northern Nat'l Gas Co., 50 F.P.C. 177 (1973); Farmland Indus. Inc., 23 F.E.R.C. ¶ 61,063 (1983); Louisiana Intrastate Gas Corp. v. FERC, 962 F.2d 37 (D.C. Cir. 1992).

8. Although this paper does not discuss the extensive federal rules applicable to interstate pipelines, producers, pipelines, local distribution companies and end users should be aware of a recent rule making proceeding before the FERC that may be the FERC's greatest attempt yet to

In Oklahoma, there have been recent inquiries concerning whether additional rules should be promulgated to provide for more active regulation than those currently regulating intrastate pipelines and gas gathering systems.⁹ As a result, in September 1991, the Oklahoma Corporation Commission (Commission) issued a formal notice of inquiry,¹⁰ soliciting, *inter alia*, comments concerning the possible need for more active regulation over intrastate pipelines and gathering systems. At the present time, additional regulations contemplated by the Commission may be unnecessary, as market forces and the current statutes and regulations seem to be operating effectively.

This article analyzes and discusses the Oklahoma statutory and regulatory framework applicable to intrastate gas pipelines and gathering systems.¹¹ The matters discussed below provide an historical background and framework within which to address many of the current issues relating to the natural gas industry in Oklahoma, with particular reference to intrastate gas pipelines and gathering systems.

II. HISTORY OF OKLAHOMA PIPELINE REGULATION

During the last part of the 1800's and into the early 1900's, oil and gas companies began drilling for oil in Oklahoma. While drilling, they typically encountered natural gas strata either separately from the producing oil horizons or in the same formation as the oil. Although there were limited uses for natural gas at the time, some of the larger oil producers who also owned gas pipelines were able to transport the natural gas to nearby towns for various residential and industrial uses.¹²

Producers without pipelines were forced to make a decision: they could either vent their natural gas into the atmosphere in order to produce the oil, or they could shut-in their wells to preserve the gas, which allowed other producers to drain the oil in the meantime. These problems created a need for legislation to address the inequities that were occurring.¹³

restructure the rules applicable to the interstate transportation of natural gas. On April 8, 1992, the FERC issued Order No. 636, which promulgated major rule changes applicable to open access interstate pipelines. *See supra* note 3.

9. These issues have been discussed at various meetings of the Oklahoma Commission on Natural Gas Industry Practices.

10. *In re: Inquiry of the Oklahoma Corporation Commission Concerning Oklahoma's Natural Gas Industry*, Cause No. PUD 01153 (Sept. 13, 1991).

11. The NGPA regulations applicable to the sale or transportation of natural gas by intrastate pipelines are too extensive and will not be discussed.

12. *See* Oklahoma Corporation Commission Order No. 937 (Sept. 1, 1915).

13. *See, e.g.*, Oklahoma Corporation Commission Order No. 776 (Jan. 1, 1913); Oklahoma Corporation Commission Order No. 715 (July 12, 1913); Oklahoma Corporation Commission Order

A. *The Pipelines Act of 1907: Earliest Pipeline Regulation*

In 1907, the First Session of the Oklahoma Legislature apparently recognized the need for some regulation over pipelines. During that session, the Legislature passed the Pipelines Act of 1907 (1907 Act).¹⁴ The 1907 Act addresses many matters relating to intrastate pipelines, including the requirements that signs be posted where pipelines cross highways and roads, and that pipeline plats be filed with the Commission before constructing pipelines.¹⁵

In addition, under Section 5 of the 1907 Act,¹⁶ the Commission is authorized to adopt rules and regulations concerning pipeline construction and pipeline safety and has done so in various orders.¹⁷ The pipeline safety rules and regulations are too extensive to analyze in this paper. However, for reference purposes, the Commission has adopted in large part the federal pipeline safety rules.¹⁸

Moreover, if any person is involved in excavation operations within the vicinity of a pipeline or a public or private easement, that person should follow the "Okie one-call" system and other statutory requirements of the Underground Facilities Damage Prevention Act.¹⁹ The purpose of this Act is to minimize injuries during dirt excavations and minimize damage to underground pipelines.

However, the 1907 Act was limited in its scope. As the production of oil and natural gas in Oklahoma continued to expand, the Commission recognized the value of natural gas as a cheap fuel for domestic, municipal, and industrial use.²⁰ Since oil was still the primary objective for most producers, they wasted huge volumes of natural gas through venting.²¹ In fact, the Bureau of Mines estimated that, as of 1913, approximately 365 billion cubic feet of gas was lost in Oklahoma through wasteful practices.²²

A second problem not addressed by the 1907 Act involved unratable production and unratable taking. Certain integrated gas companies that owned both oil and gas wells and the pipelines connected to them would

No. 792 (Mar. 2, 1914); Oklahoma Corporation Commission Order No. 793 (Feb. 27, 1914); Oklahoma Corporation Commission Order No. 825 (June 9, 1914).

14. OKLA. STAT. tit. 52, §§ 1-10 (1991).

15. *Id.*

16. *Id.* § 5.

17. See Oklahoma Corporation Commission Order No. 346106 (Mar. 30, 1990).

18. Transportation of Natural and Other Gas by Pipeline, 49 C.F.R. pts. 191, 192 (1992).

19. OKLA. STAT. tit. 63, §§ 142.1-142.11 (1991).

20. See Oklahoma Corporation Commission Order No. 937 (Sept. 1, 1915).

21. *Id.*

22. *Id.*

take their own oil and gas production and transport it in their own pipelines to the exclusion of other oil and gas owners in the fields involved.²³ These discriminatory practices compelled the Legislature to enact more legislation relating to pipeline companies.

B. *The First 1913 Act: The First Natural Gas Common Carrier and Common Purchaser Requirements*

In order to address the discriminatory practices employed by integrated oil and gas companies, the Legislature passed an oil pipeline act in 1910 (1910 Act).²⁴ The 1910 Act required oil pipeline companies to either (i) comply with the nondiscriminatory requirements of the common purchaser and common carrier statutes, or (ii) divest themselves of any oil production interests.

In 1913, the Legislature passed a similar act known as the Production and Transportation Act of 1913 (First 1913 Act).²⁵ This Act was intended to address the inequities and wasteful practices occurring in the gas fields of Oklahoma. As a result of the First 1913 Act, every pipeline company that claims or exercises the right to carry or transport natural gas by pipeline for compensation or otherwise must comply with the common purchaser and common carrier requirements.²⁶ As a common purchaser, the pipeline company must purchase, without discrimination, all of the natural gas produced by wells in the area that may be reasonably reached. If a pipeline company is unable to purchase and transport all of the natural gas produced or offered, it must purchase and transport from each person or producer ratably, in proportion to the average production of the applicable wells.²⁷

The First 1913 Act also provided that every transporter of natural gas must be a common carrier and, as such, could not unjustly or unlawfully discriminate, directly or indirectly, in favor of any natural gas offered to it or in which it may be interested.²⁸ Thus, if a producer, gas marketer, or other shipper of gas believes that a pipeline company is unjustly refusing to transport its gas or is discriminating in allocating its pipeline capacity in favor of its own system or in favor of some other

23. *Id.*; Oklahoma Natural Gas Co. v. State, 150 P. 475, 476 (Okla. 1915).

24. OKLA. STAT. tit. 52, §§ 51-66 (1991).

25. *Id.* §§ 21-34.

26. *Id.* § 23.

27. *Id.* The Oklahoma Supreme Court found that section 23 "was never intended to mandate that a purchaser . . . purchase gas from a single well from all having an ownership interest in the well." Anderson v. Dyco Petroleum Corp., 782 P.2d 1367, 1377 (Okla. 1989).

28. OKLA. STAT. tit. 52, § 24 (1991).

person, the shipper can use the common carrier statute to address the situation. However, it was not until 1978 that the Legislature provided a remedy for aggrieved producers that gave them the right to file a complaint before the Commission.²⁹ The Commission is then required to conduct an evidentiary hearing concerning the complaint. If the Commission finds discrimination, it may order the common carrier to purchase or transport the natural gas at fair rates.³⁰ However, the carrier may be exempted from the common carrier requirements if it can prove to the Commission that:

- (1) The natural gas cannot reasonably be carried by the common carrier because of the difficulty or expense involved;
- (2) Some other common carrier of natural gas can more conveniently purchase or transport the natural gas; or
- (3) The gas might dilute or pollute the gas being carried in the pipeline.³¹

C. *The Second 1913 Act: A Further Attempt to Prohibit Discriminatory Practices*

In addition to the First 1913 Act, the Legislature passed a second act (Second 1913 Act) applying to natural gas.³² Although the act was directed primarily to producers who owned pipelines, the Second 1913 Act may be viewed as a supplement to the First 1913 Act, because it extended the regulatory framework to the production side of the gas market.

The Second 1913 Act was intended to address the wasteful venting practices by defining the ownership of natural gas and restricting output. Section 1 of the Second 1913 Act states that all natural gas is owned by the owners of the surface under which the gas is located in its original state.³³ This statute arguably modifies the common law rule of capture, which provided that a producer owned any gas that he could produce and capture from a well, regardless of its original state or original location underground.³⁴

29. *Id.* § 24.1.

30. *Id.*

31. *Id.*

32. OKLA. STAT. tit. 52, §§ 231-235 (1991).

33. *Id.* § 231.

34. *But see* Wood Oil Co. v. Corporation Comm'n, 239 P.2d 1023 (Okla. 1950) (holding that landowners do not have absolute title to oil and gas that may be below the surface, but have the right to drill wells and take all oil and gas that they can reduce to possession, including that coming from land belonging to others, subject to the state's power to prevent unnecessary loss or waste).

The modification of the rule of capture provided in Section 1 is further defined in Section 2 of the Second 1913 Act,³⁵ which states that any owner of oil and gas rights may drill a well to the natural gas under its surface estate and may take gas therefrom until the "gas under such surface" is exhausted. The statute further provides that if other parties have the right to drill to a common reservoir, "the amount of gas each owner may take therefrom shall be proportionate to the natural flow of his well or wells," subject to the right of other owners to the natural flow from wells they own which draw from the same common source of supply.³⁶

The third section of the Second 1913 Act³⁷ provides that, unless taking for his own domestic use, a producer must take ratably from the source in proportion to his interest. The gas must be taken according to terms as may be agreed upon between the owners and the party taking the gas, or in case they cannot agree, at a price and upon such terms as may be fixed by the Commission.

D. *The 1915 Act: An Additional Effort to Prevent Waste of Gas and Discriminatory Purchases*

Despite the passage of the two 1913 Acts, enormously wasteful practices continued to occur in Oklahoma. In 1915, the Oklahoma Legislature took a more direct approach and passed an act that specifically prohibited wasteful venting (1915 Act).³⁸ Under the 1915 Act, producers are specifically prohibited from allowing gas to escape in commercial quantities or from engaging in other wasteful practices.³⁹

Also designed to prevent waste, section 5 of the 1915 Act⁴⁰ requires every person or corporation engaged in the business of purchasing and selling natural gas to be a common purchaser. This provision, much like the First 1913 Act, is intended to prevent waste by providing all producers with a method of transporting their gas. Also under the 1915 Act, any person aggrieved by discriminatory practices may institute a proceeding before the Commission to enforce the provisions of the Act.⁴¹ The 1915 Act also authorizes the Commission to promulgate regulations for the prevention of waste and for the protection of all natural gas.⁴²

35. OKLA. STAT. tit. 52, § 232 (1991).

36. *Id.*

37. *Id.* § 233.

38. *Id.* §§ 236, 237.

39. *Id.*

40. *Id.* § 240.

41. *Id.* § 241.

42. *Id.* § 243.

Under the Act, the Commission has promulgated various rules, including Oklahoma Corporation Commission Oil and Gas Rule (OCC-OGR) 1-305.⁴³

Under OCC-OGR 1-305, any common purchaser, as defined in Section 24 of the 1915 Act, must purchase "all of the gas which may be offered for sale, and which may be reasonably reached by its trunk lines or gathering lines, without discrimination."⁴⁴ In order to make this requirement feasible, the Commission has implemented a priority schedule that must be followed by first takers of gas. Essentially, whenever the permitted production "from all wells in any common source of supply . . . is in excess of that purchaser's reasonable market demand . . . the first taker" is responsible for implementing a priority schedule. This priority schedule dictates which producers must be serviced by the transporters first.⁴⁵ At least one court has held that the foregoing ratable take or priority purchase requirements may not be enforced against interstate pipeline companies.⁴⁶ Thus, the Commission currently enforces the priority schedule only against intrastate pipelines.⁴⁷

III. ENVIRONMENTAL MATTERS RELATING TO THE CONSTRUCTION OF GATHERING LINES AND INTRASTATE PIPELINES

Protection of the environment and of historical sites during pipeline or gathering line construction is an important consideration. For example, anyone encountering or discovering human skeletal remains or "burial furniture" is required to report the discovery to "an appropriate law enforcement officer."⁴⁸ Knowingly disturbing such a site is a felony.⁴⁹

43. Oklahoma Corporation Commission Oil and Gas Rule No. 1-305 (June 1, 1987).

44. *Id.* § 1-305(A).

45. *Id.* § 1-305(B). The Commission has adopted the following priority schedule:

B.1 Priority One. Hardship and distressed wells. (6-1-87)

B.2 Priority Two. Enhanced recovery wells. (6-1-87)

B.3 Priority Three. Wells producing casinghead gas and associated gas. (6-1-87)

B.4 Priority Four. Gas wells classified by Commission orders as Section 108 Stripper gas wells under the Natural Gas Policy Act of 1978. (6-1-87)

B.5 Priority Five. All remaining gas wells, which are in allocated special allocated, and unallocated pools. (6-1-87)

Id.

46. *ANR Pipeline Co. v. Corporation Comm'n*, 643 F. Supp. 419, 424 (W.D. Okla. 1986), *aff'd*, 860 F.2d 1571 (10th Cir. 1988).

47. In addition to the anti-discrimination provisions of OCC-OGR 1-305, under OCC-OGR 1-303, the Commission has adopted the natural gas common purchaser and common carrier rules set forth in their entirety at OKLA. STAT. tit. 52, § 240 (1991).

48. OKLA. STAT. tit. 21, § 1168.4 (1991).

49. *Id.*

Before construction, operators should contact the Office of the State Archeologist to determine if an intended location of a pipeline or gathering line is in the vicinity of any known archeological areas of concern.

The Oklahoma Department of Wildlife Conservation publishes a list of endangered or threatened species or subspecies.⁵⁰ Builders should contact the department to ensure that no such species inhabit the proposed pipeline location.

Also, when considering construction, a biologist should be retained to conduct a quick preview of the land to ensure that the project will not affect an environmentally sensitive area. The FERC has levied significant fines against interstate pipeline operators who have excavated in environmentally sensitive areas without first conducting an appropriate assessment of the area involved.⁵¹

Another environmental consideration is air quality. If gas compressors are to be used, the party constructing the pipeline should contact the Air Quality Division of the Oklahoma Department of Health to determine whether an air permit is necessary under Oklahoma's Clean Air Act.⁵²

Pipelines crossing streams, rivers, or other waterways may require permits from the U.S. Army Corps of Engineers, whose regional office is in Tulsa, Oklahoma. If the pipeline will be pressure tested with water drawn from a stream, reservoir, or other natural water source, the owner should contact the Oklahoma Water Resources Board in Oklahoma City to determine whether withdrawal and discharge permits are required.

IV. OBLIGATION TO REMIT PRODUCTION REPORTS AND PAY GROSS PRODUCTION AND PETROLEUM EXCISE TAXES

A pipeline or gas marketer will usually be the first purchaser of gas from the wellhead. In such instances, the first purchaser will be required to remit the following to the Oklahoma Tax Commission: (1) a gross production tax equal to 7% of the gross value of the production,⁵³ (2) an excise tax equal to .095 of 1% of the gross value of the production,⁵⁴ and (3) a conservation excise tax of \$.07 per Mcf, less 7% of the gross value of each Mcf purchased.⁵⁵ Each of these taxation provisions requires that

50. OKLA. STAT. tit. 29, § 5-412.1 (1991).

51. *See, e.g.*, Transcontinental Gas Pipe Line Corp., 48 F.E.R.C. ¶ 61,189 (1989) (\$37 million fine in past for damage to archeological sites).

52. OKLA. STAT. tit. 63, §§ 1-1801 to -1808 (1991).

53. OKLA. STAT. tit. 68, §§ 1001, 1009 (1991).

54. *Id.* § 1102.

55. *Id.* § 1108.

the purchaser deduct the amount of each tax paid from the amounts given to the producer and/or royalty owner⁵⁶ and then remit the taxes to the Oklahoma Tax Commission.

V. CONSIDERATION OF CURRENT ISSUES RELATING TO INTRASTATE PIPELINES AND GATHERING SYSTEMS

A. *Common Purchaser and Common Carrier Disputes*

As evidenced by the foregoing discussion, there are various statutes, rules, and regulations currently directed at intrastate pipeline companies and owners of gathering lines. If a dispute arises over an alleged refusal by an intrastate pipeline company or the owner of a gathering system to purchase or transport natural gas being offered by a producer, the producer may commence a proceeding before the Commission to compel action.⁵⁷

However, valid reasons may support a pipeline company's refusal to purchase or transport natural gas. For example, the quality of the gas may not be acceptable because it contains too much water, hydrogen sulfide, or other matter; there may not be sufficient pipeline capacity; or all existing capacity may be used by persons who are paying a higher price for firm transportation service. Section 24.1 expressly provides these defenses.⁵⁸

Typically, when a refusal to take gas occurs, a pipeline owner or gathering line owner is attempting to give priority to wells in the area in which it holds an interest. This type of discriminatory practice is exactly what the common carrier and common purchaser statutes were designed to prevent.

Disputes can also arise concerning the price to be paid for the offered gas or the transportation fee. The statutes provide that if the parties cannot agree upon the terms, a producer may commence a proceeding before the Commission for a determination of a fair and reasonable purchase price or transportation rate.⁵⁹

The question as to whether the Commission may establish a fair

56. *Id.* §§ 1009(d), 1102(A), 1108(C).

57. OKLA. STAT. tit. 52, § 24.1 (1991).

58. *Id.*

59. *Id.* (authority of the Commission to set transportation rates); *Id.* § 233 (authority of the Commission to fix a price for the taking of gas). However, there is some question as to the Commission's authority to establish a price for gas in light of the federal government's exercise of authority under the NGPA. The issue of federal preemption, however, is well beyond the scope of this article. For a brief discussion of the preemption issue, see *Anderson v. Dyco Petroleum Corp.*, 782 P.2d 1367 (Okla. 1989).

purchase price under either section 24.1 or section 233 is subject to debate.⁶⁰ Given the extent to which the federal government has regulated and deregulated wellhead prices after the United States Supreme Court's 1954 decision in *Phillips Petroleum Co. v. Wisconsin*,⁶¹ there is a question as to how much price regulation is still available to the states with respect to the wellhead sales price for natural gas. In *Phillips*, the Supreme Court held that producers who make sales for resale in interstate commerce are subject to the jurisdiction of the Federal Power Commission. Following the *Phillips* decision, the Federal Power Commission spent the next twenty-five years experimenting with various methods of regulating producer sales of natural gas in interstate commerce. With the enactment of the NGPA in 1978,⁶² Congress imposed federal price controls on all wellhead and first sales of natural gas. The NGPA established eight categories of natural gas production and maximum lawful ceiling prices for each category. Furthermore, the NGPA provided for a phased deregulation of the various wellhead prices. Today, all natural gas prices have been deregulated.⁶³

Since Congress has expressed its intent that the Government should no longer be involved in the establishment of gas prices, there is a question as to whether the Commission has jurisdiction to set gas prices under Section 233.⁶⁴ With respect to the intrastate transportation rates and gathering rates, as opposed to the wellhead sales price for the gas commodity itself, it would seem that the appropriate state regulatory commissions should still be able to set a fair rate if there is a dispute over the rate being charged.

However, if a gathering system is owned by an interstate pipeline company or an affiliate of an interstate pipeline company, there is currently a debate, and apparently conflicting decisions, as to whether the states have jurisdictional authority over the gathering rates charged by the gathering entity, or whether the FERC has preemptive authority to

60. Under section 24.1, the Commission shall fix a fair rate "for such transportation" if the parties cannot agree, but does not clearly address the purchase price. Section 233 does not address whether that statute applies only to producers who are "taking" gas, or whether it can be extended to purchasers. The Oklahoma Supreme Court has refused to address this issue. See *Anderson*, 782 P.2d at 1377.

61. 347 U.S. 672 (1954).

62. 15 U.S.C. §§ 3301-3432 (1988) (amended at 15 U.S.C. § 3301-3432 (Supp. I 1989)).

63. See FERC Order Nos. 436, 500, and 636, *supra* note 3, for a detailed discussion of the history of federal regulation of the price of natural gas; see also *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987); *Natural Gas Wellhead Decontrol Act of 1989*, *supra* note 2.

64. OKLA. STAT. tit. 52, § 233 (1991).

regulate such rates.⁶⁵ This important question will hopefully be resolved in the near future.

Finally, if a producer believes that the pipeline company or gatherer is not taking ratably from the various wells to which such pipeline company is connected, the producer may commence an action before the Commission under the common purchaser or common carrier statutes to compel the pipeline company to take ratably from all of the wells involved. If the producer has a gas purchase or gas transportation agreement with the pipeline company that specifically defines the rights and obligations of the parties, such as the purchaser's "take" requirements, a subsequent dispute as to whether the pipeline is fulfilling its obligations under the contract would likely be deemed a private contract dispute. The Commission would probably lack jurisdiction to adjudicate the private matter.⁶⁶ Thus each case would have to be analyzed upon its own facts after a review of the applicable gas purchase or transportation agreement between the parties, considering the disputed issues.

B. *Gathering Systems as Common Carriers*

Another issue that may arise in a producer's attempt to enforce the common purchaser or common carrier statutes is whether the owner of a gas gathering system is bound by the statutes. According to the specific language of Sections 23 and 240,⁶⁷ the owner of a gathering system should be deemed a common purchaser. Section 23 specifically refers to "gathering branches," and Section 240 specifically refers to "gathering lines." Thus, the owner of a gathering system should be required to purchase gas on a non-discriminatory and ratable basis.

Unlike the two common purchaser statutes, however, the common carrier statute⁶⁸ does not mention gathering lines. Thus, some may argue that the owner of a gathering system is not a common carrier and may not be compelled to transport gas on a non-discriminatory, ratable basis. However, this argument may be untenable as it is inconsistent with the

65. See *Northwest Pipeline Corp. v. FERC*, 905 F.2d 1403 (10th Cir. 1990) (holding that gathering facilities are exempt from the FERC's jurisdiction). But see *Northern Natural Gas Co. v. FERC*, 929 F.2d 1261 (8th Cir. 1991) (holding that FERC has jurisdiction to review gathering rates charged by an interstate pipeline or an affiliate that owns the gathering facilities), *cert. denied*, 112 S. Ct. 169 (1991). For further analysis, see Angela S. Chitwood-Beehler, Comment, *A Conflict in the Circuits: The FERC's Jurisdiction Over Gathering Rates*, 13 ENERGY L.J. 375 (1992).

66. See *Tenneco Oil Co. v. El Paso Natural Gas Co.*, 687 P.2d 1049 (Okla. 1984); *Samson Resources Co. v. Corporation Comm'n*, 702 P.2d 19 (Okla. 1985).

67. OKLA. STAT. tit. 52, §§ 23, 240 (1991).

68. *Id.* § 24.

statutory scheme applicable to common purchasers and common carriers. Since the Legislature apparently intended for the owner of a gas gathering system to be covered by the common purchaser statutes, the same owner should logically be bound by the common carrier statutes. It strains logic to require the owner of a gathering system to purchase gas on a non-discriminatory basis while permitting discriminatory transportation of the same gas simply because the producer chooses to have its gas transported instead of purchased by the gatherer. Therefore, the use of the word "pipeline" in the common carrier statute⁶⁹ should be liberally construed to cover and include the owner of a gathering system to provide a consistent statutory framework applicable to the purchasing and transportation of natural gas by intrastate pipelines and owners of gathering systems.

C. *Bypass and Public Utility Issues*

Traditionally, pipeline companies sell their gas to local gas distribution companies or utilities, who in turn sell the gas to residential, commercial, and industrial customers. Some pipeline companies have begun to aggressively pursue end user markets and bypass the local utilities by laying lines directly to the end user of natural gas. This arrangement eliminates the local utility as a middleman and generates more revenue for the pipeline companies. As a result, the local gas utility often raises strenuous objections because of the loss of customers who use large volumes of natural gas.

Many legal issues can arise as a result of a bypass situation. An intrastate pipeline company considering a bypass arrangement should be aware that, when making direct sales to end users, it could be deemed a "public utility" or a "public service company" as a result of the direct sales.⁷⁰ If a pipeline company is deemed to be a "public utility", it will then probably be subject to the Commission's rate regulations and all of the other rules and regulations applicable to natural gas public utilities in

69. *Id.*

70. Numerous cases provide guidance in determining whether a gas pipeline becomes a "public utility" as a result of direct sales arrangements. *See, e.g.,* *Nowata County Gas Co. v. Henry Oil Co.*, 269 F. 742 (8th Cir. 1920) (holding that a gas producer who built pipelines for direct sale to end-users was not a public utility); *Coastal States Gas Transmission Co. v. Alabama Pub. Serv. Comm'n*, 524 So. 2d 357 (Ala. 1988); *Public Util. Comm'n v. Colorado Interstate Gas Co.*, 351 P.2d 241 (Colo. 1960); *Dome Pipeline Corp. v. Public Serv. Comm'n*, 439 N.W.2d 700 (Mich. Ct. App. 1989); *Griffith v. New Mexico Pub. Serv. Comm'n*, 520 P.2d 269 (N.M. 1974); *Llano Inc. v. Southern Union Gas Co.*, 399 P.2d 646 (N.M. 1964); *Atwood Resources Inc. v. Public Util. Comm'n*, 538 N.E.2d 1049 (Ohio 1989); *State v. Oklahoma Ordnance Works Auth.*, 613 P.2d 476 (Okla. 1980) (supplier providing steam to only seven industry end-users held to be providing a service to the general public).

Oklahoma. Although there is no current Oklahoma case law directly addressing this issue, an administrative law judge with the Commission recently ruled that an intrastate pipeline company who sells to only a few end users can become a public utility.⁷¹ Of course, intrastate pipeline companies do not want to subject themselves to such burdensome regulation. Thus, pipeline companies of any size should carefully analyze the effect of any bypass proposal before investing money in such a project.

D. Rate Regulation

Unless a pipeline company is a "public utility" in Oklahoma, the Commission historically has not regulated the transportation rates or resale rates of intrastate pipeline companies. However, there is some discussion among government representatives, industry representatives, and others concerning whether more active rate regulation of intrastate pipeline rates and gathering charges should be pursued.

In 1991, the Commission filed a notice of inquiry requesting input concerning almost all facets of the natural gas industry, including the necessity of more active regulation of intrastate pipelines and gathering systems. However, the Commission was not overwhelmed with complaints of excessive transportation rates being charged by intrastate pipeline companies. Therefore, there may not be widespread displeasure over current transportation rates in Oklahoma. Since the enactment of the NGPA in 1978,⁷² authorizing expanded transportation by intrastate pipelines, and since the enactment of the open access requirements of FERC Orders 436 and 500, the market forces seem to have done a good job of maintaining competitiveness between pipelines. Transportation rates on most intrastate pipelines are reasonable, and there is no indication that they will increase dramatically in the future. It is even possible that active rate regulation over intrastate pipelines could prove to be counterproductive to gas shippers in Oklahoma. The regulated cost of service-based rates could actually cause an increase in intrastate transportation rates.

The most common complaints seem to arise from the unregulated rates being charged for gathering services. All too often, the owner of a small gathering system charges exorbitant rates for gathering services and makes tremendous profits at the expense of producers or other gas

71. See Report of Administrative Law Judge, *In the Matter of the Complaint of Arkansas Louisiana Gas Company ("ALG"), a Division of Arkla, Inc., Against Intersearch Corporation for Unauthorized Provision of Service to ALG Customers*, Cause No. PUI 000853 (March 29, 1991).

72. 15 U.S.C. §§ 3301-3432 (1988) (amended 1989).

shippers. In fact, there are reports that in some instances the gathering rates to move gas a few miles from the wellhead to a main pipeline in the area exceed the transportation rates that are then charged to transport the gas hundreds of miles. Under these circumstances, which seem to be the exception rather than the rule, the producer should be able to seek relief from the Commission under the existing statutes and regulations.⁷³ Legislation requiring the Commission to periodically review and set rates for all gathering companies in Oklahoma is neither necessary nor practical. In fact, without substantial additional funding and staffing, it would be very difficult for the Commission to review rates for all owners of gathering lines in Oklahoma.

VI. CONCLUSION

Many rules and regulations are in place that apply to the construction and installation of gas gathering systems or intrastate pipelines in Oklahoma. Even if only contemplating the construction of a small gathering system or pipeline in Oklahoma, a party would be wise to consider the foregoing rules and seek appropriate counsel before commencing the pipeline or gathering project. Furthermore, once the pipeline or gathering system is operational, there are other statutes, rules, and regulations which must be followed. Hopefully, the foregoing discussion will provide guidance to all segments of the natural gas industry concerning the proper construction and operation of gathering systems and intrastate pipelines in Oklahoma.

73. Since neither OKLA. STAT. tit. 52, § 24 nor § 24.1 mention gathering lines or gathering rates, there is currently a debate as to whether the existing pipeline statutes authorize the Corporation Commission to set fair and reasonable "gathering rates." Although the authors believe that the statutes should be read within their historical context, to grant such authorization, a statutory amendment clarifying this point would resolve the debate.