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THE PRORATIONING OF NATURAL GAS IN OKLAHOMA

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A multiplicity of statutes and legal precedents determine the shares of gas production, and the economic benefits generated therefrom, to which owners of interests in Oklahoma oil and gas fields are entitled. Under the modified Rule of Capture that determines the ownership of migratory minerals in Oklahoma, the capacity to gain dominion and control over migratory minerals is prerequisite to the establishing of ownership rights in specific volumes of natural gas production. The degree to which an individual possessing the right to mine for oil and gas may exercise his or her total capacity for producing natural gas depends upon whether it is necessary to restrain mining activities in order to prevent waste, increase the ultimate recovery of natural gas, or protect the correlative rights of all who possess the right to mine for oil and gas in a common source.

Oklahoma's Conservation Statutes give the Oklahoma Corporation Commission (OCC) and owners of mineral and royalty interests in natural gas powerful tools for preventing waste, increasing ultimate recoveries, and protecting correlative rights. These tools give the OCC explicit authority: (1) to limit production as is necessary to prevent various types of waste;1 (2) to impose well spacing and forced pooling requirements on separately owned tracts overlying a common source of natural gas in order to discourage the drilling of unnecessary wells, preserve reservoir pressure, and equitably divide the economic benefits of exploiting the common source;2 (3) to impose forced unitization requirements on separately owned tracts overlying a common source in order to increase ultimate recoveries of natural gas through nonprimary production methods requiring the cooperative development of large areas;3 and (4) to impose restraints on the activities of those producing, selling, and purchasing natural gas in Oklahoma to insure that all who have rights to mine common sources of natural gas have the opportunity to receive their ratable share of the economic benefits.

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1. OKLA. STAT. tit. 52, §§ 86.3, 86.4, 236-239 (1981).
benefits flowing from the production of natural gas.\textsuperscript{4}

\textbf{I. OwnershIp PrI ncIeS}

In Oklahoma the ownership of migratory minerals was originally determined by a pure form of the Rule of Capture, whereby "an owner of oil and gas mining rights...becomes the owner of all the oil and gas that he may produce from his wells, whether the oil and gas originally inhabited his own lands or were drained from neighboring lands."\textsuperscript{5} In its earliest modifications of the Rule of Capture, the Oklahoma Legislature declared in 1913 that "[a]ll natural gas under the surface of any land in this state is hereby declared to be and is the property of the owners, or gas lessees of the surface under which gas is located in its original state."\textsuperscript{6} A literal reading of this statutory language (hereinafter referred to as section 231) suggests that Oklahoma now recognizes the ownership of gas in place. Yet the Oklahoma courts have never pronounced section 231 to be the statutory prescription of the ownership in place principle.

In \textit{Frost v. Ponca City},\textsuperscript{7} the court and the parties agreed that in Oklahoma landowners do not acquire title to migratory substances until, in compliance with the Rule of Capture, they are reduced to actual possession by being brought to the surface and then controlled.\textsuperscript{8} The Oklahoma Supreme Court also ruled in \textit{State ex rel. Huddleston v. Bond}\textsuperscript{9} that in administering production allowables, the OCC does not have to permit owners to recover production underages caused by their past inabilitys to produce their full allowables, where the underages were not caused by compliance with OCC orders, since owners have no vested right to recover underages. The cases of \textit{Wood Oil Co.}

\textsuperscript{4} \textit{Okla. Stat. tit. 52, §§ 232, 239 (ratable production), 233 (ratable taking), 541-547 (split stream balancing), 23, 240 (common purchaser) (1981)}.
\textsuperscript{5} H.F. Wilcox Oil & Gas Co. v. Bond, 173 Okla. 348, 351, 45 P.2d 820, 823 (1935).
\textsuperscript{6} It is now well settled that the state has an interest, paramount to the owners, in the potential production of oil (and gas) from the underground reservoirs, and that within reasonable limits it is the duty of the state to preserve to the owners of oil (and gas) producing lands, where production is had from a common source of supply, the natural forces and elements necessary for the ultimate production of the maximum amount of oil (and gas) by the owners producing from said common source of supply. ... With this recognition of the paramount right of the state to restrict production of oil (and gas) to prevent waste, a consequent duty to prevent inequitable taking from a common source of supply necessarily arose. In exercising this function, the state necessarily was compelled to consider and safeguard the correlative rights and obligations of the operators in a common pool.
\textsuperscript{7} Id.
\textsuperscript{8} Id. at 1323.
\textsuperscript{9} 172 Okla. 415, 418, 45 P.2d 712, 715 (1935).
1986] OKLAHOMA PRORATIONING LAWS AND POLICIES 171

*Corporation Commission*,¹⁰ made it clear that in Oklahoma owners of wells producing successfully before inclusion in a spacing unit incorporating tracts owned by others need not share the benefits of pre-spacing production with the other spacing unit owners. Taken together, the *Frost, Bond* and *Wood* cases demonstrate that it is the capacity to produce through successful drilling and production operations (except as limited where necessary to prevent waste or to protect correlative rights) that determines the ownership of migratory minerals.

There is further support for the notion that in Oklahoma a modified Rule of Capture prevails, despite the "ownership in place" language of section 231. The OCC’s Gas Pool Classification and Allowable Rules determine how a gas pool is classified and how production allowables are set for the pool and for each operator in the pool. Of special relevance to the discussion of ownership principles is the fact that production from unallocated pools is limited only by the general requirement that no well within an unallocated pool shall produce at a rate in excess of 50% of its potential production capacity."¹¹

Recent hearings, concerning whether Oklahoma’s ratable take rules should be changed in response to falling market demand for natural gas at the wellhead, revealed that about 64% of Oklahoma’s annual natural gas production comes from unallocated pools.¹² This means that well over half of Oklahoma’s gas production comes from wells with production rates limited chiefly by production capacities rather than by the surface acreage, the gas in place, or both.

Finally, there is the case of *Sinclair Oil & Gas Co. v. Corporation Commission*,¹³ wherein the Oklahoma Supreme Court rejected contentions that, in setting production allowables compatible with market demands for gas, the OCC is compelled by section 231 to use an allowable formula that will permit each owner of mining rights in a common source to recover all of the gas in place beneath the acreage which he or she is entitled to mine. In reaching this holding, the court was not only unwilling to recognize the principle of ownership in place, but also ruled that, to the extent that the ownership in place principle has any applicability in Oklahoma, it is subordinate to the


¹¹. Rule 2-331(a) of the Oklahoma Corporation Commission’s Oil & Gas Rules — General Rules & Regulations [hereinafter cited as O.G.R.].


conservation laws designed to prevent waste and protect correlative rights.

II. PROTECTING CORRELATIVE RIGHTS — RATABLE PRODUCTION

A. Statutory Authority

The OCC imposes production limitations for the protection of the correlative rights of owners of common sources of natural gas by setting production allowables in accordance with three major statutory authorities. Section 239 permits the OCC to reduce total production from a common source where necessary to equalize production of, and demands for, natural gas from the common source, and directs the OCC to set production levels for each person, firm or corporation having the right to produce from the common source on the basis of a ratio equal to "the natural flow of the well or wells owned or controlled by any such person, firm or corporation...to the total natural flow of such common source of supply having due regard to the acreage drained by each well. . . ." The first paragraph of section 87.1 authorized the Commission to calculate, on the basis of productive capacity ratios, ratable production shares for each well in a common reservoir when necessary to prevent waste or to prevent uncompensated drainage from one leasehold to another.

In addition, section 232 specifies restrictions on production from wells drilled pursuant to individual drilling and production

14. OKLA. STAT. tit. 52, § 239 (1981) (emphasis added). The statute states in relevant part that:

"Whenever the full production from any common source of supply of natural gas in this state is in excess of the market demands, then any person, firm or corporation, having the right to drill into and produce gas from any such common source of supply, may take therefrom only such proportion of the natural gas that may be marketed without waste, as the natural flow of the well or wells owned or controlled by any such person, firm or corporation bears to the total natural flow of the such common source of supply having due regard to the acreage drained by each well, so as to prevent any such person, firm or corporation securing any unfair proportion of the gas therefrom. . . . The [Corporation] [C]ommission is authorized and directed to prescribe rules and regulations for the determination of the natural flow of any such well or wells, and to regulate the taking of natural gas from any or all such common sources of supply within the state, so as to prevent waste [and] protect the interests of the public. (Emphasis added.)"

15. OKLA. STAT. tit. 52, § 87.1 (Supp. 1984). The statute in relevant part states:

"Whenever the production from any common source of supply of oil or natural gas in this state can be obtained only under conditions constituting waste or drainage not compensated by counterdrainage, then any person having the right to drill into and produce from such common source of supply may, except as otherwise authorized or in this section provided, take therefrom only such proportion of the oil and natural gas that may be produced therefrom without waste or without such drainage as the productive capacity of the well or wells of any such person considered with the acreage properly assignable to each such well bears to the total productive capacities of the wells in such common source of supply considered with the acreage properly assignable to each well therein. (Emphasis added.)"

rights that are not necessarily tied to limits on total production from a common source. Under section 232:

Any owner or oil and gas lessee of the surface, having the right to drill for gas shall have the right to sink a well to the natural gas underneath the same and to take gas therefrom until the gas under such surface is exhausted; in case other parties having the right to drill into the common reservoir of gas drill a well or wells into the same, then the amount of gas each owner may take therefrom shall be proportionate to the natural flow of his well or wells to the natural flow of the well or wells of such other owners of the same common source of supply of gas, such natural flow to be determined by any standard measurement at the beginning of each calendar month; provided, that not more than fifty percent (50%) of the natural flow of any well shall be taken unless, for good cause shown and upon notice and hearing, the Corporation Commission may, by proper order, permit the taking of a greater amount. The drilling of a gas well or wells by any owner or lessee of the surface shall be regarded as reducing to possession his share of such gas as is shown by his well.\textsuperscript{17}

\textbf{B. Statutory Interpretations}

While cases have not been found from which the meaning of the term \textit{productive capacity} as used in section 87.1 can be divined, two cases interpreting the term \textit{natural flow} as used in sections 232 and 239 appear to set the general parameters governing the OCC's exercise of its prorationing authority. In \textit{Anderson-Prichard Oil Corp. v. Corporation Commission},\textsuperscript{18} it was contended that in setting an allowables formula pursuant to its authority under section 239, the OCC is limited to considering well potentials and acreage drained, and therefore may not “take into consideration such factors as the porosity percentage underlying each lease. . .the average thickness of the producing formation underlying each lease. . .[and] the absolute open flow raised to the 0.1 power,” as it did in setting the allowable formula at issue.\textsuperscript{19} The Oklahoma Supreme Court rejected this contention and upheld the OCC's allowables formula with the observation that:

\textit{[A]pplicant's formula is based upon certain "potentials" of its wells, which means no more than "the daily rate of flow." The statute does not base allowables upon potentials, but bases them upon the natural flow of the wells. Natural flow, as that term is employed in the Act, means the total volume of gas which a given

\textsuperscript{17} \textit{Id.} (emphasis added).
\textsuperscript{18} 207 Okla. 686, 252 P.2d 450 (1953).
\textsuperscript{19} \textit{Id.} at 689-90, 252 P.2d at 453-54.
well will produce (emphasis added). Moreover, the statute does not delineate the course the Commission must take to determine the natural flow of a gas well, or wells, as they bear to the total natural flow of the common source of supply. . . . [T]he statute does not limit the take of gas to the “natural flow of the well per day,” but is based upon its “natural flow.” To determine this volume of gas the Commission may properly consider the ascertained area of the reservoir, based upon production acres underlying each lease, the thickness of the producing formation, and the percentage of effective porosity and its permeability.20

Notwithstanding the emphasis in Anderson-Prichard on gas in place as a factor to be considered in setting allowables for ratable production purposes, in Sinclair Oil & Gas Co. v. Corporation Commission,21 the Oklahoma Supreme Court rejected the contentions that “a valid allowable formula must include a factor representing gas in place,” and that “in not being founded solely upon the basis of gas in place, the formula and the order appealed from tends to deprive [the appellant] of property without due process of law.”22 It is significant that the allowables formula contested in Sinclair was based solely upon the factors of acreage, potential and shut-in pressure despite the appellants’ request that gas in place (as represented by a factor measuring the number of feet of productive sand in each well bore) be included in the allowables formula. Moreover, the court in Sinclair seemed hostile to the notion that allowables formulae must give the owners of low-potential wells the guarantee of recovering over time the total volume of gas in place beneath the acreage attributed to their wells.23

20. Id. at 689-90, 252 P.2d at 454.
22. Id. at 851-55.
23. Gas in place does not become the subject of an allowable-fixing device, nor constitute the wherewithal for meeting market demands — until it is capable of being produced by the permissible well or wells. And if, when there is ample market demand for a common reservoir’s gas, the production of the wells, through which most of the reservoirs’ (sic) contents naturally flow, is drastically restricted, to await attempts, over an extended time period in the uncertain future (when the market demand may conceivably become substantially diminished or non-existent) to procure through the reservoir’s other wells possessing lesser capabilities, a quantity of gas that some geologists or gas engineers may calculate by admittedly questionable measuring devices or dimensions, as being in place under the latter wells’ spacing units — with the detrimental reservoir conditions that the testimony indicates such attempted reversal of natural processes may bring about — the cause of conservation, and of underground waste prevention is not served. In placing first consideration and emphasis in sec. 239, [the ratable production section the Court had to reconcile with section 231] . . . upon “natural flow” rather than upon “acreage drained”, we think our State’s Legislature, consistent with its apparent attitude toward economic waste in the drilling of what would appear to be unnecessary wells . . . has regarded the necessity of draining such reservoirs with a minimum of waste, as more important than attempting to guarantee to any owner or operator that his permitted
In short, the court approved the OCC’s allowables formula in *Sinclair* because it gave the owners of common source mineral production rights the opportunity to produce the *recoverable reserves* beneath the acreage drained by their wells as opposed to the total volume of gas in place beneath such acreage.24 Note, however, that in an earlier *Anderson-Prichard* case,25 the Oklahoma Supreme Court stated that to base the acreage factor in an allowables formula on non-productive acreage would be unfair.26

The OCC allowables formulae contested in the second *Anderson-Prichard* case and the *Sinclair* case were quite different from one another, yet the court upheld them both. This illustrates that Oklahoma’s ratable production statutes give the OCC much discretion in carrying out its prorationing responsibilities. As the Court concluded in the second *Anderson-Prichard* case:

> We do not treat the rules of the Commission as *talismanic or magical formulas*, but as rational instruments for doing justice between owners having correlative rights in the recovery of a natural resource from a common pool.

> The record discloses that the Commission has given careful consideration to the expert opinions of physicists, geologists and petroleum engineers, and the opinion of laymen based upon their empirical experience. We therefore conclude that their determination of the controversy has been properly resolved.27

### C. Production Allowables — Gas Pools

In exercising its production allowables authority, the OCC has developed an allowables framework for gas production from common sources classified as gas pools, requiring that gas pools be classified as allocated, special allocated, and unallocated pools.28 An allocated gas well or wells will produce the precise quantity of gas which some may predict to be in place under the entire surface area of his land, or drilling unit.

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24. *Id.* at 852-53.
25. *Id.* at 851-54.
26. *Id.* at 674-75, 241 P.2d at 367.
28. O.G.R. Rule 307(a). Although it is not clear upon what bases the OCC must classify common sources, O.G.R. Rule 1-201(b) specifies that “[a]ny pool may be classified or reclassified by the Commission . . . as an oil pool, gas pool, combination pool or condensate pool. All pool rules and regulations so promulgated shall be based on operation and technical data and shall be consistent with the characteristics attributable to each classification.” The OCC appears to classify sources by analyzing whether the productive wells expected to be completed in a common source will be predominantly oil wells or gas wells. See Application of Bennett, 353 P.2d 114, 116-19 (Okla. 1960); Application of R. Olsen Oil Co., 250 Okla. 498, 239 P.2d 415 (1951). For allowable purposes the OCC classifies “[a]ny
pool is a common source wherein owners of production rights are allocated ratable shares of the total production on a per spacing unit basis, regardless of whether total production from the pool is limited. A special allocated pool is a common source for which special field rules, triggered when total productive capacity exceeds market demands, have been established. Special field rules serve to limit the pool’s total production to a volume equal to total purchaser nominations for its gas and to allocate ratable shares of the pool’s permitted production on a per well basis. Unallocated gas pools are those classified as neither allocated pools nor special allocated pools, and therefore not subject to either production limits or prorationing. A recent OCC order found that 64% of Oklahoma’s gas production comes from unallocated gas wells, 23% from oil wells in the form of casinghead gas, 12% from special allocated gas wells, and less than 1% from allocated gas wells.

1. Allocated Gas Pool Allowances

The total production of an allocated pool is ordinarily not limited, but is allocated among owners on a per spacing unit basis. Each spacing unit is entitled to produce a volume of gas equal to the ratio of its acreage to that of the total developed acreage in the common pool, multiplied by the total common pool production. If a spacing unit underproduces, it may make up the underage by producing in the future at levels in excess of its pro-rata share. A spacing unit may accumulate underage up to a volume equal to six times the spacing unit’s annual reference allowable before its accrued underage is cancelled and it is declared ineligible to accumulate underage. A spacing unit may have its cancelled underage administratively reinstated within six months of the cancellation upon proof that it is capable of producing in the future at least its pro-rata share of the common source’s total monthly production. Cancelled underage that is not reinstated is distributed on a pro-rata basis among all the spacing units

well having a gas-oil ratio of 15,000 to one or more . . . as a gas well . . . [and] any well having a gas-oil ratio of 10,000 to one or less . . . as an oil well.” O.G.R. Rule 2-109(a), (b). Operators of wells with gas-oil ratios of greater than 10,000 to one and less than 15,000 to one shall choose which classification to apply to each well. O.G.R. Rule 2-109(c).

32. Market Demand Order, supra note 12.
33. O.G.R. Rule 2-310(b).
34. O.G.R. Rule 2-310(c).
35. O.G.R. Rule 2-310(c), (e).
36. O.G.R. Rule 2-310(b), (c).
that are eligible to accumulate underage. 37

Spacing units that overproduce may accumulate overages without incurring a production limit until their accumulated overage exceeds six times their reference allowables. 38 However, if a spacing unit accumulates excessive overage, it is subject to a production cap equal to 25% of its pro-rata share until the excess accumulation is made up. 39 Production may be curtailed from spacing units that have incurred excessive accumulated overage unless steps are taken to make up the excess. 40

2. Special Allocated Gas Pool Allowables

Allowables for special allocated pools are calculated on a per well basis in accordance with allowables formulae that are unique to each special allocated pool. 41 For each special allocated pool, total monthly production is limited to the total demand for gas produced from that pool as measured by monthly purchasers’ nominations. 42 The well allowables within any specific special allocated pool are calculated on the basis of the unique allowables formula contained in the special field rules promulgated to regulate production activities and levels within the pool. It is beyond the scope of this paper to describe the allowables formula of each special allocated pool in Oklahoma. The formulae vary significantly, 43 but with the exception of the Guymon Hugoton pool, no well within any special allocated pool is assigned an allowable less than 150 mcf per day. 44 Although the reference allowable of special allocated pools is calculated by different methods than those used by allocated pools, underage and overage are treated similarly for both pool types. 45

3. Unallocated Gas Pool Allowables

There is no limit on total production from unallocated gas pools. Production limits on wells within unallocated pools are specified as follows:

(a) The production from an unallocated well shall not exceed fifty percent (50%) of its potential capacity to produce as reflected

37. O.G.R. Rule 2-310(c).
38. O.G.R. Rule 2-310(d).
39. Id.
40. Id.
41. O.G.R. Rule 2-320(a).
42. O.G.R. Rule 2-320(d).
43. See supra text accompanying notes 18-27.
44. O.G.R. Rule 2-320(a).
45. O.G.R. Rule 2-320(d)-(i).
by its last official potential test adjusted by any allowable limitation factor as established by the Commission. The provisions of the Rule shall not apply to any well having a potential of 2,000,000 cubic feet per day or less, and the production from such well shall not exceed 1,000,000 cubic feet of gas per day.

(b) If the production from an unallocated well exceeds the foregoing limitation for the annual allocation period, the operator shall not produce and no purchaser or transporter shall take in excess of fifty percent (50%) of the permitted production specified in Paragraph (1) until the overproduction is fully made up.46

Of special interest with respect to the production limits on unallocated wells is the fifty percent potential capacity limitation initiated in January, 1974, by the OCC in response to the Arab Oil Embargo. This order permitted operators of unallocated natural gas wells to produce at a level double the statutory maximum contained in that year's version of section 232. The Oklahoma legislature enacted the current version of section 232 in 1981 in order to legislatively ratify the OCC's fifty percent potential capacity production limitation. In response to sharp reductions in the market demand for natural gas produced in Oklahoma, and to avoid the waste inherent in excess gas production, the OCC in 1983 temporarily halved the permissible production level of wells within unallocated pools, but later rescinded the production limitation order in the face of strong protest from Oklahoma's natural gas industry.47

4. Administering Underage and Overage

As discussed above, excessive underage may be cancelled and excessive overage may lead to shut-in orders. Moreover, the OCC has the discretion to restore cancelled underage and forgive excessive overage. With respect to restoring cancelled underage, the OCC has been given wide latitude by the judiciary. In State ex rel. Huddleston v. Bond,48 the Oklahoma Supreme Court held that the OCC may cancel underages since its willingness to give credit for them is simply a matter of legislative grace and not a vested right.49 The court listed several reasons why the OCC might cancel underage: (1) declines in production potentials of wells within a common source do not occur uniformly; (2) perpetuation of past underage credits into future proration periods could produce inequities, since the OCC must ultimately

46. O.G.R. Rule 2-331.
47. Letter from James H. Bailey, OCC General Counsel to the Hon. Marvin York, President Pro Tempore of the Oklahoma State Senate (June 7, 1983).
49. Id. at 418, 45 P.2d at 715.
set allowables on the basis of well potentials, and well potentials must be measured periodically and compared with accumulated underage credits to avoid granting wells with declining potential allowables in excess of their abilities to produce; and (3) preservation of underage may cause underproduction to absorb a large percentage of the reasonable demand allocated to the zone in the current proration period, thus necessitating that all underage be cancelled to insure ratable taking and to prevent unjust discrimination.50

However, the court in Bond articulated a cancellation exemption applicable to the underage incurred by operators taking voluntary conservation measures for the benefit of all the operators in the field.51 This exemption has been extended to underage incurred by operators as a result of their compliance with mandatory OCC conservation orders.52 The conservation compliance rationale has also been used to forgive excessive overage incurred by an operator producing at levels mandated by OCC orders that were later overturned by the Oklahoma Supreme Court.53

Any remaining doubts as to the OCC's authority to shut-in overproduced wells as a means of protecting the correlative rights of others were ended by Choctaw Gas Co. v. Corporation Commission.54 Pursuant to conclusive evidence that Choctaw had overproduced its wells, the OCC ordered Choctaw to shut-in the wells despite the fact that the shut-in order would render Choctaw unable to meet its contract obligations to gas purchasers.55 In contesting the shut-in order, Choctaw contended that by destroying its capability to serve its contract customers, the OCC order deprived it of its market in violation of due process, and that the order was invalid because the OCC did not demonstrate that the shutting-in of the overproduced wells was necessary to prevent waste. In sustaining the OCC's shut-in order, the Oklahoma Supreme Court stated that Choctaw's market is not a property right that the OCC has the duty to preserve or protect. The court also held that the OCC can enter proration orders to protect correlative rights without a showing that they are needed to prevent waste, since protection of correlative rights is necessary to discourage the wasteful drilling of pre-proration days.56

50. Id. at 417-18, 45 P.2d at 714-15.
51. Id.
54. 295 P.2d 800 (Okla. 1956).
55. Id. at 804-05.
56. Id. at 805.
D. Production Allowables — Casinghead Gas

The OCC defines casinghead gas as "any gas or vapor, or both indigenous to an oil stratum and produced from such stratum with oil." Therefore, the production allowables applicable to casinghead gas are those applicable to the oil pool from which it is produced. Oil production allowables are expressed with regard to the amount of oil that may be produced. Consequently, for each well producing casinghead gas, the amount of casinghead gas that it may produce is a function of its applicable oil production allowable and its gas/oil ratio. However, gas flaring is not favored in Oklahoma, so if market demands for natural gas drop, oil wells producing casinghead gas may face OCC shut-in orders to prevent the waste associated with flaring.

Oil pools, like gas pools, are further classified for allowables purposes. O.G.R. Rule 2-200 provides:

Each producing oil pool in the State of Oklahoma, and the wells producing therein, shall be classified by the Commission into one of the following categories:

1. Discovery Pool;
2. Allocated Pool;
3. Unallocated Pool;
4. Pressure Maintenance Project;
5. Gas Repressuring Project;
6. Enhanced Recovery Project;
7. Excessive Water Exempt Project.

58. Faced with dramatic downturns in world demand for natural gas produced in Oklahoma, the OCC was called upon recently to consider the gas flaring or venting issue in the context of oil wells that also produce casinghead gas and that have adequate markets for oil but inadequate markets for the gas. Application to Flare Gas by HPC, Inc., Order No. 242,317 (July 22, 1983). HPC, Inc. was informed by its major natural gas purchaser that a considerable portion of its casinghead gas would be shut-in on a rotating basis. Desiring to maintain its oil production and sales activities, and concerned that forced shut-ins could damage its wells so that its ultimate recovery of oil and gas would be reduced significantly, HPC, Inc. filed with the OCC an application for permission to flare casinghead gas for which it lacked market outlets. In denying HPC’s application, the OCC’s order stated in relevant part that:

The commission is mandated to prevent waste and in a case such as this involving the issue of flaring casinghead gas, the commission must consider the amount of waste which will occur if the subject wells are flared as compared to the amount of potential waste that may occur if the wells are shut-in during times of purchaser curtailment. . . . [U]nder the conservation laws of the State of Oklahoma, the commission’s responsibility and statutorily mandated duty is that of a conservator of the all-important native resource on which so much of Oklahoma’s economy relies. Therefore, the commission’s role as a regulator is limited. . . . HPC has failed to demonstrate by persuasive evidence that waste resulting from curtailment would be equal to, or in excess of, that which would result from flaring. . . . Had HPC shown that curtailment would carry with it a strong possibility of permanent physical damage, i.e. waste, in excess of that waste which would result from flaring, the commission’s responsibility would likely have required it to grant the application.
1. Discovery Pool Allowables

As the name suggests, Discovery Pools are new pools.59 Discovery Pools are entitled to receive on a per well basis a temporary discovery allowable that is administratively determined by the OCC through reference to a Discovery Allowable Table. This table assigns a barrel-per-day allowable, and a duration period specifying how long the well can receive the allowable, based on the well's completion depth.60 Once a well's Discovery Allowable is determined, the operator may produce at the highest level specified by the Discovery Allowable or the allowable that otherwise would apply.61

2. Allocated Pool Allowables

Allocated Pools are those the OCC determines should be regulated as to production levels to prevent waste or to rationalize production with market demands.62 Once a pool is classified as an Allocated Pool, and if it is a pool for which drilling and spacing units have been established, "[e]ach well. . .shall be assigned the applicable allowable from the Allocated Well Allowable Table multiplied by the current market demand factor, or the capacity of the well to produce without waste, whichever is less."63 The Allocated Well Allowable Table specifies a barrel-per-day production limit based upon the size of the spacing unit in which the well operates and the depth of the pool from which the well produces. For unspaced Allocated Pools, "[e]ach well. . .shall be assigned the applicable 10 acre allowable from the Allocated Well Allowable Table. . .multiplied by the current allowable factor."64 Upon request by either the Director of Conservation or any interested party, the OCC may set the allowables for an allocated pool on the basis of a pool-specific allowable formula established within the applicable pool rules.65

The OCC sets market demand factors on the basis of market demand hearings at which it determines "the reasonable market demand for oil, gas and other hydrocarbons produced in Oklahoma for consumption in and outside the State for the ensuing proration period that can be produced from each common source of supply on a statewide basis without avoidable waste."66

59. O.G.R. Rule 2-211(a).
60. Id.
61. O.G.R. Rule 2-221(b).
62. O.G.R. Rules 2-220; 2-222(a), (b), (d); 2-231.
63. O.G.R. Rule 2-222(d).
64. O.G.R. Rule 2-222(e).
65. O.G.R. Rule 2-222(f).
Reasonable market demand includes:

[the demand for oil, gas and other hydrocarbons for reasonable current requirements for current consumption and use within and outside the State, with such adjustments as may be necessary upward or downward to maintain adequate aboveground stocks of crude oil and its products and underground stocks of natural gas, so as to provide a continuous supply of petroleum products to the consumer and essential strategic supplies for national defense.]

Factors considered by the OCC in determining market demand include the following:

(1) Any statement communicated to the Commission by any purchaser or taker of oil and gas, stating the amount of oil and gas produced from common sources of supply that such purchaser or taker contemplates or intends to purchase during the period of time involved; or in lieu thereof, the capacity of the purchaser's transportation or marketing facilities which will be, during the time involved, available for transporting and/or marketing the oil or gas that may be produced from common sources of supply.

(2) Official records, reports and statistical information compiled and kept by the Conservation Division that can be utilized in determining reasonable market demand.

(3) Reports, facts and materials by the Bureau of Mines or any other recognized authority that impartially reflects reasonable market demand.

(4) Sworn or unsworn statements of interested parties and any other evidence which the Commission may deem relevant to the determination of reasonable market demand.

Finally, "[a]fter the Commission has determined the amount of oil or gas to be produced from all oil and/or gas pools during the following proration period, the amount so determined will be allocated ratably and without discrimination among the various pools within the State."

The OCC sets the waste factor for allowables purposes, which is the amount of oil that can be produced without waste during the proration period, upon consideration of the following factors:

67. O.G.R. Rule 1-202(d).
68. Id.
69. O.G.R. Rule 1-202(e). Today, this Market Demand Hearing Process is conducted semiannually on a perfunctory basis only, since the allowables set by this process apply only to wells producing in excess of 60 barrels per day, and very few oil wells in Oklahoma produce that much. Moreover, the allowables set by reference to the allowables tables are, even after adjustment for market demand factors, usually greatly in excess of deliverability from the wells. As an example of how little most Oklahoma oil wells produce, in 1984 Oklahoma had about 100,000 operational oil wells which produced in the aggregate about 435,000 barrels per day. Interview with Ben Jackson, Staff Attorney Oil & Gas Conservation Division, Oklahoma Corporation Commission, in Oklahoma City (June 21, 1985).
Productive capacity of the wells' effective pay thickness of the producing zones; size and content of the reservoir; reservoir performance, including bottom hole pressure, gas-oil ratios, average depth of the pay zone, type of drive, permeability, water encroachment and water production, porosity, productivity indices and proper withdrawal rates from the reservoir as a whole.\(^{70}\)

For new pools for which adequate information is not available, the Commission shall:

- establish allowables based upon such factors as are available to the Commission, including acreage, average depth of the pay zone, productive capacity of the wells, effective pay thickness, and, as a practical measure of the size of the reservoir, the size of the area to be drained by the well.\(^{71}\)

3. Unallocated Pool Allowables

Unallocated pools are those which do “not require specific regulation and control by the Commission to restrict production to the market demand, aid in the prevention of waste, assure the maximum ultimate recovery of oil and gas from the pool or area or protect correlative rights. . . .”\(^{72}\) “An individual lease in an unallocated pool or area shall be assigned allowables on either (1) a per-well basis, or (2) a lease basis, at the option of the operator.”\(^{73}\) “If the operator elects to accept the per-well basis allowable, each well on the lease shall be assigned the applicable well allowable from the Allocated Well Allowable Table. . . .”\(^{74}\) “If the operator elects to accept the lease basis allowable, the allowable for the lease shall be the shallowest 10 acre allowable from the Allocated Well Allowable Table. . . .multiplied by the number of wells on the lease.”\(^ {75}\)

4. Enhanced Recovery Projects Allowables

Pools are classified as Enhanced Recovery Projects when they have been approved by the OCC for enhanced recovery operations. Pools qualify as Enhanced Recovery Projects whenever the OCC determines that “substantial quantities of additional oil can be recovered” by the injection into them “of fluid or fluids” which “would not be recoverable under ordinary primary depletion methods.”\(^ {76}\) OCC

\(^{70}\) O.G.R. Rule 2-222(a).
\(^{71}\) O.G.R. Rule 2-222(b).
\(^{72}\) O.G.R. Rule 2-231.
\(^{73}\) O.G.R. Rule 2-323(a).
\(^{74}\) O.G.R. Rule 2-232(b).
\(^{75}\) O.G.R. Rule 2-232(c).
\(^{76}\) O.G.R. Rule 2-238.

\textit{a. Pressure Maintenance Project Allowables}

Operators of pressure maintenance projects may have their allowables set on a unit or lease basis.\textsuperscript{77} Allowables are computed by “multiplying the number of wells in the project by the applicable allowable from the Allocated Well Allowable Table.”\textsuperscript{78} Upon application, the OCC may adjust the allowables for the project “to maintain the most efficient rate of production.”\textsuperscript{79}

\textit{b. Gas Repressing Project Allowables}

Allowables for Gas Repressing Projects are computed on a total project basis.\textsuperscript{80} For each project, the allowable is calculated by “multiplying the total number of wells on the project (injection and producing wells) by forty-five (45) barrels and by the number of calendar days [in the proration period].”\textsuperscript{81} Upon application the OCC may adjust the allowable for the project “to maintain the most efficient rate of production.”\textsuperscript{82}

\textit{c. Waterflood Project Allowable}

OCC rules specify that:

For any project to qualify for a waterflood allowable, the injection well or wells must be located on or serving such project and completed in the same common reservoir, and the current water injection rate must equal or exceed the current rate of oil and water production; or the cumulative water injected must exceed the cumulative oil and water produced since the commencement of the waterflood project.\textsuperscript{83}

“An approved and qualified waterflood project shall be entitled to produce an allowable of forty-five (45) barrels of oil per well per day including producing and injection wells on a project basis upon the acreage developed for waterflooding.”\textsuperscript{84} Finally, “[i]n no case will the waterflood oil allowable be permitted to exceed the volume of water

\textsuperscript{77} O.G.R. Rule 2-240(a).
\textsuperscript{78} Id.
\textsuperscript{79} Id.
\textsuperscript{80} O.G.R. Rule 2-249(b).
\textsuperscript{81} Id.
\textsuperscript{82} Id.
\textsuperscript{83} O.G.R. Rule 2-240(c)(1).
\textsuperscript{84} O.G.R. Rule 2-240(c)(3).
injected. Acreage developed for water flooding shall be that acreage whereon are located input wells and producers whose production rates can be reasonably expected to be affected by the existing program.™

5. Excessive Water Exempt Project Allowables

Excessive water oil wells are those having a water-oil ratio of 3 to 1 or more.® The allowables for excessive water oil wells within unallocated pools, or within the Oklahoma City Wilcox or Oklahoma City Simpson pools, are equal to the "basic daily allowable of like depth on 10 Acre spacing shown on the Allocated Well Allowable Table. . . ."® The allowables for excessive water oil wells within an allocated pool may be specially set by order of the OCC.® Specially set allowables "shall be computed separately and added to the allowable for the lease."®

6. Administering Underage and Overage

"All underage in an allocated pool in excess of 15% of the current month's allowable shall be cancelled."® Such cancelled underage may be administratively reinstated upon application to the OCC if, after written notice is mailed to all off-set operators, the OCC receives no written protest within ten days.® Once the OCC has reinstated the underage, it may authorize the purchaser to run it "during the second month after the cancellation."® "Failure or refusal of the purchaser to run or take the allowable shall be grounds for reinstatement of any underage accumulated by reason of such failure or refusal. Underages may be accumulated until they are balanced by equal runs in excess of current allowables."®

As for overage, "[n]o lease, unit, project, or operation shall be overproduced in excess of 15% of the allowable for the proration period. . . . All overage shall be deducted from the lease allowable for the second succeeding proration period."®

® O.G.R. Rule 2-240(c)(4).
® Id.
® Id.
® Id.® O.G.R. Rule 2-271(b).
® O.G.R. Rule 2-105(b).
® Id.
® Id.
® Id.® O.G.R. Rule 2-105(d).
® O.G.R. Rule 2-105(a).
III. Allocating Market Demands — Ratable Taking and Purchasing

A. Statutory Authority

Oklahoma has four statutes comprising a legislative mandate that persons taking or purchasing gas in Oklahoma fields for purposes other than developing oil and gas fields or for their own domestic use shall not discriminate among wells and pools connected to their delivery systems with respect to their takes and purchases of natural gas. Two Oklahoma statutes, sections 233 and 239 of title 52 (hereinafter referred to as sections 233 & 239), give the OCC the power to require ratable taking.

Section 233 is a pure ratable take statute. While section 239 is primarily a ratable production statute designed to prevent waste by authorizing the OCC to rationalize production capabilities with market demands, it also gives the OCC authority to:

regulate the taking of natural gas from any or all such common sources of supply within the state so as to prevent waste, protect the interests of the public, and of all those having a right to produce therefrom, and to prevent unreasonable discrimination in

95. OKLA. STAT. tit. 52, § 233 (1981) provides:

Any person, firm or corporation, taking gas from a gas field, except for purposes of developing a gas or oil field, and operating oil wells, and for the purpose of his own domestic use, shall take ratably from each owner of the gas in proportion to his interest in said gas, upon such terms as may be agreed upon between said owners and the party taking such, or in case they cannot agree at such a price and upon such terms as may be fixed by the Corporation Commission after notice and hearing; provided, that each owner shall be required to deliver his gas to a common point of delivery on or adjacent to the surface overlying such gas.

96. The OCC is empowered to reduce production to market demand levels when market demands are less than the aggregate production capacity of the operators in any common source. As a consequence, some natural gas cannot be marketed without waste occurring. This authority is contained in OKLA. STAT. tit. 52, §239 (1981), which in relevant part states that:

Whenever the full production from any common source of supply of natural gas in this state is in excess of the market demands, then any person, firm or corporation, having the right to drill into and produce gas from any such common source of supply, may take therefrom only such proportion of the natural gas that may be marketed without waste, as the natural flow of the well or wells owned or controlled by any such person, firm or corporation bears to the total natural flow of such common source of supply having due regard to the acreage drained by each well, so as to prevent any such person, firm or corporation securing any unfair proportion of the gas therefrom. . . . The [Corporation] [Commission] is authorized and directed to prescribe rules and regulations for the determination of the natural flow of any such well or wells, and to regulate the taking of natural gas from any or all such common sources of supply within the state, so as to prevent waste, and to protect the interests of the public. . . . (Emphasis added.)

Pursuant to its authority under section 239, the OCC has at various times subjected natural gas pools experiencing aggregate market demands less than the aggregate production capacity of all the operators therein to special field rules. These rules limit total allowable production from such fields to a volume of gas equal to total purchaser nominations. See Sinclair Oil & Gas Co. v. Corporation Comm'n, 378 P.2d 847 (Okla. 1963).
favor of any one such common source of supply as against another.\textsuperscript{97}

In the case of \textit{Republic Natural Gas Co. v. State},\textsuperscript{98} the Oklahoma Supreme Court held that section 239, which authorizes the OCC to set production allowables, also vests in the OCC the power to enforce ratable taking as mandated by section 233.\textsuperscript{99}

Ratable purchasing is required by statute in section 23, title 52 (hereinafter referred to as section 23) and section 240, title 52 (hereinafter referred to as section 240). Section 23 is primarily directed to pipeline operators.\textsuperscript{100} Section 240 is directed less to pipelines, and was passed as a part of a legislative package more concerned with the prevention of waste than with the protection of correlative rights.\textsuperscript{101} Nevertheless, the language of section 240 is substantially identical to that of section 23.\textsuperscript{102}

\textsuperscript{97} OKLA. STAT. tit. 52, § 239 (1981).
\textsuperscript{98} 198 Okla. 350, 180 P.2d 1009 (1947).
\textsuperscript{99} Id. at 355, 180 P.2d at 1015.
\textsuperscript{100} OKLA. STAT. tit. 52, § 23 (1981), which states in relevant part that:

\begin{quote}
Every corporation, joint stock company, limited copartnership, partnership or other person, now or hereafter claiming or exercising the right to carry or transport natural gas by pipe line or pipe lines, for hire, compensation, or otherwise, within the limits of this state, is allowed by, and upon compliance with the requirements of this act, as owner, lessee, licensee, or by virtue of any other right or claim, which is now engaged or hereafter shall engage in the business of purchasing natural gas shall be a common purchaser thereof, and shall purchase all the natural gas in the vicinity of, or which may be reasonably reached by its pipe lines, or gathering branches, without discrimination in favor of one producer or one person as against another, and shall fully perform all the duties of a common purchaser; but if it shall be unable to perform the same, or be legally excused from purchasing and transporting all the natural gas produced or offered, then it shall purchase and transport natural gas from each person or producer ratably, in proportion to the average production, and such common purchasers are hereby expressly prohibited from discriminating in price or amount for like grades of natural gas or facilities as between producers or persons; and in the event it is likewise a producer, it is hereby prohibited from discrimination in favor of its own production, or production in which it may be directly or indirectly interested, either in whole or in part, and its own production shall be treated as that of any other person or producer. All persons, firms, associations, and corporations are exempted from the provisions of this act . . . where the nature and extent of their business is such that the public needs no use in the same, and the conduct of the same is not a matter of public consequence. . . .
\end{quote}

\textsuperscript{102} OKLA. STAT. tit. 52, § 240 (1981), which states in relevant part that:

\begin{quote}
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 Corporation Commission . . . 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 person, and shall be taken only in the ratable proportion that such production bears to the total production available
B. Statutory Interpretations

*Republic Natural* contains many lessons for those seeking to learn how Oklahoma applies its ratable taking and common purchaser statutes. Republic produced natural gas from its own wells in the Oklahoma portion of the Hugoton field, and carried its production (and the royalty owners' in-kind royalty gas), through its pipelines to common purchasers in Kansas and Oklahoma. Republic did not produce at levels in excess of OCC-prescribed well allowances.  

Another producer (Peerless) had a well surrounded by those of Republic. With the production capacity of the Hugoton field in excess of market demands, Peerless had not found a purchaser for its gas, and its well was suffering drainage. Over Republic's protests the OCC found Republic to be both a common carrier and a common purchaser and ordered Republic to either take gas ratably from Peerless' well or to discontinue producing gas in Oklahoma.  

On appeal, Republic argued that it could not be considered either a common purchaser or a common carrier since it had never performed either function for another producer in the Hugoton field. Also, Republic argued that section 233 had been superseded by provisions of section 240, and therefore the OCC lacked authority to impose ratable taking on a person who was not engaged in purchasing natural gas.

The Oklahoma Supreme Court rejected both arguments. The court stated that it was obvious that section 233 had not been repealed, because both section 233 and the act purportedly superseding it had been brought forward in each subsequent revision of the state's conservation laws. The court then held that the ratable take provisions of the later act apply to persons engaged in purchasing and selling natural gas so as to make them common purchasers, while section 233 applies to persons who produce, transport and sell their own natural gas so as to require them to take gas ratably from other purchasers.

The case of *Oklahoma Natural Gas Corp. v. State* illustrates...
nicely the general parameters of the common purchaser’s duties as prescribed by statute. Certain well owners were suffering drainage from their wells because the common purchaser to which they were connected (ONG) had less need for gas than the common purchaser (Empire) that was taking gas from surrounding wells. To prevent further drainage, the aggrieved well owners requested that the OCC require Empire (with which they did not have a gas purchase contract) to begin taking gas ratably from their wells.

In resisting the well owners’ request, Empire argued that the OCC lacks the power to force common purchasers to take gas from wells with which they do not have a contract. ONG also resisted the request, contending that the OCC lacks the power to require or permit another purchaser to take gas from reserves for which ONG has contracted and is managing in the interest of its public service customers. Nevertheless, the OCC ordered Empire to take gas in the quantities necessary to achieve ratable taking as compared to the gas taken from the offset wells, and ONG was ordered to make the necessary connections for Empire to carry out the ratable take order. The Oklahoma Supreme Court sustained the OCC’s ratable take orders against the contentions of ONG and Empire that the orders impermissibly impaired their gas purchaser contracts.

*Republic Natural* illustrates that any person taking or purchasing natural gas from an Oklahoma pool must give each owner of the right to produce gas from the pool an equal opportunity to market his or her production. Equal opportunity means that producers lacking adequate market outlets for their gas have the right to force takers or purchasers with whom they do not have a contract to buy their gas. The producers need only demonstrate that their wells can, with reasonable efforts and costs, be connected to the pipeline of such takers and purchasers. Sections 23, 233, 239 and 240 also condition the producers’ rights to be treated ratably by takers and purchasers on their abilities to offer gas of like quality and pressure to gas being taken or

110. *Id.* at 105, 17 P.2d at 488-89.

111. *Id.*

112. *Id.* at 106, 17 P.2d at 489.

113. *Id.* at 106-07, 17 P.2d at 489-90.

114. *Id.* at 110, 17 P.2d at 493-94.

115. *Id.* at 111-12, 17 P.2d at 497. *See also* Oklahoma Natural Gas Oil v. Choctaw Gas Co., 205 Okla. 255, 236 P.2d 970 (1951). *But see* Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Bd., 106 S. Ct. 709, 717 (1986), where the Court noted that forcing purchasers to take ratably from wells with whom they do not have a contract will result in higher prices to consumers, because purchasers would take less gas from a well with whom they had contracted; this would likely trigger take-or-pay provisions.
demanded by the takers and purchasers with whom they desire to do business.

The OCC also is given the power by sections 23, 233, 239, and 240 to insure that takers and purchasers take gas of like quality and pressure on terms that do not discriminate among producers as to price and quantity. Purchasers satisfy the price obligation by offering a price equal to the going field price for gas of a particular quality and pressure. As to the quantity obligation, takers and purchasers are not required to take more gas than they need, but they must take what they need on a pro-rata basis from all wells that can be reasonably connected to their pipeline. In the Matter of Rules and Orders of the Corporation Commission Regarding Market Demand for Gas, the OCC declined to issue a definition of "ratable" as it is used in the ratable taking and purchasing statutes. Instead, the OCC approved a hypothetical case wherein each well's share of a purchaser's demand

116. See Application of Moran, 201 Okla. 47, 49-51, 200 P.2d 758, 760-62 (1948). The OCC does not presently, and has not for some years, attempted to regulate or set the price of natural gas sales. Interview with Ben Jackson, Staff Attorney Oil & Gas Conservation Division, Oklahoma Corporation Commission, in Oklahoma City (June 21, 1985). The OCC's abstinence from regulating or setting gas sales prices at the wellhead stems from past federal court disapproval of such pricing activities. In Natural Gas Pipeline Co. v. Panoma, 349 U.S. 44 (1955), the U.S. Supreme Court invalidated certain minimum price orders of the OCC by holding that such state pricing activities as applied to gas purchased "by a company which transports the gas for resale in interstate commerce . . . are subject to the exclusive regulations of the Federal Power Commission." Id. at 44-45. More recently, the OCC attempted to declare that the pricing of natural gas below certain minimum prices was wasteful. The decision was overturned by a three-judge federal district court ruling that held, among other things, that:

The Natural Gas Act leaves no room for direct regulation of the prices of interstate wholesale sales of natural gas. Likewise it leaves no room for indirect state regulation which accomplishes the same result, even though the regulation be framed to achieve ends which ordinarily fall within the ambit of state power.


While the thrust of these cases is that states cannot impose regulations affecting the price of gas flowing in interstate commerce, with the passage of the comprehensive price ceilings of the Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3312-3319 (Supp. IV 1977-1981), arguably the states are preempted from regulating the price of gas in intrastate commerce. However, regulation covering maximum prices has been enacted by several states. See Kansas Natural Gas Price Protection Act, KAN. STAT. ANN. §§ 55-1401 to -1455 (1983); New Mexico Natural Gas Pricing Act, N.M. STAT. ANN. §§ 62-7-11 to -23 (1978); Oklahoma Natural Gas Price Protection Act, OKLA. STAT. tit. 52, §§ 260.1 to -.13 (West Supp. 1984-85). This form of state price regulation was upheld against Commerce Clause and preemption attacks in Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400 (1983). Moreover, certain categories of natural gas were deregulated as of Jan. 1, 1985, arguably re-opening the regulatory role for the states that existed prior to the application of the Natural Gas Act to wellhead price regulation. See Transcontinental Gas Pipeline Corp. v. State Oil & Gas Bd., 457 So. 2d 1298, 1316-18 (Miss. 1984). Transcontinental was expressly reversed by the U.S. Supreme Court, however, on January 22, 1986. See Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Bd., 106 S. Ct. 709 (1986).


118. Market Demand Order, supra note 12.
was calculated on the basis of the ratio of its absolute open flow (i.e. capacity to produce) to the sum of the absolute open flow rates of all the wells from which the purchaser is obligated to take gas.\textsuperscript{119}

Finally, although takers and purchasers are prohibited from discriminating in favor of one pool as compared to others when they take gas from Oklahoma wells, this prohibition does not require them to connect to gas pools with which they have had no previous connection. Rather, takers and purchasers are simply required to take gas ratably from the pools from which they have chosen to be connected. Thus, if a taker or purchaser is connected to pools A and B, it is required to treat pools A and B, and the producers therein, ratably with respect to its takes, but the taker or purchaser is not required to take gas from any other pool.\textsuperscript{120}

\textit{C. Market Demand Order}

Ratable taking and purchasing recently have become important issues within Oklahoma's natural gas industry as the demands for gas at the burnertip have stabilized or fallen in the wake of increased deliverability of gas from Oklahoma gas pools. The economic pressures created by these natural gas supply and demand imbalances caused the OCC to consider setting gas allowables on the basis of statewide demands for gas as indicated by purchaser nominations.\textsuperscript{121} Eventually, the OCC established a priority schedule to govern the taking and purchasing of Oklahoma gas, instead of imposing production re-

\textsuperscript{119} Id. at 13.

\textsuperscript{120} See Peppers Ref. Co. v. Corporation Comm'n, 198 Okla. 451, 454, 179 P.2d 899, 902 (1947) (In determining market demand the OCC must calculate the demand for each pool, and is prohibited from dealing with the various common sources as a unit for purposes of calculating and allocating market demands for and among individual pools); O.G.R. Rule 1-305(b) (requiring purchasers to follow a priority schedule in taking gas "whenever the permitted production from all wells in any common source of supply in its system in this state . . . is in excess of that purchaser's reasonable market demand." Id. (emphasis added)).

\textsuperscript{121} Sharp reduction in demand in Oklahoma for natural gas caused the OCC in early 1983 to be confronted with numerous applications for ratable take orders and for permission to flare casinghead gas. Market Demand Order, supra note 12, at 1. On Feb. 8, 1983, Oklahoma Natural Gas Co. (ONG), Oklahoma's largest natural gas utility, filed an application requesting an OCC order to limit "the production of natural gas in the State of Oklahoma to the reasonable demand therefor, to provide procedures for the determination of such market demand to assure equitable participation in such market demand by producers and suppliers." Market Demand Proceedings, Notice of Inquiry, at 1 (OCC June 1, 1983) [hereinafter cited as Notice of Inquiry]. In essence, ONG was requesting that the OCC promulgate rules that would set natural gas allowables on the basis of purchaser nominations for all wells producing natural gas in Oklahoma rather than just for wells within Special Allocated Pools. See Market Demand Proceedings, Proposed Gas Proration Rules Submitted by Oklahoma Natural Gas (June 8, 1983). Subsequently, the OCC dismissed the ONG application and converted it into a general rule making proceeding. Notice of Inquiry, supra.
In the interest of waste prevention, the Priority Schedule for Supply and Demand Imbalance articulated by O.G.R. Rule 1-305,123

122. Throughout the Market Demand Proceedings, the strong resistance from most participants to any market demand rationalization procedure that in any way affected the level of producer allowables continued unabated. For example, producers consistently alleged that the promulgation of statewide proration rules would allow gas purchasers to escape their take-or-pay obligations in gas purchase contracts and would also cause natural gas drilling and production activities to decline in Oklahoma relative to states without such rules. See Market Demand Proceedings, Response of Gulf Oil Co. to Notice of Inquiry (June 7, 1983). Largely as a result of this resistance, at the urging of the OCC's Oil and Gas Conservation Division, the OCC converted the Market Demand Proceedings from an examination of natural gas production allowables to a hearing on a proposed priority schedule directing purchasers and takers of natural gas to curtail their purchases and takes in a particular order “to prevent waste, protect correlative rights, and provide a continuous supply of petroleum products to the consumer and most importantly, provide essential strategic supplies for our national defense.” See Market Demand Proceedings, Suggested Rules of the OCC's Oil and Gas Conservation Division (June 9, 1983).

The final market demand rules emanating from the Market Demand Proceedings did indeed merely establish a priority schedule for purchasers and takers of Oklahoma natural gas to follow when they find it necessary to reduce their purchases below the production capacity of operators within Oklahoma natural gas pools. To drive home the point that these rules in no way affect permissible production levels, in its finding number 13 (13) the OCC stated that “The Commission also finds and states emphatically for the record that these new rules were not intended to and do not affect or alter the allowables for any well, pool, or common source of supply as previously established by the Commission rule or order.” Market Demand Order, supra note 12, at 14.

123. As promulgated by the OCC, the Priority Schedule for Supply and Demand Imbalance is contained in a new rule, O.G.R. Rule 1-305, which in relevant part provides that:

(b) In the interest of the prevention of waste and protection of correlative rights, the following priority schedule shall be implemented by any first purchaser of gas whenever the permitted production from all wells in any common source of supply in its system in this state, including gas which is processed, is in excess of the purchaser's reasonable market demand; provided, however, if the first purchaser does not contractually control wellhead production, then the first taker of gas shall be responsible for implementation of the following priority schedule.

i. Priority One — Hardship and distressed wells.

ii. Priority Two — Enhanced recovery wells.

iii. Priority Three — Wells producing casinghead gas and associated gas.

iv. Priority Four — If after the first purchaser or first taker has taken gas from Priorities One through Three above and still has further market demand in its system for gas, said purchaser or taker shall take ratably from all allocated, special allocated and unallocated common sources of supply 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.

(c) When permitted production of gas from all wells from which a purchaser or taker is required to take exceeds the market demands of said purchaser or taker, all reductions in gas purchases or takes from wells in each Priority shall be ratably. All production from the lower priority wells shall be shut-in before production from any well in the next higher priority is curtailed.

(d) Any interested party may file an application requesting that the Commission, for good cause shown, authorize limited deviation from the general priority schedule provided under (b) above. The Commission on its own motion may initiate a review of the continued need for such a limited deviation. After notice and hearing, the Commission may authorize limited deviation upon finding that the same is necessary in order to prevent waste, protect correlative rights, or is otherwise required by the public interest or authorized by law.

The OCC defined the terms hardship well, distressed well, enhanced recovery well, and associated gas in a new O.G.R. Rule 1-101 as follows:
commands takers and purchasers to make departures from ratable taking that favor certain wells, pools and projects when allocating their demands for gas among producers connected to their pipeline systems. The Priority Schedule establishes four taking priorities: (1) hardship and distressed wells, (2) enhanced recovery wells, (3) wells producing casinghead gas and associated gas, and (4) all other types of wells within allocated, special allocated or unallocated pools. If their market demands permit, takers and purchasers are to take the full amount of gas each well on their systems is allowed to produce. If their market demands are exceeded by the total production capacity of the wells on their systems, takers and purchasers are to take the full production from wells classified in an upper priority before taking any gas from wells classified in the next lower priority.

Under this scheme, takers and purchasers must take the full production from wells within priority one before taking any gas from priority two, and take the full production from wells in priority two before taking gas from priority three, and so on. Obviously, this pattern of taking departs from the ratable taking patterns mandated in Inexco. The OCC justified favoring hardship and distressed wells by opining that such wells "would suffer... an inordinate amount of waste if shut in during times of purchaser curtailments..." and that "many distressed wells could cause danger to the public safety due to possible surface and underground blowouts." As for enhanced re-

1. Hardship well shall mean a well authorized by commission order to produce at a specified rate because reasonable cause exists to expect that production below said rate would damage the well and cause waste.
2. Distressed well shall mean a well authorized by Commission order to produce at an unrestricted rate in the interest of public safety due to technical difficulties which temporarily cannot be controlled.
3. Enhanced recovery well shall mean a well producing in an enhanced recovery operation in accordance with Commission order.
4. Associated Gas shall mean gas produced from Commission ordered combination oil and gas reservoir in which allowed rates of production are based upon volumetric withdrawals.

124. O.G.R. Rule 1-305(b).
125. O.G.R. Rule 1-305(b)(iv), (c). The OCC has permitted Oklahoma Natural Gas Co. (ONG) to depart from the priority schedule established by O.G.R. Rule 1-305 in order to acquire enough low priced gas to implement a special Oklahoma Fertilizer Gas Sales Program. Application of Oklahoma Natural Gas for Limited Deviation from the General Priority Schedule Established by O.G.R. Rule 1-305, Order No. 274,690, at 15 (Mar. 15 1985). Under the Fertilizer Program, ONG is permitted to sell gas to certain fertilizer plants at a rate of $2.518 for 35% of the gas sales and at a rate between $3.20 and $3.50 for 65% of the gas sales. Id. To facilitate the Fertilizer Program, the OCC permits ONG to establish a category 3½ so that it may purchase on a preferential basis enough priority 4 gas that is priced below $2.00 per mcf. to satisfy 35% of the fertilizer sales volumes before it must purchase priority 4 gas priced in excess of $2.00 mcf. Id.
126. See supra note 117 and accompanying text.
127. Market Demand Order, supra note 12, at 5.
covery wells:

The justification for placing enhanced recovery wells in Priority Two was that once a flood front has been established in a secondary oil recovery project, it is a commonly accepted fact that if the enhanced recovery project is shut in for any length of time, there is a possibility waste will occur due to the fact that the flood front will be lost and therefore total oil production will decline and in most cases will not regain the production capacity experienced prior to shutting in the field.\textsuperscript{128}

Finally, as to casinghead gas and associated gas:

The justification for placing oil wells producing casinghead gas in Priority Three is that demand for oil exceeds supply and, therefore, the operators can sell all the oil they produce. In addition, it is extremely expensive to technically return oil wells to production if they have been previously shut-in due to casinghead gas not being taken by the purchaser. Finally, the economy of the State and the supply of petroleum products to the nation must be considered.

The justification for placing associated gas in the same priority as casinghead gas is that if wells producing gas in association with the oil in an associated gas reservoir are not allowed to produce, it could reduce the amount of oil capable of being produced, thereby causing waste and violation of correlative rights.\textsuperscript{129}

If takers and purchasers can take some, but not all, of the gas produced from a particular priority, they must allocate a ratable share of their remaining demand to each well therein. The ratable share of any specific well shall be determined by the ratio of its absolute open flow to the sum of the absolute open flow rates of all the wells within the applicable priority.\textsuperscript{130}

\textit{D. Application to Interstate Pipe Lines}

On January 9, 1984, the OCC initiated proceedings to consolidate a number of cases pending before it concerning the application of

\textsuperscript{128} Id.
\textsuperscript{129} Id.
\textsuperscript{130} Id. at 13.

On June 4, 1985, the OCC held in In Re: Contempt Proceedings Against Arkla, Inc. for Violating O.G.R. Rule 1-305, Order No. 279,532, that:

Oklahoma Corporation Commission Order No. 246,797 . . . specifically declined to establish or define what is ratable and that order did not adopt the hypothetical example of a method of calculation included in [Appendix III] . . . as a part of the rule. Arkla's calculations for ratable takes were identical to the method suggested in [Appendix III], with the exception that deliverability was substituted for absolute open flow in the calculations . . . . Considering the foregoing, and the method used by Arkla to calculate its obligations under Rule 1-305, it would be unreasonable to hold Arkla, Inc. in contempt.

\textit{Id. at 2}.
Oklahoma's ratable take and common purchaser statutes and regulations to specific circumstances. On Feb. 27, 1984, the OCC issued Order No. 254,451, which among other things scheduled for argument and hearing the issues of whether:

1. The State of Oklahoma is preempted by the Commerce Clause of the United States Constitution from enforcing the requirements of §240 requiring the ratable taking of gas against interstate pipelines which are the first purchasers of Oklahoma-produced natural gas?

2. The Federal Energy Regulatory Commission under the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978 has sole authority over the regulation of gas purchases by interstate purchasers of natural gas thereby preempting the State of Oklahoma from acting under §§239-240?

After due consideration, the OCC answered the foregoing questions in the negative on July 3, 1985.

1. Commerce Clause Issues

The OCC held that sections 239 and 240 are consistent with the requirements of Pike v. Bruce Church, Inc., in that they (1) do not discriminate against interstate commerce, (2) only incidentally affect interstate commerce, (3) effectuate legitimate local public interest, and (4) do not impose excessive burdens on interstate commerce in relation to putative local benefits. The OCC rejected contentions that section 235 and 240 are discriminatory and promote economic protection by noting that both apply to interstate and intrastate pipelines. The OCC also stated that regulation of interstate pipeline takes was merely incidental to, and an alternative method for, regulating production to prevent waste and protect correlative rights. The cases of Cities Service Gas Co. v. Peerless Oil & Gas Co., Champlin Refining Co. v. Corporation Commission, and Walls v. Midland Carbon Co., were cited for the proposition that gas producing states have a legitimate

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131. 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, at 1 (July 3, 1985) [hereinafter cited as Ratable Take Order].
132. Id.
133. Id. at 17-18.
135. Ratable Take Order, supra note 131, at 5-10.
136. Id. at 5, 9.
137. Id. at 6, 10.
139. 286 U.S. 210, 233-34 (1932).
140. 254 U.S. 300, 319 (1920).
interest in establishing regulations to conserve their valuable natural gas resources.\textsuperscript{141}

The OCC rejected several contentions that Oklahoma's ratable taking requirements are overly burdensome to interstate commerce. The OCC noted that interstate pipelines presently help administer the field rules applicable to special allocated gas pools without incurring excessive costs or operational responsibilities. These field rules require tasks very similar to those required to comply with Oklahoma's ratable take regulations.\textsuperscript{142} The OCC dismissed as speculative the contention that by complying with Oklahoma's ratable taking regulations, interstate pipelines will incur increased construction and operational costs and increased contractual liabilities that will lead to higher natural gas prices at the burnertip.\textsuperscript{143} While acknowledging that compliance with state ratable taking laws could increase the take-or-pay liabilities of some pipelines, the OCC stated that such economic scenarios are for now only hypothetical. To conclude that there are other methods to accomplish the legitimate purpose of conserving Oklahoma's natural gas resources "would subject the state's power to protect its interest to that of private contracting practices."\textsuperscript{144}

The U.S. Supreme Court, ruling in \textit{Peerless} prior to the extension of natural gas price regulation to the wellhead, upheld the validity of sections 239 and 240 against a commerce clause challenge.\textsuperscript{145} In discussing the relevance of \textit{Peerless} to the issues before it, the OCC concluded: "We are mindful that the Court's analysis of the State's order setting prices is no longer valid under \textit{Phillips Petroleum Co. v. Wisconsin}, 347 U.S. 672 (1954), but believe that the Court's analysis of the State's conservation measures as determined by the legislature in enacting Sections 239 and 240 is precedential."\textsuperscript{146}

Finally, the OCC concluded that its ratable taking regulation may be "an incident of production and not part of interstate commerce."\textsuperscript{147} In reaching this conclusion, the OCC stated: "[I]t seems only logical that when production is dictated by pipeline capacity and demand and limited by this agency's setting of an allowable, the pipeline must be an integral part of that production function and regulation."\textsuperscript{148}

\begin{footnotes}
\item[141.] Ratable Take Order, \textit{supra} note 131, at 6-7.
\item[142.] \textit{Id.} at 7.
\item[143.] \textit{Id.} at 7-8.
\item[144.] \textit{Id.} at 9.
\item[145.] 340 U.S. at 185.
\item[146.] Ratable Take Order, \textit{supra} note 131, at 9-10.
\item[147.] \textit{Id.} at 10.
\item[148.] \textit{Id.} The U.S. Supreme Court's most recent decision on the application of state ratable take statutes to interstate pipelines did not reach commerce clause issues. \textit{Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Bd.}, 106 S. Ct. 709, 718 (1986).
\end{footnotes}
2. Preemption Issues

In ruling that Oklahoma's ratable taking regulations are not pre-empted by the federal natural gas regulation scheme created by the Natural Gas Act of 1938 (NGA) and the Natural Gas Policy Act of 1978 (NGPA), the OCC held that the NGPA has effectively eliminated the federal regulatory authority that, according to the U.S. Supreme Court in *Northern Natural Gas Co. v. State Corporate Commission*, preempts state regulation of interstate pipeline wellhead purchasing activities under state ratable taking and common purchaser statutes. The OCC reached this conclusion by pointing out that at the time *Northern Natural* was decided, the price of wellhead natural gas purchases by interstate pipelines was firmly under federal regulatory control, whereas the passage of the NGPA established statutory rate ceilings that "had the effect of supplanting FERC's authority to establish rates for the wholesale market."

Moreover, the OCC concluded that Oklahoma's ratable taking regulations do not stand "as an obstacle to the accomplishments of the full purposes and objects of Congress." To justify this conclusion, the OCC noted that:

The FERC's responsibility to determine just and reasonable prices under the "firm sale" of natural gas has been replaced by categorical price ceilings on natural gas. Congressional objectives have changed since the passage of the NGPA to encourage exploration for, and development of, natural gas reserves. In this regard, the Oklahoma Statutes complement the federal objective as they attempt to prevent waste, thus preserving natural gas for the future.


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151. *Id.* at 15.
152. *Id.* at 16.
153. *Id.*