

# STUDENT NOTES

## MISSISSIPPI'S RATABLE-TAKE RULE PREEMPTED: *TRANSCONTINENTAL GAS PIPELINE CORP. V.* *STATE OIL AND GAS BOARD*

In a five-to-four decision<sup>1</sup> the United States Supreme Court, in *Transcontinental Gas Pipeline Corp. v. State Oil & Gas Board (Transco)*,<sup>2</sup> held that Mississippi's ratable-take regulation<sup>3</sup> which required natural gas pipelines to purchase ratably<sup>4</sup> from all owners of a common pool of gas,<sup>5</sup> was preempted by the Natural Gas Act (NGA)<sup>6</sup> and Natural Gas Policy Act (NGPA).<sup>7</sup>

The Court concluded that Congress had not intended to open the way for the states to regulate interstate pipelines when it enacted the NGPA and limited the jurisdiction of the Federal Energy Regulatory Commission (FERC).<sup>8</sup> Further, it reasoned that ratable-take rules disturb the federal regulatory scheme by subjecting interstate pipelines to varied state regulation of their purchases.<sup>9</sup> Finally, it noted that ratable-take rules either would interfere with the federal goal of ensuring low prices to consumers by forcing interstate pipelines to take higher priced gas or would conflict with the FERC's orders.<sup>10</sup>

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1. Justice Blackmun delivered the majority opinion in which Burger, Brennan, White and Marshall joined. Justice Rehnquist filed a dissenting opinion, in which Powell, Stevens and O'Connor joined. It is interesting to speculate whether the retirement of Warren Burger and the appointment of Antonin Scalia to the Supreme Court would have affected the outcome of the decision.

2. 106 S. Ct. 709 (1986).

3. Mississippi's ratable-take rule provides: "Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, or producers shall purchase without discrimination in favor of one owner, operator, or producer against another in the same common source of supply." Statewide Rule 48, State Oil and Gas Board Rules.

4. Ratability means that each owner has a fair opportunity to recover oil and gas originally in place beneath his land. See H. WILLIAMS & C. MEYERS, *MANUAL OF OIL AND GAS TERMS* 721 (6th ed. 1984).

5. A common pool refers to an accumulation of gas underlying an area. See H. WILLIAMS & C. MEYERS, *supra* note 4, at 138.

6. Natural Gas Act, 15 U.S.C.A. §§ 717-717w (West 1983 & Supp. 1986). For discussions of the NGA, see Pierce, *Natural Gas Regulation, Deregulation, and Contracts*, 68 VA. L. REV. 63, 65-69 (1982); Note, *Legislative History of the Natural Gas Act*, 44 GEO. L.J. 695 (1956).

7. Natural Gas Policy Act, 15 U.S.C.A. §§ 3301-3432 (West 1983 & Supp. 1986). For discussions of the NGPA, see Moody & Garten, *The Natural Gas Policy Act of 1978: Analysis and Overview*, ROCKY MTN. MIN. L. INST. 2-1 (1979); MacAvoy, *The Natural Gas Policy Act of 1978*, 19 NAT. RESOURCES J. 811 (1979); Williams, *Federal Preemption of State Conservation Laws After the NGPA, a Preliminary Look*, 56 U. COLO. L. REV. 521 (1985); Note, *Legislative History of the Natural Gas Policy Act: Title I*, 59 TEX. L. REV. 101 (1980).

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

9. *Id.*

10. *Id.* at 717-18.

While the Court makes clear its objections to Mississippi's ratable-take rules as applied to interstate pipelines, the *Transco* case concerns conservation lawyers both because of its impact upon the states' legitimate interest in conservation of oil and gas and because the opinion does not make clear the Court's view of the limits of preemption of state conservation legislation.<sup>11</sup>

### I. BACKGROUND

Transcontinental Gas Pipeline Corporation (Transco) operates an interstate natural gas pipeline that purchases gas in Louisiana, Mississippi, and Texas. From 1978 to 1982, Transco negotiated thirty-five take-or-pay contracts<sup>12</sup> with various producers<sup>13</sup> of high-cost natural gas<sup>14</sup> from the Harper Sand Gas Pool in Mississippi. Demand for gas was sufficiently high that Transco also purchased the gas from certain smaller interest owners in the Harper Sand Wells, despite the fact that Transco had no contract with them. By 1982 consumer demand for gas had decreased, however, so that Transco no longer needed the high-cost gas from Mississippi.<sup>15</sup> As a result, Transco refused to purchase gas from any non-contracted owner. Coastal Exploration, Inc., a small non-contracted owner, attempted to enter into a contract with Transco under the same terms as Transco's contract with Getty Oil Company (Getty). Transco refused, but offered either to purchase Coastal's share of gas at a significantly lower price than that being paid to Getty or to transport Coastal's gas to another purchaser if Coastal arranged a sale.<sup>16</sup> Coastal rejected this offer, but many other small owners accepted similar offers. Accordingly, Transco stopped purchasing gas from Coastal and the owners who did not agree to its terms.<sup>17</sup>

Coastal filed a petition with the State Oil and Gas Board of Mississippi to

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11. Currently, there are at least seven states which have ratable-take rules similar to the one struck down in *Transco*. On the basis of the *Transco* decision these statutes may also be found unconstitutional if challenged on preemption grounds. See KAN. STAT. ANN. § 55-703 (1983); LA. REV. STAT. ANN. § 30:42 (West Supp. 1984); NEB. REV. STAT. § 57-907 (1984); N.M. STAT. ANN. § 70-2-19 (1986); N.D. CENT. CODE § 49-19-07 (1978); OKLA. STAT. tit. 52, §§ 23, 233 (1981); TEX. NAT. RES. CODE ANN. § 111.083 (Vernon 1978).

12. In a take-or-pay contract the purchaser generally agrees to pay for a specified minimum percentage of gas, typically 70-80% of the quantity of gas the purchaser is empowered to take daily from the producer even if the purchaser takes no gas. See H. WILLIAMS & C. MEYERS, *supra* note 4, at 883.

13. Under contract with Getty Oil Company and Tomlinson Interests Inc., Transco was obligated to buy only shares of gas produced from wells operated by Getty and Tomlinson. However, under contract with Florida Exploration, Transco was obligated to take all the gas produced regardless of ownership. See *Transco*, 106 S. Ct. at 712.

14. The term "high-cost natural gas" is defined by the NGPA as natural gas "produced from any well the surface drilling of which began on or after February 19, 1977, if such production is from a completion location which is located at a depth of more than 15,000 ft." 15 U.S.C.A. § 3317(c)(1) (West Supp. 1986).

15. In the 1970's serious gas shortages appeared as reserves decreased in 1967 from 289.3 trillion cubic feet to 259.6 trillion cubic feet in 1970. See *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 626 n.2 (1972).

16. Transco had been paying non-contracted owners \$7.907/MMBtu, the same price as Getty. Under its market-out-agreement, Transco offered to purchase gas from non-contracted owners at \$5.000/MMBtu. *Transcontinental Gas Pipeline Corp. v. State Oil & Gas Bd.*, 457 So. 2d 1298, 1308-10 (Miss. 1984).

17. Fifty-five non-contracted owners accepted Transco's offer to purchase gas and to further reduce the price paid for gas under certain conditions. See *Transco*, 106 S. Ct. at 712.

enforce statewide Rule 48, which required pipeline purchasers to take ratably from all owners of a common pool of natural gas. The Board ruled that Transco's refusal to purchase gas from Coastal violated Rule 48 and constituted waste as defined by Mississippi's Code.<sup>18</sup> The State Circuit Court of Mississippi in Hines County upheld the order.<sup>19</sup> On appeal, the Supreme Court of Mississippi considered two issues raised by Transco, first, whether the NGPA preempted state regulation of wellhead sales of natural gas and, second, whether Rule 48 constituted an impermissible burden on interstate commerce.<sup>20</sup> The Mississippi court rejected the preemption claim, concluding that the enactment of the NGPA removed the FERC's jurisdiction over high-cost gas.<sup>21</sup> The court reasoned that the state had authority to regulate production of gas from in-state pools because of the enactment of section 601(a)(1) of the NGPA which removed the FERC's jurisdiction from deregulated high-cost gas. The court concluded there was no implicit preemption of Rule 48 because Congress, in enacting the NGPA, did not ban state regulation of deregulated gas.<sup>22</sup> The court further held that *Northern Natural Gas Co. v. State Corp. Commission of Kansas*, a 1963 Supreme Court case which struck down ratable-take rules virtually identical to Rule 48 because they invaded the exclusive jurisdiction of the NGA, was not applicable because the enactment of the NGPA deregulated "deep" gas like that from the Harper Sand Pool.<sup>23</sup> With respect to the commerce clause, the court held that Mississippi's ratable-take rule had a legitimate local purpose of protecting the correlative rights of owners in a common pool of gas although the effect on interstate commerce would result in higher prices to consumers.<sup>24</sup>

The United States Supreme Court noted probable jurisdiction of the case because of the importance of the issues to the functioning of the interstate natural gas market.<sup>25</sup>

## II. THE SUPREME COURT DECISION

### A. Contentions of Transco and Coastal

The thrust of Transco's argument before the Supreme Court was that

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18. The term "waste" refers to "the abuse of correlative rights and opportunities of each owner of gas due to non-uniform, disproportionate or unratable withdrawals causing undue drainage between tracts of land." MISS. CODE ANN. § 53-1-3(k)(3) (1982 & Supp. 1985).

19. *Transco*, 457 So. 2d at 1312.

20. *Id.* at 1304.

21. Under Section 601(a)(1) of the NGPA, "the Natural Gas Act of 1938 (NGA) and FERC's jurisdiction under the Act never apply to deregulated gas." *Id.* at 1316.

22. "[A] federal decision to forego regulation in a given area may imply an authoritative federal determination that the area is best left unregulated, and in that event would have as much pre-emptive force as a decision to regulate." *Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 384 (1983). In *Arkansas Electric* the Court believed that the lack of federal authority left open the area for state regulation. In *Transco*, the Mississippi Supreme Court stated that because there was no congressional enactment after the decision of *Northern Natural* to leave the wellhead price of gas free from state regulation, Mississippi's ratable-take rule was not preempted. *Id.* at 1318.

23. 372 U.S. 84 (1963).

24. *Transco*, 457 So. 2d at 1321.

25. *Transco*, 106 S. Ct. at 711.

Mississippi's authority to promulgate a ratable-take rule was preempted by both the NGA and NGPA.<sup>26</sup> Transco argued three bases for preemption.

First, Transco argued that the pervasive federal interest in regulating the sale of natural gas for resale in interstate commerce precluded the enforcement of state laws in this area.<sup>27</sup> Transco reasoned that the intent of Congress in enacting the NGA and NGPA was to create a pervasive and comprehensive regulatory scheme over the natural gas industry to protect the public interest by maintaining low consumer prices.<sup>28</sup> Transco argued that in enacting the NGPA Congress intended to eliminate the gas shortage created by the dual pricing system between the interstate and intrastate markets,<sup>29</sup> therefore indicating the federal interest in regulating natural gas.<sup>30</sup>

Second, Transco argued that Mississippi's rule interfered with Congress' objective of assuring adequate supplies of gas at fair prices.<sup>31</sup> Transco contended that the ratable-take rule affected the quantity and mix of gas it was required to purchase and would ultimately result in increased consumer costs. Transco's reasoning was that the Mississippi rule would require it to take additional supplies of high priced Mississippi gas, the cost of which would be passed on to consumers along with the costs of additional take-or-pay payments for previously contracted gas which it could not take because of the Mississippi rule.<sup>32</sup>

Finally, Transco asserted that the NGPA required the FERC to review Transco's pricing practices<sup>33</sup> although the FERC did not have the authority to review Transco's purchasing practices.<sup>34</sup> Because the FERC still possessed the power to review a pipeline's pricing practices, Transco argued that Missis-

26. Brief for Appellant at 20, *Transco*, 106 S. Ct. 709 (1986) (No. 84-1076).

27. See, e.g., *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), (discussing the intent of Congress in enacting the NGA to occupy the field of sales and transportation of natural gas in interstate commerce.) Brief for Appellant at 24, *Transco*, 106 S. Ct. 709 (1986) (No. 84-1076).

28. See Section 1(a), 15 U.S.C. § 717(a) which sets forth the intent of Congress:

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

29. Brief for Appellant at 26, *Transco*, 106 S. Ct. 709 (1986) (No. 84-1076).

30. See, e.g., *Tenneco, Inc. v. Sutton*, 530 F. Supp. 411, 418 (M.D. La. 1981) (NGPA was enacted to alleviate gas shortages resulting from inadequate natural gas supplies).

31. Brief for Appellant at 30, *Transco*, 106 S. Ct. 709 (1986) (No. 84-1076).

32. *Id.*

33. 15 U.S.C. § 3431(c)(2) provides:

[T]he Commission may not deny any interstate pipeline recovery of any amount paid with respect to any purchase of natural gas if—

(A) under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4 and 5 of such Act, and . . . except to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds.

34. 15 U.S.C. § 3431(a)(1)(B) provides:

[T]he jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of November 8, 1978, and which is—

(i) high cost natural gas . . . ;

(ii) new natural gas . . . .

issippi's ratable-take rule invaded the FERC's jurisdiction.<sup>35</sup>

In defense of the state regulation, Coastal asserted that under the NGPA, Congress had expressly deregulated the first sale or purchase of high-cost gas such as that produced from the Harper Sand Gas Pool, thus restoring to the states implicit authority to regulate high-cost natural gas.<sup>36</sup> Coastal argued that Transco would be able to comply with both Mississippi's ratable-take rule and the NGPA because Transco could pass on the increase of its costs to consumers unless the amount was "excessive due to fraud, abuse, or similar grounds."<sup>37</sup> Thus, the ratable-take rule would not increase Transco's acquisition costs. Coastal also argued that Mississippi's rule created an opportunity for owners of a common pool to sell their gas in the interstate market. This action would result in more new gas becoming available to the interstate market, thus effectuating the primary objective of the NGPA.<sup>38</sup>

### B. *The Majority & Minority Opinions*

The Supreme Court held that Mississippi's ratable-take rule was preempted, although the high-cost gas was not price-regulated. The Court reasoned that Mississippi's ratable-take rule conflicted with the overall regulatory scheme Congress created in enacting the NGPA, because it would disrupt the Congressional scheme of allowing the supply, the demand, and the price of gas to be determined by market forces. Since the Court found the rule to be preempted it did not consider whether Mississippi's ratable-take rule violated the commerce clause of the Constitution.<sup>39</sup>

The supremacy clause of the Constitution provides the source of the doctrine of preemption.<sup>40</sup> When Congress acts within its constitutional powers federal law preempts inconsistent or conflicting state law.<sup>41</sup> A federal decision to forego regulation may imply that the area is best left unregulated and thus has as much preemptive effect as a decision to regulate.<sup>42</sup>

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35. The scope of the FERC's jurisdiction, as viewed by Transco, included the enforcement of "just and reasonable" standards, FERC inquiry into possible discrimination of interstate pipelines and their purchasing patterns, and the general objective of the FERC; to encourage a competitive market. Brief for Appellant at 33-34, *Transco*, 106 S. Ct. 709 (1986) (No. 84-1076).

36. Brief for the Appellee at 20, *Transco*, 106 S. Ct. 709 (1986) (No. 84-1076).

37. See *supra* note 33.

38. Brief for the Appellee at 22, *Transco*, 106 S. Ct. 709 (1986) (No. 84-1076).

39. The majority did not reach the issue of whether the ratable-take rule violated the commerce clause. Justice Rehnquist concluded that a ratable-take rule's effect on interstate commerce was incidental. Justice Rehnquist applied the balancing test set forth in *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), which held that a state statute will be upheld unless the burden imposed on commerce is clearly excessive in relation to the punitive local benefits. Justice Rehnquist reasoned that the only discriminatory burden created by Mississippi's rule was on Transco's independent supply contracts. Therefore, a ratable-take rule in combination with private contracts or take-or-pay obligations should not be invalidated because the burden is short-lived. In further support of his argument, Justice Rehnquist relied on *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179 (1950), where the Supreme Court held that ratable-take rules did not violate the commerce clause. In Justice Rehnquist's view, enforcement of Mississippi's ratable-take rule would not burden interstate commerce because high-cost gas makes up such a small fraction of the aggregate supply of natural gas.

40. U.S. Const. art. VI, § 2 (supremacy clause).

41. See *Pacific Gas & Elec. Co. v. State Energy Comm'n*, 461 U.S. 190, 203-04 (1983).

42. *Arkansas Electric*, 461 U.S. at 385-86; see also *supra* note 22.

The *Transco* Court addressed the issue of whether Mississippi's ratable-take rule was preempted absent express congressional intent to regulate high-cost gas.<sup>43</sup> Justice Blackmun, writing for the majority, initially considered whether Congress in enacting the NGPA had altered the scheme of federal regulation to such an extent that its prior decision in *Northern Natural* was no longer valid.<sup>44</sup> In *Northern Natural*, the Court stated that Congress in enacting the NGA had created a comprehensive scheme of regulation over natural gas in interstate commerce.<sup>45</sup> The *Northern Natural* Court held that state ratable-take rules were not permissible because they were targeted at interstate purchasers and wholesales for resale and as such, conflicted with the Federal regulatory scheme enacted under the NGA.<sup>46</sup>

The majority in *Transco* found preemption in *Northern Natural* to rest on two considerations: "First, Congress had created a comprehensive regulatory scheme, and ratable-take orders fell within the limits of that scheme rather than within the category of regulatory questions reserved for the States. Second, in the absence of ratable-take requirements, purchasers would choose a different and presumably less costly, purchasing pattern."<sup>47</sup> According to the *Transco* majority, the intent of Congress in enacting the NGPA was to eliminate the natural gas supply and demand problems associated with direct federal price control. In enacting the NGPA, Congress did not intend to permit the states to regulate an area which was still the subject of federal concern. "To the extent that Congress denied FERC the power to regulate . . . it did so because it wanted to leave determination of supply and [demand] to the market . . . . [Congress'] decision to remove jurisdiction from FERC cannot be interpreted as an invitation to the States to impose additional regulations."<sup>48</sup>

The Court also condemned ratable-take rules as applied to interstate pipelines on two other grounds. First, it reasoned that such rules would disturb "the uniformity of the federal scheme" by requiring pipelines to comply with

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43. In some instances the Court has chosen to abstain from deciding state issues in order to avoid conflict with the administration of its own affairs by a state. The leading case, *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), involved proration orders in Texas oil fields. The Court held that questions of regulation of industries, not limited only to the oil and gas industry, involve basic problems of state policy and thus the state courts should be given the first opportunity to consider them. *Burford* may be distinguished from *Transco* on two bases. First, *Burford* was decided 43 years before *Transco* during a time in which the courts were less concerned with preemption than state conservation measures. *Id.* at 332. Second, the intent of Congress in enacting the NGPA was to completely deregulate the natural gas market, thus precluding state regulation in this area. See *Transco*, 106 S. Ct. at 717.

44. In *Northern Natural*, Northern had a take-or-pay contract with Republic to purchase all gas Republic could produce, prior to purchasing from any other producers in a common pool. Although Northern had contracts with other producers, these contracts only required Northern to purchase gas to the extent that its requirements could not be satisfied by Republic. At the time the contracts were executed, Northern's gas purchases were approximately ratable according to ownership in the wells. An increase in production allowables and a concurrent decrease in gas requirements forced Northern to reduce purchases from other wells, causing drainage to Republic's wells. *Northern Natural*, 372 U.S. at 85-89.

45. *Id.* at 91.

46. The Court noted that it had previously upheld state legislation preventing the waste of natural resources. *Id.* at 93-94 (citing *Cities Serv. Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179 (1950); *Champlin Ref. Co. v. Corporation Comm'n*, 286 U.S. 210 (1932)).

47. *Transco*, 106 S. Ct. 715-16.

48. *Id.* at 717.

varied state regulations.<sup>49</sup> Second, it concluded that ratable-take rules would disrupt the federal regulatory scheme by increasing costs to consumers or conflicting with FERC orders. The Court reasoned that if Transco took high-cost gas under the Mississippi rule, it would trigger take-or-pay obligations elsewhere. If the FERC permitted the higher costs incurred by Transco to be passed through to consumers, the Congressional purpose of making gas available at low prices would be frustrated.<sup>50</sup> If the FERC did not permit the pass-through of costs,<sup>51</sup> the FERC's order and Mississippi's rule would be "in direct conflict."<sup>52</sup>

Justice Rehnquist, writing for the dissent, applied a different view of preemption, articulated in *Silkwood v. Kerr-McGee Corp.*<sup>53</sup> Justice Rehnquist reasoned that in *Silkwood* the Court presented two different circumstances in which a state law may be preempted: first, if Congress evidences an intent to occupy a given field any state law within this field is preempted; and, second, if a state law stands as an obstacle to the accomplishment of the objectives of Congress. Justice Rehnquist argued that based on the reasoning presented by the Court in *Northern Natural*, a ratable-take rule was preempted if it invaded the jurisdictional coverage of the NGA. As such, *Northern Natural* merely exemplified the first situation in *Silkwood*. Justice Rehnquist concluded that *Northern Natural* did not govern the circumstances in *Transco* because the NGPA removed the wellhead sales of high-cost and new gas from the coverage of the NGA and NGPA thus indicating that Congress did not intend to occupy the field.

Therefore, to Rehnquist, the issue then became whether Mississippi's ratable-take rule violated the second test of preemption, i.e., if the rule stood as an obstacle to the full accomplishment of the NGPA's purpose.<sup>54</sup> In Justice Rehnquist's view, "The purpose of the NGPA with respect to high-cost gas is to eliminate governmental controls on the wellhead price of such gas."<sup>55</sup> According to Justice Rehnquist, a rule which interfered with this purpose would be preempted, but because ratable-take rules merely define property rights and establish contractual rules, they are necessary to ensure an efficient market, and do not interfere with the NGPA's purpose.<sup>56</sup>

The majority and minority opinions in *Transco* are based upon very different views of the impact of ratable-take rules upon the market. The market scheme as stated by the majority was based on the intent of "Congress, in revising a comprehensive federal regulatory scheme to give market forces a more significant role in determining the supply, the demand, and the price of natural gas."<sup>57</sup> In the majority's view, Mississippi's action directly undermined Con-

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49. *Id.*

50. See *supra* note 33, discussing the FERC's authority under the NGPA to review pricing practices of interstate pipelines to determine whether those practices are fraudulent or abusive.

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

52. *Id.*

53. *Transco*, 106 S. Ct. at 721 n.3 (citing *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238 (1984)).

54. *Id.* at 722.

55. *Id.*

56. *Id.*

57. *Id.* at 717.

gress' determination that the supply, demand, and price of high-cost gas be determined by the market.<sup>58</sup> The majority concluded that ratable-take rules would disrupt the market by artificially increasing the supply and price of high-cost gas. Similarly, long-term contracts would interfere with the market by postponing the adjustment of consumer selling and purchasing patterns.<sup>59</sup>

In contrast, Justice Rehnquist saw ratable-take rules as serving the purposes of conservation and fairness by removing the incentive of owners to remove and capture gas quickly to prevent other owners from draining their share of reserves.<sup>60</sup> By this view, a ratable-take rule is an attempt by the states to cure a market failure.<sup>61</sup> According to Justice Rehnquist, a ratable-take rule promotes rather than inhibits the efficiency of a competitive market because it eliminates the "perverse incentives" associated with common ownership of a gas pool.<sup>62</sup> If Mississippi's rule required a pipeline that purchases gas from one instate pool to purchase equal amounts from every other instate pool this would burden interstate commerce and the free market purpose of the NGPA. In Justice Rehnquist's view, a ratable-take rule does not have this burdensome effect because the enactment of a ratable-take rule is the equivalent of regulating the condition of contracts. The possibility of Transco's increased take-or-pay liability is viewed as a contractual risk assumed by Transco.<sup>63</sup> Justice Rehnquist concluded that Mississippi's ratable-take rule did not conflict with either a uniform federal scheme or Congress' goal of consumer protection because Mississippi's rule did not attempt to recontrol national gas prices.<sup>64</sup>

### III. ANALYSIS OF THE DECISION

*Transco* presents problems to state oil and gas conservation administrators and practitioners both because of its result and because its scope is undefined. The majority implies that ratable-production rules are not preempted and may be used by the states instead of ratable-take rules.<sup>65</sup> However, ratable production rules are economically and politically unpopular, and may be ineffective in achieving the conservation goals of prevention of waste and protection of correlative rights.

In order to protect its natural resources, a state may be forced to shut in

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58. *Id.* at 716-17.

59. *Id.* at 718.

60. *Id.* at 719. "The withdrawal of gas from a common pool causes changes in pressure, resulting in migration and spreading out of the remaining gas over the entire pool. This migration is called 'drainage.'" *Id.* at 718-19 n.1.

61. A market failure can be characterized as a situation in which prices do not move sufficiently to keep demand and supply in equilibrium. See S. MAISEL, *MACROECONOMICS THEORIES AND POLICIES* 72 (1982).

62. The "tragedy of commons" or common pool problem refers to the "tendency toward present overproduction that arises when competitors seek to exploit an exhaustible resource in which no one has adequately defined and protectable rights." See H. WILLIAMS & C. MEYERS, *supra* note 4, at 138.

63. "Indeed, the implication in the Court's opinion that a midstream expansion in the coverage of a state regulation justifies preemption of the party to whom the rule is applied claims disappointed expectations is nothing less than contract clause jurisprudence masquerading as preemption." *Transco*, 106 S. Ct. at 723.

64. *Id.*

65. See, e.g., *id.* at 715 n.4.

all production from certain fields.<sup>66</sup> There are several negative consequences of this action. First, a shut-in of production would affect the state economy by decreasing the revenues obtained from interstate pipelines.<sup>67</sup> Second, this action may serve as a defense to a pipeline's take-or-pay liability because a producer subject to a shut-in order could not deliver the gas if the pipeline requested delivery.<sup>68</sup> Because of the adverse economic consequences, members of conservation agencies who are elected officials and are therefore subject to pressure from their constituents may be hesitant to issue ratable production orders.

There is also uncertainty about the scope of *Transco*.<sup>69</sup> The majority opinion does not make clear the limits of federal preemption of oil and gas conservation laws. Thus, there is a substantial risk that lower courts may interpret the case in a way that will further cripple the ability of the states to achieve legitimate conservation goals. For example, the *Transco* decision has been extended to invalidate Oklahoma's priority schedule for natural gas as applied to interstate pipelines.<sup>70</sup> When the priority schedule was enacted, the

66. The only effective way to use ratable-production rules to prevent drainage and protect correlative rights in the fact situation of *Transco* is to order a complete shut-in. Unless this is done, non-contracted producers will not be able to produce their share and contracted producers will overproduce their share. J. Grower & R. Montjoy, *The Impact of the Recent Transco Decision on State Regulation of the Natural Gas Industry*, American Bar Association, Section of Natural Resources Law Seminar and Workshop on Ratable-Take and Take-or-Pay Problems and Issues (July 8, 1986) (on file with the National Energy Law and Policy Institute Library, University of Tulsa, College of Law).

67. If the state shuts in producers who have markets for high prices, purchasers may be expected to replace the gas shut in with low-priced gas, which may come from another state. *Cf. id.* at 723 (rule requiring pipeline that purchases gas from one in-state pool to purchase equal amounts from every other in-state pool would burden interstate commerce).

68. The typical take-or-pay clause obligates the purchaser to pay only for gas if available and not taken. *See* J. Grower & R. Montjoy, *supra* note 66, at 32-33.

69. A broad view of preemption was taken by the Supreme Court in another recent case, *Nantahala Power and Light Co. v. Thornburg*, 106 S. Ct. 2349 (1986), where the court held that a retail rate-making order of the North Carolina Utilities Commission (NCUC) was preempted by federal law. Two public utilities, subsidiaries of ALCOA, Nantahala and Tapoca, exchanged the output of their facilities for low cost entitlement power from the Tennessee Valley Authority (TVA). Nantahala bought a variable amount of high cost power from the TVA's power grid to serve public customers in North Carolina, while Tapoca sold its power to an ALCOA plant in Tennessee. The NCUC issued an order allocating Nantahala a greater percentage of the cheaper entitlement power than that ordered by FERC. *Nantahala*, 106 S. Ct. at 2354-60.

The *Nantahala* court stated that the FERC had jurisdiction over the wholesale power rates charged to interstate customers. However, this authority was not limited strictly to rates but included the entire field of interstate electric sales. Thus, the NCUC's rate-making order was preempted. The court did not strike down the authority of a state commission to question whether there were reasonable alternatives to a utility's wholesale power purchases. *Id.* at 2357-60.

Both *Transco* and *Nantahala* indicate the court's willingness to give an expansive interpretation to federal authority in the energy field. Similarly, the decisions leave open for question the extent to which a state may conserve its natural resources.

70. *ANR Pipeline Co. v. Corporation Comm'n*, No. CIV-85-1929A, slip op. (W.D. Okla. Sept. 4, 1986). RULE 1-305, PRIORITY SCHEDULE FOR SUPPLY AND DEMAND IMBALANCE.

(a) Any common purchaser as defined in 52 O.S. 1981, Section 240, shall purchase all the gas which may be offered for sale . . . without discrimination . . . .

(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 . . . is in excess of that purchaser's reasonable market demand . . . .

(i) Priority One - Hardship and distress wells.

Oklahoma Corporation Commission referred to an Oklahoma ratable-take statute, as its legal basis. Later, the Oklahoma Corporation Commission affirmed the constitutionality of the priority rules and indicated that Oklahoma's ratable-take statute must be operated together with Oklahoma's ratable production statute.<sup>71</sup> The operation of the ratable-take statute together with the ratable-production statute would eliminate those burdens sought to be avoided in the *Transco* decision. Although under Oklahoma's priority rules, the pipelines were required to balance well output, and purchase requirements were limited to market demand,<sup>72</sup> the United States District Court for the Western District of Oklahoma held that the priority rules were preempted by the federal regulatory scheme established under the NGA and NGPA. The Oklahoma court reasoned that the priority rules resulted in the regulation of the taking of gas. The court then applied the preemption test set forth in *Transco* to find that the rules interfered with the federal regulatory scheme and undermined the intent of Congress to allow market forces to determine the supply, demand and price of natural gas.<sup>73</sup>

#### IV. CONCLUSION

The *Transco* majority failed to articulate clearly its vision of the scope of preemption. As a result, we can expect to see a variety of state regulatory legislation challenged in many different contexts. For example, interest on royalties statutes,<sup>74</sup> payment procedures statutes such as Oklahoma Senate Bill 160,<sup>75</sup> or even ratable-production statutes may arguably subject interstate pipelines to conflicting regulations or result in higher prices to customers and thus fall within the scope of state activities preempted by *Transco*. Likewise, the eco-

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(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 the 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 . . . common sources of supply which may be offered for sale . . . without discrimination . . . .

(c) When permitted production of gas from all wells from which a purchaser or taker is required to take exceeds the market demand of said purchaser or taker, all reductions in gas purchases or takes from wells in each Priority shall be ratable. 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 well which meets the definition of more than one priority shall be assigned the higher priority.

(e) When there is more than one purchaser or taker involved in the taking of gas from a well into any purchaser's system, all purchasers and takers within that system shall be responsible for compliance with this rule.

71. Order Determining Authority of the Commission to Require Ratable Takes of Natural Gas by First Purchasers Who May be Interstate Pipelines, Order No. 281285, General Cause No. 28770 (July 3, 1985).

72. J. Grower & R. Montjoy, *supra* note 66, at 37-39.

73. ANR Pipeline Co. v. Corporation Comm'n, No. CIV-85-1929A, slip op. at 9 (W.D. Okla. Sept. 4, 1986).

74. OKLA. STAT. tit. 52, § 540 (Supp. 1985).

75. *Id.* §§ 541-547 (Supp. 1985).

conomic impacts prohibited by *Transco* may result from state regulation of intrastate pipelines as well as regulation of interstate pipelines.

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