NOTE

NORTHWEST CENTRAL PIPELINE CORP. v. STATE CORPORATION COMMISSION OF KANSAS: A NARROW PATH FOR STATE REGULATION OF GAS PRODUCTION

The regulation of the natural gas industry historically has been a dual federal-state task. Increasingly, however, courts have held that federal legislation preempts state regulation, leaving in doubt the extent of the states' regulatory authority. The Supreme Court's decision in *Northwest Central Pipeline Corp. v. State Corporation Commission of Kansas*[1] attempts to clarify the perimeters of state regulatory authority, especially in regard to conservation and protection of correlative rights. This note will examine the Court's decision, analyze the distinctions between *Northwest Central III* and the preemption findings in *Northern Natural Gas Co. v. State Corporation Commission of Kansas*[2] and *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board*,[3] and evaluate the potential impact of the *Northwest Central III* decision on the states' ability to regulate the natural gas industry for conservation purposes and to protect correlative rights.

I. *THE NORTHWEST CENTRAL III* HOLDING

Northwest Central III affirmed a decision of the Kansas Supreme Court that federal legislation and regulatory schemes did not preempt an order of the State Corporation Commission of Kansas (KCC).[4] The state order, directed at producers of natural gas, provided for permanent cancellation of certain entitlements to produce gas from the Hugoton gas field.[5] The Supreme Court held that the order was not preempted by the Natural Gas Act (NGA)[6] or by the Federal Energy Regulatory Commission (FERC) jurisdiction to regulate the sale and transportation of natural gas in interstate commerce. Finally, the Supreme Court determined that the order did not violate the commerce clause of the United States Constitution.[7]

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1. Northwest Cent. Pipeline Corp. v. State Corp. Comm'n of Kansas, 109 S. Ct. 1262 (1989) (hereinafter *Northwest Central III*).
2. Northern Natural Gas Co. v. State Corp. Comm'n of Kansas, 372 U.S. 84 (1963) (hereinafter *Northern*).
3. Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Bd., 474 U.S. 409 (1986) (hereinafter *Transco*).
4. *Northwest Central III*, 109 S. Ct. at 1267.
5. *Id.*
6. 15 U.S.C. §§ 717-717z (1982).
7. *Northwest Central III*, 109 S. Ct. at 1267.

II. THE BACKGROUND AND DEVELOPMENT OF *NORTHWEST CENTRAL III*

A. *The Factual Background*

To appreciate the holding of *Northwest Central III*, one needs to understand some basic aspects of natural gas production and the states' interest in regulating production for conservation purposes. Natural gas is found in geologic structures known as reservoirs. Before wells are drilled into the reservoir, the gas and oil are under natural pressure. As gas and oil flow out of the well bore, the pressure near the well is lowered. Gas from other areas of the reservoir will flow toward the low-pressure areas around producing wells. This phenomenon is known as drainage.[8]

Drainage is significant in two respects: first, drainage can result in the waste of gas resources; second, drainage can impair the rights of the owners of the gas to their share of the gas within the reservoir. Waste occurs when a reservoir is not properly produced. A gas field may be depleted or gas lost to production because of unregulated drainage.[9] Drainage also affects the rights of owners of the gas reserves to produce their proportionate share of the reserves. If one owner produces at a high rate, drainage of his neighbor's gas to the producing well deprives the neighbor of his right to produce the drained gas.

The federal government over the years developed a comprehensive regulatory scheme in the areas of sale and transportation of natural gas. Although the federal regulatory system affects producers, especially in the area of pricing,[10] the states historically have regulated the production of natural gas. Kansas statutes direct the KCC to prevent waste and to regulate the production of gas from reservoirs, to prevent inequitable taking from common sources.[11] The KCC's regulations recognize the correlative rights of producers—the producers' right to a *prorata* share of the reservoir's gas.[12] Prorationing is a primary regulatory device utilized by the state of Kansas.[13] Prorationing orders set allowables, or production rate quotas, that allow production at specified rates. Ideally, prorationing balances production throughout the gas field. Waste is curbed and correlative rights are protected from drainage. However, kansas' proration order provides for tolerances in actual production under the allowable rates.[14] When the demand for natural gas is high and purchasers buy more gas, wells are produced at rates higher than

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8. *See* D. Pierce, *Reconciling State Oil and Gas Conservation Regulation with the Natural Gas Act: New Statutory Revelations*, 1989 B.Y.U. L. Rev. 9, 12-13 (1989).

9. *Northwest Central III*, 109 S. Ct. at 1267.

10. The complex history of federal regulation of the gas industry is discussed in R. Pierce, *Reconstituting the Natural Gas Industry From Wellhead to Burnertip*, 9 Energy L.J. 1, 11 (1988).

11. Kan. Stat. Ann. §§ 55-701—55-703(a) (Supp. 1987).

12. The KCC has defined "correlative rights" in Kan. Admin. Regs. 82-3-10(15) (1978):

"Correlative rights" means that each owner or producer in a common source of supply is privileged to produce from that supply only in a manner or amount that will not injure the reservoir to the detriment of others, take an undue proportion of the obtainable oil or gas, or cause undue drainage between developed leases.

13. *Northwest Central III*, 109 S. Ct. at 1268.

14. Basic Proration Order, ¶¶ (g)-(1), KCC (1944) (available at Kansas Corporation Commission).

their set allowables and overages occur. When purchasers buy less gas, the wells may be produced at less than their allowable rate. This production at less than the allowable results in underage.

Prior to 1983, the KCC had allowed underages to accumulate indefinitely.[15] By 1982, the Hugoton field had become substantially underproduced and enormous underages had accumulated.[16] Two factors combined to cause the underproduction: (1) lower demand, resulting from the downturn in the gas industry in the early 1980's, and (2) the corresponding actions of interstate pipelines to comply with the "take or pay" contracts made during the energy crisis of the 1970's.[17] The interstate pipelines, therefore, had reduced their purchases from the Hugoton field's producers. At the same time, producers under contract with intrastate purchasers were in an overproduced status.[18] This situation—overproduction for the intrastate market and underproduction for the interstate market—resulted in a production imbalance in the Hugoton field.

One consequence of the imbalance in the field was the problem of drainage. Drainage was wasting gas reserves and depleting the field's long-term production capacity. Experts estimated that production of the enormous accumulated underages would take six to ten years.[19] Drainage over the period required to produce the underages could cause a permanent loss of the field's ability to produce.[20]

Closely tied to the drainage problem was the resulting infringement upon correlative rights.[21] As drainage occurred between the overproduced and underproduced areas within the field, those producers whose interests were underproduced lost gas reserves to the overproducing wells. This drainage threatened the correlative rights of the producers to produce gas in the future from underproduced wells.[22]

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15. *See*, Northwest Central Pipeline v. State Corp. Comm'n, 699 P.2d 1002, 1007 (Kan. 1985), *vacated and remanded*, 475 U.S. 1002 (1986) (hereinafter *Northwest Central I*).

16. *Id.* at 1008.

17. *Id.*

18. Justice Brennan explains in *Northwest Central III*:

> Many pipelines responded to the availability of new, higher-priced deregulated gas [under the NGPA] by committing themselves to long-term contracts at high prices that required them to take-or-pay for a large part of a producer's contractually dedicated gas reserves. When the market dwindled in the early 1980's, interstate pipelines reduced their takes under contracts with Kansas-Hugoton producers for "old," low-priced gas, in large part because these contracts included no take-or-pay penalty. As a result, production from parts of the field fell. In effect, interstate purchasers began to use the Hugoton field for storage while they took gas for their immediate needs from elsewhere—a practice facilitated by paragraph (p) of the Hugoton Basic Proration Order, which permitted stored gas to be produced more or less at any time.

Northwest Central III, 109 S. Ct. 1269-1270.

19. *Northwest Central I*, 699 P.2d at 1008.

20. *Id.*

21. Testimony of Ron Cook before the KCC: "There is a definite possibility that near the end of many of the wells['] production li[ve]s, there will be a tremendous amount of cancelled underages that will never be reinstated due to the physical inability of the wells to make up such underage." *Hearings on the Need for Revision of the Basic Proration Order for the Kansas Hugoton Field Before the Kansas Corp. Comm'n*, (1982) (Statement of Ron Cook, KCC staff).

22. *Northwest Central III*, 109 S. Ct. at 1270.

In an attempt to protect against further drainage and its resultant waste and to assure the correlative rights of producers, the KCC promulgated the 1983 amendment to paragraph (p) of the Basic Proration Order.[23] The amendment provided that underages in production, previously allowed to accumulate for production at a later date, could be permanently cancelled if production were unduly delayed.[24] The KCC hoped that the threat of permanent cancellation of unproduced, accumulated underages would stimulate interstate purchasers to take more Hugoton gas. The increased production in underproduced areas would allow compensating drainage to correct the waste problem and the infringement on correlative rights.[25]

Northwest Central Pipeline Co. (Northwest Central), one of five interstate purchasers from the field,[26] challenged the order before the KCC and later filed suit in the District Court of Gray County, Kansas. Both the KCC and the District Court upheld the regulation. On Northwest Central's subsequent appeal, the Kansas Supreme Court also held the order viable. Northwest Central then appealed to the United States Supreme Court, which remanded the case to the Kansas Supreme Court for reconsideration in light of the Court's decision in *Transco*. The Kansas Supreme Court again upheld the regulation and Northwest Central again appealed to the United States Supreme Court.[27]

B. *The Judicial Background of Federal Preemption*

1. The *Northern* Decision

In the 1963 *Northern*[28] decision, the Supreme Court invalidated a "ratable-take"[29] order of the KCC. The purpose of the regulation was to promote conservation and to preserve correlative rights by ordering purchasing pipelines to take proportionately from their producers in the Hugoton field.[30] The Supreme Court held the orders were preempted by federal regulation.

The Court's preemption finding had several bases. First, because the orders were directed at purchasers, they were preempted by the express language of the NGA which reserved regulatory rights to the states only in the area of production and gathering of gas.[31] Secondly, the KCC orders conflicted with the comprehensive federal scheme of regulating wholesale gas

23. Basic Proration Order, ¶ (p), KCC (amended 1983) (available at Kansas Corporation Commission).

24. Northwest Cent. Pipeline Corp. v. State Corp. Comm'n of Kansas, 732 P.2d 775, 776 (Kan. 1987) (hereinafter *Northwest Central II*).

25. *Northwest Central III*, 109 S. Ct. at 1271.

26. *Id.* at 1269.

27. *Id.* at 1272-1273.

28. Northern Natural Gas Co. v. State Corp. Comm'n of Kansas, 372 U.S. 84 (1963).

29. "Ratable take" orders require purchasers of gas to take ratably, or in proportion, to the producers' ownership interests in the production field.

30. Kan. Admin. Regs. 82-2-219 (February 8, 1960): "In each common source of supply under proration by this Commission, each purchaser shall take gas in proportion to the allowables from all the wells to which it is connected and shall maintain all such wells in substantially the same proportionate status as to overproduction or underproduction . . . ."

31. *Northern*, 372 U.S. at 90.

prices. The Court held that, whether the conflict was direct or indirect, state regulations having such impact were preempted.[32] The NGA preempted state regulations, even conservation measures, where the regulations were aimed directly at interstate purchasers and wholesales for resale.[33] *Northern*'s preemption standard would invalidate those state measures aimed directly at purchasers, as well as state orders which could possibly affect the pipelines' purchasing decisions so as to impact consumer prices for gas.[34]

2. The *Transco* Decision

In 1986, the Supreme Court considered the effect of the passage of the Natural Gas Policy Act[35] (NGPA) on the states' power to regulate the sale and transportation (the purchasers' prerogatives under the NGA) of natural gas in the post-NGPA "deregulated" era.[36] The *Transco*[37] decision dealt with a Mississippi ratable-take regulation[38] designed to protect correlative rights and promote conservation. The Court, in holding that the federal regulatory scheme preempted the Mississippi order, reaffirmed the *Northern* standard for preemption. State regulations directed at purchasers were preempted, notwithstanding deregulation of the FERC price controls under the NGPA,[39] because such regulations disturbed the uniformity of the federal scheme and would ultimately increase consumer prices.[40]

The *Transco* decision left the states with a two-faceted test for preemption.[41] The test asked first whether the regulation was directed toward purchasers or producers. If the state measure was directed toward purchasers, there was preemption because purchasers fall exclusively under the regulatory powers of the FERC. The test also asked whether the regulation would *possibly* affect purchasing practices of interstate pipeline and, thus, affect consumer prices. If so, there was federal preemption.

III. An Analysis of *Northwest Central III*

A. *The Issues*

Northwest Central Pipeline challenged the KCC regulation on two bases: (1) that federal law preempted the KCC order, and (2) that the order violated the Commerce Clause of the United States Constitution.[42]

32. *Id.* at 92.
33. For a concise treatment of the facts and issues in *Northern*, see D. Pierce, *supra* note 8, at 19-22.
34. *Id.*
35. 15 U.S.C. §§ 3301-3432 (1982).
36. For a discussion of the deregulation aspects of the NGPA, *see* R. Pierce, *supra*, at note 10.
37. Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Bd. of Mississippi, 474 U.S. 409 (1986).
38. Rule No. 48, Ratable-take regulation, Rules of the State Oil and Gas Bd. of Mississippi (1982).
39. *Transco*, 474 U.S. at 422.
40. *Id.*
41. The Kansas Supreme Court in *Northwest Central II* stated the *Transco/Northern* test in the following terms: "First, we must consider whether the order . . . falls within the limits of a comprehensive federal regulatory scheme rather than within the regulatory questions reserved for the states; and, if so, whether the effect of the order will be to impair market forces." *Northwest II*, 732 P.2d at 778-779.
42. *Northwest Central III*, 109 S. Ct. at 1267.

In its preemption challenge, Northwest Central first claimed that the federal government occupied the field[43] in regulation of pricing and transportation of "old" gas[44] and in regulation of pipelines' purchasing mixes, thus, preempting the KCC order. Northwest Central argued that the NGA[45] and the NGPA granted the authority to comprehensively regulate the gas industry in the areas of transportation, pricing and purchasing mixes to the FERC. According to Northwest Central's premise, the FERC's authority thus, "occupied the field."[46]

Northwest Central also maintained that federal regulation preempted the KCC order because it conflicted with federal regulation of purchasers' cost structures.[47] Northwest Central alleged that the KCC order would affect the prices paid for gas by influencing the pipelines' decisions about where and when to purchase. This supposedly would prevent the "attainment of [the] FERC's regulatory goals."[48] Such conflict between federal goals and the order's effects would require preemption.[49]

The third preemption issue raised by Northwest Central concerned the NGA abandonment regulation. Northwest Central argued that the NGA's producer certification requirements and the producers' contractual obligations to supply "old" gas preempted Kansas' cancellation of accumulated underages.[50] Northwest Central maintained that permanent cancellation of underages under the KCC order would constitute abandonment, an area clearly within the purview of the FERC under section 7(b) of the NGA.[51]

In addition to the preemption arguments, Northwest Central raised a two-pronged Commerce Clause issue. First, Northwest Central claimed that the KCC order was *per se* unconstitutional because it was, in effect, economic protectionism.[52] The company contended that the regulation discriminated against interstate purchasers to the benefit of intrastate purchasers, thus, constituting a *per se* violation of the Commerce Clause. Alternatively, Northwest Central claimed that if the order were not *per se* invalid, then its effects on

43. *Id.* at 1273.

44. "Old" gas is, generally, that low-priced gas produced under contracts made prior to the passage of the NGPA. 15 U.S.C. § 3301-3432 (1982). The gas produced from the Hugoton field was "old" gas.

45. 15 U.S.C. §§ 717-717z (1982).

46. As the court explained in *Northwest Central III*, there are various tests of preemption, all centering on congressional intent. The tests are:

> 1. Express preemption: Explicit statutory language indicating congressional intent to preempt. This basis was not raised by Northwest Central.
>
> 2. Field preemption: Inference of congressional intent where comprehensive legislation occupies an entire field of regulation.
>
> 3. Conflict preemption: Preemption where state law conflicts with federal law either (a) because compliance with both federal and state laws is impossible or (b) because the state law is an obstacle to the accomplishment of congressional goals.

Northwest Central III, 109 S. Ct. at 1273.

47. *Id.* at 1277.

48. *Id.*

49. *Id.* at 1278.

50. *Id.* at 1279.

51. 15 U.S.C. § 717f(b) (1982).

52. *Northwest Central III*, 109 S. Ct. at 1280.

interstate commerce conflicted with congressional energy policy.[53]

B. *The Decision*

In affirming the Kansas Supreme Court's decision, the United States Supreme Court rejected all of the preemption arguments raised by Northwest Central. The Court also determined that the KCC regulation did not violate the Commerce Clause.

As to the pipeline's contention that there was preemption by reason of federal occupation of the field, the Court recognized the express statutory authority granted to the states to regulate the production of natural gas. Because section 1(b) of the NGA[54] expressly relegates to the states the power to regulate the production and gathering of natural gas,[55] the Court examined the Act's legislative history to determine whether Congress intended to occupy the field. It concluded that the NGA's express reservation of the power to regulate to the states was a plain indication of Congress' intent not to interfere with the state's power in that area, at least insofar as the power was utilized to curb waste and protect correlative rights.[56] Because Congress had drawn a "bright line"[57] in regard to regulation of production, to cross the line and preempt the states' power would be an "extravagant interpretation of the scope of federal power."[58] By acknowledging the states' traditional powers in conservation and protection of correlative rights, the Supreme Court recognized that preempting state regulation of producers "merely because purchasers' costs and, hence, rates might be affected"[59] would defeat the dual regulatory system envisioned by the NGA.

On the issue of preemption by reason of the KCC order's conflict with federal regulation of pipelines' cost structuring, there was no preemption.[60] The Court reiterated the express statutory power of the states to regulate natural gas production. Specifically acknowledging that *any* order regulating production would conceivably, and even probably, affect purchasers' costs and buying decisions, the Court nevertheless found that the KCC order could be followed without preventing achievement of the FERC's regulatory goals.

However, the Court did not completely foreclose the possibility of preemption of state regulation of production: "[t]here may be circumstances in which the impact of state regulation of production on matters within federal control is so extensive and disruptive of interstate commerce in gas"[61] that preemption would have to be found. Further, where state law impacts on matters within the FERC's control, there must be a legitimate state purpose

53. *Id.*
54. 15 U.S.C. § 717(b) (1982).
55. *Northwest Central III*, 109 S. Ct. at 1274.
56. *Id.* at 1275.
57. *Id.* at 1276.
58. *Id.* at 1275.
59. *Id.* at 1276.
60. *Id.* at 1279.
61. *Id.* at 1277-1278.

and the production regulation must plausibly relate to that purpose.[62] The Kansas regulation was found to plausibly relate to the legitimate goals of conservation and protection of correlative rights. However, state producer-directed orders which, under the guise of production regulation, actually are efforts to influence pipelines' purchasing decisions and cost structures will probably be preempted.[63]

Finally, the FERC's power to regulate certification of producers and the abandonment of production contracts did not preempt the KCC order. Section 7(c) of the NGA[64] gives to the FERC the power to issue certificates to producers of gas for interstate sale. Section 7(b) of the NGA[65] prohibits these producers from terminating the supply of gas under interstate contracts unless the FERC authorizes an abandonment. The Court rejected the pipeline's argument that cancellation of the right to produce underages per the KCC order constitutes an abandonment without the FERC's authorization. Instead, the order determines producers rights to produce gas,[66] thus, falling within the long-standing state power to define property rights. The FERC must defer to the states' definition of property rights when making its abandonment decisions, unless clear damage to federal goals occur.[67] Because the federal goal of encouraging the production of low-cost "old" gas was harmonious with the KCC order, the Court refused to find preemption.

The Court also rejected Northwest Central's claims that the KCC order violated the Commerce Clause. There was no *per se* invalidity. The order, on its face, provided for cancellation of underages, making no distinction between producers for the interstate and intrastate markets. Consequently, there was no discrimination against the interstate pipelines on the face of the order.[68] The argument that the order was unconstitutional because of its effects on interstate commerce was also rejected. Applying the balancing test articulated in *Pike v. Bruce Church, Inc.*,[69] the Court determined that even though the order might affect interstate commerce, such an effect was no greater nor different than Congress had foreseen when it expressly granted production regulation authority to the states.[70]

C. *Reconciling* Northwest Central III *and* Northern/Transco

The decision of the Supreme Court in *Northwest Central III*, with its apparent support of state efforts at conservation and protection of correlative

62. *Id.* at 1278.
63. *Id.*
64. 15 U.S.C. § 717f(c) (1982).
65. 15 U.S.C. § 717f(b) (1982).
66. *Northwest Central III*, 109 S. Ct. at 1277.
67. *Id.* at 1280.
68. *Id.*
69. 397 U.S. 137 (1970). The *Pike* test of determining whether a state law is violative of the Commerce Clause is a balancing test. So long as the state law "regulates evenhandedly to effectuate a legitimate local public interest and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Id.* at 142.
70. *Northwest Central III*, 109 S. Ct. at 1282.

rights, cannot be viewed in a vacuum. In order to evaluate the impact of the decision upon future state attempts to curb waste and preserve producers' interests, one must analyze the distinctions between *Northwest Central III* and the Court's prior preemption rulings in *Northern* and *Transco*.

1. The Distinctions

In *Northern* and *Transco*, the Supreme Court found federal preemption of state conservation measures. In *Northwest Central III*, it refused to preempt a state conservation order directed at producers because regulation of gas production is expressly reserved to the states. *Northern* and *Transco* based preemption largely on the fact that the challenged regulations in both cases were directed at purchasers, over whom the FERC exercises exclusive jurisdiction. Although *Northwest Central III* appears to have abandoned the second prong of the *Transco* test,[71] relating to possible effects upon purchasing decisions, such is not actually the case. In *Northwest Central III*, the Court specifically indicated that where state orders directed at producers impact "extensively" or "disruptively" on interstate commerce, such regulations—even if producer-directed—may be preempted.[72]

Northwest Central III, thus, modifies the *Northern/Transco* preemption test only marginally. After *Northwest Central III*, the test can be stated as follows:

(1) If the order is directed at purchasers, it is "inevitably" preempted.[73] Purchasers fall within the FERC's regulatory domain under both the NGA and the NGPA. If the order is directed at producers, preemption is not automatic because states have express statutory authority to regulate production.

(2) If the regulation is directed at producers, the question is whether it extensively and disruptively affects interstate commerce. If there is such an effect, there may well be conflict preemption,[74] because extensive disruption of interstate commerce could prevent achievement of federal regulatory goals.

2. Unresolved questions

Northwest Central III raises—and leaves unresolved—various questions. The first question stems from the fact that *Northwest Central III* dealt with production regulation of "old" gas.[75] "Old" gas contracts are governed by the NGA. In *Northwest Central III*, the Court relied solely on the NGA's express reservation of the power to regulate production to the states. The question thus arises whether such freedom to regulate production will be extended to post-NGPA production. *Transco* preempted purchaser-directed post-NGPA orders, stating that Congress' "decision to remove jurisdiction from [the] FERC cannot be interpreted as an invitation to the states to impose additional regulations."[76] Because *Transco* refused to expand state power at the FERC's

71. See text, *supra*, at 11.
72. *Northwest Central III*, 109 S. Ct. at 1277-1278.
73. *Id.* at 1276.
74. *Id.* at 1278.
75. *Id.* at 1271.
76. *Transco*, 474 U.S. at 423.

expense and *Northwest Central III* warned that producer-directed orders which extensively and disruptively affect the federal regulatory scheme may be preempted, it is not clear what course the Court will take in post-NGPA producer-directed regulation situations.

A second question left unanswered by *Northwest Central III* is what sort of state action will be necessary to constitute "extensive and disruptive impact on interstate commerce." The Court gives no guidelines beyond stating that a mere *potential* impact on pricing is insufficient to result in preemption.[77] One is left with the question of whether a showing of actual impact on the wholesale pricing of gas will be sufficient. Or whether an actual or potential effect on ultimate consumer pricing will be required. Or whether preemption is possible if an order would benefit consumers but disrupt the pipelines' profit margins.

A final unresolved question is what remains of the historical state power of conservation by regulating the production of natural gas. *Northwest Central III* does not clarify how far the states can venture in preserving their natural resources by curbing or promoting production before such efforts are preempted because of disruptive or extensive impact on interstate commerce. The Court's recognition of conservation as a legitimate state purpose in *Northwest Central III* was limited in scope to the producer-directed Kansas regulation in question. Legitimate state goals of conservation and protection of correlative rights will probably not be sufficient to overcome the Court's view under *Northern* and *Transco* that purchaser-directed regulations with any potential impact on purchaser's pricing structures are preempted.[78]

IV. CONCLUSION

The Supreme Court's decision in *Northwest Central III* appears to clarify those circumstances in which states may regulate free of federal preemption. The narrowness of the holding, however, clarifies only that there is not *automatic* preemption in situations where the states' regulations are producer-directed. The Court, in those situations, will continue to scrutinize the effects of the state orders and will likely preempt when the state order substantially infringes on or disrupts the federal regulatory scheme. *Northwest Central III*'s recognition of conservation and protection of correlative rights is only nominal in that situation. As a result, states will continue to be forced to walk a narrow line in attempting to conserve natural gas resources and protect the correlative rights of interest owners and producers.

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77. *Northwest Central III*, 109 S. Ct. at 1276.

78. The Supreme Court recently declined to review a Tenth Circuit decision which held that Oklahoma's ratable-take order was preempted. Oklahoma had attempted to justify the purchaser-directed order on conservation grounds. ANR Pipeline Co. v. Corporation Comm'n of Oklahoma, 860 F.2d 1571 (10th Cir. 1988), *aff'g* 643 F. Supp. 419 (W.D. Okla. 1986), *cert. denied*, 109 S. Ct. 1967 (1989).