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RATABLE TAKING OF NATURAL GAS

INTRODUCTION

The doctrine of correlative rights of owners of adjacent mineral interests has come a long way since the case of *Barnard v. Monangabela Natural Gas Co.*,¹ where, in a suit to enjoin drainage, the court said: "What then can the neighbor do? Nothing; only go and do likewise. He must protect his own oil and gas." Since then the common law concept of correlative rights has been expanded by case law and by legislation. One legislatively created correlative right which severely limits the Rule of Capture² is the concept of ratable take.³

DEFINITION OF RATABLE TAKE

What is "ratable take?" What does this rather vague term mean? One eminent authority has said:

Perfect ratability may be defined as the opposite of operation under the rule of capture, that is, allowing each producer the opportunity to produce the reserves underlying his properties. Since administrative agencies have usually not adopted reserve basis allocation factors, the practical definition of ratability amounts to allowing each producer a fair opportunity to produce that share of the field reserve which is proportionate to his well's allocation factor.⁴

Various state statutes define the term as it is to be applied in the operation of the particular ratable take statute in each particular jurisdiction. The Kansas statute⁵ defines ratable take on a "reserve basis" and gives consideration to such factors as acreage, pressure, open flow, porosity, permeability, and thickness of pay. The Louisiana statute⁶ and the Oklahoma statute⁷ base ratability on "natural flow" while the North Dakota statute⁸ bases ratability on "open flow." The Mississippi statute⁹ provides for a "fair and equitable basis . . .

¹ 216 Pa. 362, 65 Atl. 801 (1907).

² E.g., *Ryan Consolidated Petroleum Corp. v. Pickens*, —Tex.—, 285 S.W.2d 201, 5 OIL AND GAS REP. 99 (1955).

³ KAN. GEN. STAT. ANN. § 55-703 (1949); LA. REV. STAT. tit. 30, § § 41-42 (1950); MISS. CODE ANN. § 6132-10 (1942); N.M. STAT. ANN. § 65-3-15 (1953); N.D. REV. CODE §§ 49-1901,-1907,-1911,-1919 (1943); OKLA. STAT. tit. 52, § § 232, 233, 240 (1941); TEX. REV. CIV. STAT. ANN. art. 6049a (1948).

⁴ Jacobs, *Governmental Regulation of Gas Production—1956*, FOURTH ANNUAL INSTITUTE ON MINERAL LAW, La. State Univ. 1956.

⁵ KAN. GEN. STAT. ANN. § 55-703 (1949).

⁶ LA. REV. STAT. tit. 30, § 41 (1950).

⁷ OKLA. STAT. tit. 52, § 232 (1941).

⁸ N.D. REV. CODE § 49-1919 (1943).

⁹ MISS. CODE ANN. § 6132-10 (1942).

to prevent reasonably avoidable drainage." There is no statutory definition in Texas or New Mexico. Much discretion has apparently been left to the respective state regulatory agencies. The Supreme Court of Oklahoma defined "ratable taking" as:

... the proportion which natural flow of gas from wells of one producer bears to amount of natural flow from wells of other producers from same common source of supply or common reservoir.¹⁰

For purposes of this discussion the term "ratable take" is to mean that the wells which are producing gas from a common non-associated natural gas pool or reservoir shall be produced in such a manner that the owners will ultimately recover their "fair share" of the reservoir. The factors and methods of determining the proportionate share of each well is immaterial. We are concerned with whether the various state agencies have the power to enforce ratable take—however determined—and with the problems which must be considered in the enforcement of a ratable take program.

The emphasis of this comment is on the production of natural gas. Some, but not all, of the statements will also be true in regard to oil and associated natural gas. The problems of these two products are different, for (a) natural gas cannot be stored while oil can, (b) there are posted field prices for oil but not for gas, (c) the Federal Power Commission exerts much more control over gas than oil, (d) pipeline interconnections are much less common for gas than for oil, and (e) every oil producer has a market while gas producers must have a pipeline connection in order to obtain a market of any consequence for their product.

METHODS OF ACHIEVING RATABLE TAKE

There are two effective ways of achieving ratable take: one is by *control of production* through ratable take statutes and proration of allowables;¹¹ the other is by *control of the purchase* of the produced product through Common Purchaser Statutes which require pipelines to purchase ratably and without discrimination against any producers.¹²

In order to achieve effective ratable take it is believed that interconnection of gas pipeline facilities is almost essential so that a

¹⁰ Republic Natural Gas Co. v. State, 198 Okla. 350, 180 P.2d 1009 (1947).

¹¹ KAN. GEN. STAT. ANN. § 55-703 (1949); LA. REV. STAT. tit. 30, § 42; OKLA. STAT. tit. 52, § 232.

¹² E.g. LA. REV. STAT. tit. 30, § 42 (1950); OKLA. STAT. tit. 52, § 240 (1941); TEX. REV. CIV. STAT. ANN. art. 6049a (1948).

"swapping" of gas can be achieved. A program of gas swapping would facilitate the achievement of ratable take much more effectively than the presently common system which does nothing more than require that excessively overproduced wells be shut in and that purchasers from those wells seek their supply from underproduced wells in the field and which may require purchasers from underproduced wells to allow other purchasers to buy gas from those wells.

Many who are acquainted with the problem believe that posted field prices for gas will be essential to secure the benefits of swapping gas within a field to achieve more effective ratable take programs.¹³ However, it should be remembered that the price of gas going into interstate commerce is subject to the exclusive control of the Federal Power Commission¹⁴ under the present version of the Natural Gas Act.¹⁵ Therefore, the state agencies will either have to continue to develop their ratable take programs without posted gas prices or will have to work with the Federal Power Commission to have such prices set.

It is also worthy of note that oil is governed by state-wide regulations¹⁶ while gas is largely regulated through field-wide regulation.¹⁷ An exception to this statement is a recently announced Louisiana program for state-wide regulation of natural gas production.¹⁸

CONSTITUTIONALITY OF RATABLE TAKE STATUTES

In 1932 a federal district court held the Texas Common Purchaser Act invalid in *Texoma Natural Gas Co. v. Railroad Comm'n*.¹⁹ The reasons given were that the act burdened interstate commerce and that it impaired the prior contractual obligations of the interstate pipeline purchasers and took property rights without due process. Even though this case has not been expressly overruled, it no longer appears to be the law. A recent United States Supreme Court case²⁰ upheld a similar Oklahoma statute,²¹ rejecting the same contentions which had been deemed controlling in the *Texoma* case.

The state commissions are of the opinion that they do have the

¹³ 54 OIL AND GAS JOURNAL 69 (September 5, 1955).

¹⁴ *Natural Gas Pipeline v. Panoma Corp.*, 349 U.S. 44 (1955).

¹⁵ 52 STAT. §§ 821-833 (1938), 15 U.S.C. §§ 717-717w.

¹⁶ E.g., TEX. REV. CIV. STAT. ANN. art. 6049a(8) (1948).

¹⁷ E.g., *ibid* at Art. 6049a(8)(aa). Also see *Col-Tex. Refining Co. v. Railroad Comm'n*, 150 Tex. 340, 240 S.W.2d 747 (1951).

¹⁸ Statewide Order No. 29-F (La. Dept. of Conservation 1955), 5 OIL AND GAS REP. 474.

¹⁹ *Texoma Natural Gas Co. v. Railroad Comm'n*, 59 F.2d 750 (W.D. Tex. 1932) (three judge constitutional court).

²⁰ *Cities Service Gas Co. v. Peerless Oil and Gas Co.*, 340 U.S. 179 (1950).

²¹ OKLA. STAT. tit. 52, §§ 233, 240 (1941).

authority to order ratable take and ratable purchase of natural gas. Therefore, the major constitutional problem of the present in this area is neither the Due Process Clause nor the Impairment of Contracts Clause. It is, rather, the question of how far the Federal Government preempted this field by the passage of the Natural Gas Act²² under its power over foreign and interstate commerce. One important aspect of this problem is the potential jurisdictional conflict between the Federal Power Commission's requirement of dedicated reserves for interstate pipelines and the state boards' power to disregard or change the contracts dedicating such reserves under an exercise of the states' police power. Needless to say, the Federal Power Commission could foil any state program of ratable take by asserting superior federal power and refusing to allow the states to interfere with such contracts. However, the Natural Gas Act expressly left control over production to the states.²³ Therefore, so long as the states allow the production of enough gas to meet market demand, it is reasonable to expect that the Federal Power Commission will do nothing to interfere with ratable take programs designed to protect the correlative rights of all producers. If, however, the state reduces allowables beneath the amount needed to meet market demand, we can anticipate a state-federal conflict in which the states will lose. Then, too, there is the possibility that the Federal Power Commission will object to state regulations (under ratable take programs or otherwise) which require producers who have dedicated their reserves to interstate pipeline companies to sell to other purchasers. This requirement was placed in the *Henze Field Order*;²⁴ it is also present in the *Blue Basin Field Order* which provides that:

... any distributor, transporter, or purchaser of gas in the field who has had wells underproduced and whose market demand is such that the underproduction cannot be made up prior to the next balancing date must allow any other distributor, transporter, or purchaser in the field to connect to any or all of the underproduced wells and to purchase gas from said wells for a sufficient length of time to insure that all underproduction is eliminated.²⁵

The reason for such an objection is, of course, that such sales would tend to deplete the reserves more rapidly and would tend to make the dedicated reserve requirement for interstate pipeline certificates meaningless.

²² 52 STAT. 821-33, 15 U.S.C. §§ 717-717w.

²³ 52 STAT. 821 (1938), 15 U.S.C. § 717.

²⁴ 4 OIL AND GAS REP. 1846 (Tex. Railroad Comm'n 1955).

²⁵ 5 OIL AND GAS REP. 1100 (Tex. Railroad Comm'n 1956).

METHODS OF ENFORCEMENT

There are a number of effective methods which have been, or may be, used to enforce ratable take programs. The most common of these is the cutting of allowables of producers who overproduce their wells.²⁶ A stricter sanction can be used where the operators continue to overproduce their wells, even after cutting of their allowables; this is the shutting down of either individual wells²⁷ or entire fields.²⁸ An effective sanction to force interstate pipeline purchasers to observe the Common Purchaser Acts is the power to forfeit the charters of domestic companies²⁹ or the permits to do business of foreign corporations³⁰ which violate ratable take orders. Financial penalties can, of course, be used to punish violators of valid ratable take or ratable purchase orders.³¹ In extreme cases, where the offender shows no regard for the milder sanctions, receivership proceedings can be instituted.³²

COMPETING RIGHTS

There are a number of competing rights which must be considered in the adoption of any comprehensive program which would set production allowables in order to achieve ratable take. There is the right of the mineral owner to have his oil and gas produced and to receive payment for it, and there is the right of the lessee to produce his leases at a rate and price which will give him a reasonable return on his investment.

The state, too, has an important right. It is the right to insist that the minerals be produced without waste and in such manner as to maximize efficient recovery. The state must protect the larger right of the public, both present and future, to have its natural resources conserved and used economically. The consumer has the ultimate right. He must be allowed the right to obtain the fuels which he needs when he needs them and at a reasonable price.

This comment will tend to overemphasize the right of the mineral owners and lessees to their proportionate share of the market so that they may share in the profits of the industry. Ratable take schemes

²⁶ See the Field Orders discussed *infra*.

²⁷ *Ibid.* See also *Republic Natural Gas Co. v. Oklahoma*, 334 U.S. 62 (1948); *Choctaw Gas Co. v. Corporation Comm'n., —Okla.—*, 295 P.2d 800, 5 OIL AND GAS REP. 1226 (1956).

²⁸ *Texoma Natural Gas Co. v. Railroad Comm'n.*, 59 F.2d 750 (W.D. Tex. 1932).

²⁹ *E.g.*, TEX. REV. CIV. STAT. ANN. art. 6049a, § 11a (1949).

³⁰ *E.g.*, *Ibid* at § 11b.

³¹ *E.g.*, *ibid* at § 11.

³² *E.g.*, *ibid* at § 11f. See also *Patton v. Texas*, 62 S.W.2d 381 (Tex. Civ. App. 1933).

are developed for their benefit, but it is to be hoped that they will not be developed at the expense of these other competing rights.

REVIEW OF CASES

Since there have been very few cases on the problem of ratable take of natural gas, the most important will be briefly discussed. The *Texoma* case³³ and the *Peerless* case³⁴ have already been discussed. In the *Peerless* case the United States Supreme Court also upheld the orders of the Oklahoma Corporation Commission which set a minimum wellhead price on gas. It should be noted that the *Peerless* case is no longer the law in regard to state control over the price of natural gas. As pointed out in *Natural Gas Pipeline v. Panoma Corp.*,³⁵ such sale is now subject to the exclusive regulation of the Federal Power Commission because of the Natural Gas Act.

A predecessor to the *Peerless* case, *Republic Natural Gas Co. v. Oklahoma*,³⁶ anticipated the *Peerless* holding regarding the constitutionality of ratable take by giving an indication of how the United States Supreme Court felt. In that case the Oklahoma Corporation Commission, acting under statute, made an order requiring a producer which owned a pipeline to a market to receive into its pipeline the same proportion of gas from the well of a producer who had no pipeline, or, in the alternative, to shut down its own wells. The majority of the court felt that the order lacked finality and was not yet reviewable. Justices Black, Murphy, and Burton dissented. They wanted the court to decide the case on its merits and stated that they felt that the order was valid.

An early Oklahoma Supreme Court case held valid a gas pro-rata order which declared the petitioner to be a common purchaser and required it to give pipeline facilities to certain unconnected gas wells and to commence

... proportionate and ratable taking of natural gas... so as to result in the taking of that ratable proportion that such production bears to the total production available for market.³⁷

This was done over the petitioner's argument that to do so would violate the Impairment of Contracts Clause of the Federal Constitution.

An early federal case held that the Oklahoma Common Purchaser

³³ *Supra*, note 28.

³⁴ *Cities Service Gas Co. v. Peerless Oil and Gas Co.*, 340 U.S. 179 (1950).

³⁵ 349 U.S. 44 (1955).

³⁶ 334 U.S. 62 (1948).

³⁷ *Oklahoma Natural Gas Corp. v. Oklahoma*, 161 Okla. 104, 17 P.2d 488 (1932).

Act does not apply to practically exhausted fields where the only producing wells are located in isolated pockets.³⁸

Anderson-Prichard Oil Corp. v. Corporation Comm'n shows some of the factors which a state commission may consider in issuing its ratable take proration orders. There the court said:

The order . . . fixing allowables for wells producing gas from a common source of supply, based upon the wells' natural flow, determined under factors including acreage underlying a lease, thickness of producing formation and porosity, which allocations are shown to be reasonable and equitable, and made to prevent waste, protect the interest of the public in a natural resource, and the rights of owners of gas produced from the common reservoir, is sustained under the police power of the State; the order does not deprive appellants of their property rights . . . or deny them the equal protection of the law. . . .³⁹

Other cases concerned with ratable take include *Republic Natural Gas Co. v. State*,⁴⁰ defining ratable take and holding that a Corporation Commission order was not arbitrary; *Choctaw Gas Co. v. Corporation Comm'n*,⁴¹ shutting in a producer's wells where the producer had not been complying with ratable take orders; and *Col-Tex Refining Co. v. Railroad Comm'n*,⁴² pointing out that the Texas Common Purchaser Act is statewide in regard to oil but only field-wide in regard to natural gas.

REVIEW OF RECENT FIELD ORDERS REQUIRING RATABLE TAKE

Six of the recent field orders which require ratable take of natural gas will be briefly discussed herein. Before discussing those orders it would be well to mention the normal procedure for determining market demand in Texas. The natural gas producers file forecasts (indicating the amount of gas they plan to produce and sell) and the purchasers file nominations (indicating the amount of gas they plan to buy and transport). The nominations are normally disregarded by the Railroad Commission, the allowables being based upon the producers' forecasts which are adjusted for previous differences between forecasts and actual production; *i.e.*, if a producer takes less than he forecasts, his future forecasts are decreased in determining his

³⁸ *Nowata County Gas Co. v. Henry Oil Co.*, 269 Fed. 742 (8th Cir. 1920).

³⁹ *Anderson-Prichard Oil Corp. v. Corporation Comm'n*, 207 Okla. 686, 252 P.2d 450, 2 OIL AND GAS REP. 234 (1953).

⁴⁰ *Republic Natural Gas Co. v. Oklahoma*, 198 Okla. 350, 180 P.2d 1009 (1947).

⁴¹ *Choctaw Gas Co. v. Corporation Comm'n*, —Okla.—, 295 P.2d 800, 5 OIL AND GAS REP. 1226 (1956).

⁴² *Col-Tex Refining Co. v. Railroad Comm'n*, 150 Tex. 340, 240 S.W.2d 747 (1951).

market demand. The converse is true where the producer takes more than he forecasts. The adjusted forecasts of all the producers in the field are then added to arrive at the field-wide market demand. The market demand as then determined is divided ratably among the wells in that field as allowables.

Balancing periods of six months are generally used. If a well is underproduced during a balancing period the underage is carried forward into the next succeeding balancing period as additional allowable. However, the wells cannot be produced in excess of twice their normal allowable or in excess of 25% of open flow. Also, the underproduction carried forward into a new balancing period may consist only of the actual underproduction that accrued in the immediately preceding balancing period. All other underproduction is cancelled.

If a well is overproduced during one balancing period it should be balanced during the next period, for if a well is overproduced during two successive balancing periods, it is shut in (except to the extent necessary to prevent material damage to the well or loss of the lease) until the overproduction is made up.

These balancing periods are used to give some flexibility to the setting of allowables and to give the producers and purchasers a chance to balance their over- and underproduction without the Commission's having to step in and cancel allowables or shut in wells. With this background in mind the recent field orders will now be discussed.

*Waskom Field Order:*⁴³ Four pipeline purchasers and a number of wells producing from different horizons were involved. The producers had been in the habit of filing exaggerated producer's forecasts which created misleading market requirements and resulted in unrealistic allowables. The order provides that in the future determination of market demand the Commission would consider in addition to producers' forecasts "... all other factors which the Commission deems pertinent. . . ." The balancing period provisions, cancellation of underages after two periods, and the shutting in of overproduced wells after two successive balancing periods are carried forward. The Commission promulgated the new order so that it could determine actual market demand and assign realistic allowables which would result in a more ratable taking from the field.

⁴³ Oil and Gas Docket No. 146, No. 6-32,647, Railroad Comm'n of Texas, December 23, 1955.

*Alco-Mag Field Order:*⁴⁴ This field had ten wells; five wells had pipeline connections, the other five did not. The latter were waiting to connect to a second pipeline purchaser. Use of the usual method of determining allowables resulted in gradually decreasing well allowables which were less than the market available. The order revised the field rules to maintain the field allowable at market demand level by the Commission's determination of market demand ". . . on basis of all pertinent factors . . ." rather than merely on the basis of producers' forecasts. It should be noted that the field allowable will continue to be divided among all wells, whether or not connected to pipelines, in order that the connected wells may produce only their ratable share of the field allowable based on actual market demand. The underproduction of the unconnected wells will continue to be cancelled at the end of the second balancing period.

*Henze Field Order:*⁴⁵ Here there were several producers and a single purchaser. The producers had been filing exaggerated forecasts, resulting in underproduction of certain wells which was cancelled under the standard balancing formula. Applicant sought to have the cancelled underproduction reinstated. The Commission refused to reinstate such underproduction and revised the field rules to eliminate producers' forecasts. It substituted a table showing the percentage of field production due each well which was to be applied *after* production to determine each well's allowable. The order provides that underproduction will be cancelled at the second balancing date and that wells which are overproduced for two successive balancing periods shall be shut in. The order further provides that purchasers whose source wells are shut in must make arrangements to take their market demand from the underproduced wells and that producers whose source wells are underproduced must allow any other purchaser to connect with such wells and purchase therefrom until the underproduction is eliminated.

*Blue Basin Field Order:*⁴⁶ A twelve well field having two interstate pipeline purchasers was involved. The order follows the *Henze* order in its provision for a retrospective, rather than a prospective, setting of allowables. Market demand is determined for each period by the actual production during that period rather than by producers' forecasts. Then the actual market demand is divided up among the wells according to a table of percentages of field produc-

⁴⁴ 5 OIL AND GAS REP. 423 (Tex. Railroad Comm'n 1955).

⁴⁵ 4 OIL AND GAS REP. 1846 (Tex. Railroad Comm'n 1955).

⁴⁶ 5 OIL AND GAS REP. 1100 (Tex. Railroad Comm'n 1956).

tion due each well. Normal provisions in regard to overages and underages are included. The order also requires that interstate purchasers from overproduced wells shut them in and take from underproduced wells. It provides that purchasers from underproduced wells (even though they be dedicated reserves) allow other purchasers to make connection with such wells and to take from them until the underages are made up.

*Spider Field Order:*⁴⁷ This is a Louisiana order involving a field with several wells but only one purchaser. The allowables had been set on the basis of market demand nominations for the entire field filed by the single purchaser. During one month the purchaser's market partially failed, and he did not take ratably. The field rules have now been revised to require the purchaser to take ratably from all the wells in the field in the proportion that the individual allowable for each well bears to the total pool allowable.

*Puckett (Ellenburger) Field Order:*⁴⁸ Two producers were involved; one owned thirteen wells and had a favorable contract with the purchaser while the other owned only one well and had an unfavorable contract which resulted in his not being allowed to produce its ratable share. The only purchaser was an interstate pipeline transporter that owned certain treating facilities which were necessary to make the gas merchantable. This order revised the field rules so that there is a retrospective or "after the fact" calculation of allowables similar to that in the *Henze* and *Blue Basin* Field Orders, *supra*. However, this order does not include a provision requiring connections between purchasers, probably because there were no immediate prospects for more than the one purchaser. The order declares the interstate pipeline to be a Common Purchaser and orders it to purchase ratably from the producers in accordance with a schedule of allowables; the order further requires the pipeline to furnish all facilities furnished by it for one producer to all other producers, including the gas treatment facilities.

Suit was filed in the Texas District Court for Travis County attacking this order on the ground that the Railroad Commission exceeded its authority and that the order was illegal, erroneous, and void. Among the reasons assigned for such alleged illegality were (a) that the method of assigning allowed production to individual wells is contrary to statutory requirements [retrospective rather than prospective proration] and (b) that the Commission does not have the power to declare the purchaser to also be a common "processor"

⁴⁷ 4 OIL AND GAS REP. 1851 (La. Dept. of Conservation 1955).

⁴⁸ 6 OIL AND GAS REP. — (Tex. Railroad Comm'n 1956).

of gas. The district court held the order illegal;⁴⁹ the Commission has appealed, and the case has begun its journey through the appellate courts. Those interested in proration and ratable take will be well advised to watch its progress; the way it is handled may be of vast importance in the further development and administration of ratable take programs.

CONCLUSIONS

In this interesting, yet technical, area of governmental regulation of oil and gas production there are a number of important problems to which final answers have not yet been resolved. The very definition of "ratable take" is vague, and it varies from state to state. The definition, of course, determines what allocation factors the regulating body will consider in setting prorated allowables. There is a potential conflict between the states' control over production and the Federal Power Commission's requirement of dedicated gas reserves for interstate pipeline transporters. State agencies are at present requiring purchasers from underproduced wells to give connections to other purchasers and are considering gas swapping requirements. Both these methods of regulation conflict with the dedicated reserve requirement, but as yet there are no cases giving any authoritative answer to this problem. Then too, especially in Texas, there is a question as to whether the Railroad Commission has power to order retrospective, as well as prospective, proration. However, this appears to be a problem of statutory construction rather than constitutional law.

All in all, it seems that the law on this subject up to the present has laid the foundation for ratable take. We shall have to wait and watch in order to learn the answers to these and other interesting problems which will be raised as effective programs of ratable take are developed.⁵⁰

Charles Robert Dickenson

⁴⁹ Phillips Petroleum Co. v. Railroad Comm'n (No. 105615, District Court of Travis County, Texas 1957); and Permian Basin Pipeline Co. v. Railroad Comm'n (No. 105696, District Court of Travis County, Texas, 1957). These cases are reported at 6 OIL AND GAS REP. 1409.

⁵⁰ Kelley, PRORATION AND RATABLE TAKE, 19 Texas B. J. 763 (1956).