

## CITIES SERVICE GAS CO. V. PEERLESS OIL & GAS CO.: A CASE STUDY IN STATE REGULATION OF INTERSTATE COMMERCE

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This article relates the principal aspects of a celebrated constitutional law case by which the United States Supreme Court, in the absence of federal preemption of the field, upheld state regulation of production and prices in a natural gas field even though the vast majority of the production was to be transported to and sold in other states.

In their inspired efforts "to form a more perfect union," the distinguished delegates to the Constitutional Convention in Philadelphia, in 1787, after considerable discussion and no little compromise, provided, that Congress shall have the power "To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes" (1). This simple but vast grant of power to the national government over foreign and interstate commerce has been the subject of much attention and controversy. Indeed, the way of the "Commerce Clause" has been studded with difficult judicial cases and conceptual decisions.

Historical development of the Commerce Clause has usually been marked by ever-widening definitions of interstate commerce and by expansion of national control over subjects once considered strictly within the purview of state regulation. By the time the guns of August had ushered in World War I, the U.S. Supreme Court had decreed, in the famous Shreveport rate case (*Houston, East and West Railway v. United States*, 234 U.S. 342), that national control of interstate commerce was authorized under the federal Commerce Clause, even if the control had an adverse effect on intrastate commerce.

A notable exception to the growing scope and strength of federal control of interstate commerce and all that it touched was the celebrated case of *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, which arose in Oklahoma in 1950 (2). The controversy grew out of attempts by the Oklahoma Corporation Commission to regulate production and marketing practices in Oklahoma's portion of the great Hugoton gas field. This magnificent deposit of dry

natural gas, stretching across parts of the states of Texas, Oklahoma and Kansas, was 120 miles long and 40 miles wide. The Oklahoma portion, located in Texas County in the Oklahoma panhandle, constituted approximately 1,062,000 proven acres overlying three interrelated producing horizons, into which some 300 wells had been drilled. So vast was the natural gas deposit there that, in its prime, the Hugoton gas field was the largest in the world and constituted 15% of the known dry gas reserves of the United States (3).

Natural gas production was traditionally treated as an unwanted child which necessarily attended the recovery of crude petroleum. The presence of vast quantities of dry natural gas was necessary before sufficient capital could be attracted for construction of interstate pipelines to transport the valuable commodity to distant metropolitan markets. The existence of the Hugoton field had been known since the 1920's and, indeed, considerable drilling had delineated the field even though no market existed for the high-quality natural gas deposited there. By the time Hitler was overthrown and the United Nations had been organized, a few large interstate pipeline companies had built into the Hugoton field and enjoyed a buyer's market. Among these business firms were Cities Service Gas Company, Panhandle Eastern Pipe Line Company and Northern Natural Gas Company. These companies served the urban markets of Kansas City, Chicago and the Middle West. Anxious to market their gas even at low prices rather than suffer it to be drained away by nearby wells connected to a pipeline, most of the well owners in the area had entered into long-term contracts with the pipeline companies to sell them

gas for approximately four cents per 1,000 cu ft. Subsequently, evidence before the Oklahoma Corporation Commission indicated that the fair market value of this gas was approximately ten cents per 1,000 cu ft at the wellhead.

In the first half of 1945, asserting its authority under laws enacted by the Oklahoma Legislature in 1913, 1915, and 1945, the Oklahoma Corporation Commission had promulgated Orders No. 17410 and No. 17867, which brought proration to the Guymon-Hugoton field, the Oklahoma portion of the great reservoir. These orders, following rules and procedures worked out arduously and painfully by the Commission during the 1920's and 1930's for the production of crude petroleum,

established 640 acres as the spacing unit, provided a workable formula for the allocation of allowables to gas wells in the area and followed the usual outline of effective proration regulations relating to common sources of supply of oil (4).

Paragraph 4(b) of Order No. 17867, issued June 1, 1945, required a producer seeking to secure a pipe line connection to tender gas at the going price in the field. Peerless Oil & Gas Company, the holder of about 100,000 acres in the field, tendered gas from several of its unconnected wells to Cities Service at prices in excess of four cents per thousand cubic feet and Cities Service refused to take the gas. The next legal move by Peerless was to apply to the Oklahoma Corporation Commission for an order directing a connection with Cities Service and setting the price and terms of purchase throughout the entire Guymon-Hugoton field, as well as between Peerless and Cities Service. Shortly thereafter, the Oklahoma Land Office, owner in trust of approximately 50,000 acres in the field, joined Peerless in requesting action by the Commission. The Commission, consisting of Reford Bond, Chairman, Ray O. Weems, Vice-Chairman, and Ray C. Jones, Member, issued written notice inviting "all producers and purchasers of gas in the field to appear and participate in the proceedings."

After hearing, from all concerned parties who chose to appear, a plethora of testimony relative to virtually every physical and economic aspect of operations in the great field, the Commission reached some fateful conclusions. It found that

there was no competitive market for gas in the Guymon-Hugoton Field, that the integrated well and pipe-line owners were able to dictate the prices paid to producers without pipe-line outlets, and that as a result gas was being taken from the field at a price below its economic value . . . that the taking of gas at the prevailing prices resulted in both economic and physical waste of gas, loss to the State in gross production taxes, inequitable taking of gas from the common source of supply and discrimination against the various producers in the field (2).

As a result of these remarkable findings, the Commission issued two orders relative to the matters in dispute between Peerless and Cities Service. The first decreed

that no natural gas shall be taken out of the producing structures or formations . . . at a price, at the wellhead, of less than 7¢ per thousand cubic feet of natural gas measured at a pressure of 14.65 pounds absolute pressure per square inch (2).

The second order directed Cities Service to purchase gas ratably from Peerless wells according to the ratable taking set forth in Order No. 17867. In essence, the Commission, considering Cities Service, as an integrated pipeline company, to be a public utility, had ordered the company to lay connecting lines it did not want to lay, to buy gas it did not want to buy, and to pay a price it did not want to pay.

Cities Service's reaction was swift and sure. It appealed the Commission's orders to the Oklahoma State Supreme Court on a multitude of grounds. Among other challenges, it attacked the orders as violative of the Oklahoma State Constitution, as beyond the Commission's authority under state statutes, as violative of the Due Process and Equal Protection clauses of the 14th Amendment to the U.S. Constitution and, finally, as invalid under the federal Commerce Clause (Article I, Section 8, Clause 3). Unimpressed with the arguments espoused by Cities Service attorneys, the Oklahoma Supreme Court upheld the validity of the Commission's orders and Cities Service appealed to the U.S. Supreme Court, which accepted jurisdiction.

The case was argued before the high tribunal, November 9-10, 1950. The oral argument for Cities Service was conducted by an exceedingly able lawyer, Glenn W. Clark. He was assisted on the brief by Joe Rolston, Jr., Robert R. McCracken, R. E. Cullison, and O. R. Stites. A clutch of redoubtable attorneys pressed the cause for

the appellees. Arguing for the State of Oklahoma came Special Counsel, T. Murray Robinson, one of the great oil and gas attorneys of his age, then in the full flower of his powers. Floyd Green argued for the Corporation Commission and D. A. Richardson represented Peerless Oil & Gas Co. Assisting on the brief were State Attorney General, Mac Q. Williamson and his assistant, Fred Hansen, with Thomas J. Lee and Richard H. Dunn representing the Commissioners of the Land Office of Oklahoma.

On December 11, the justices of the high court reached their collective decision in a quiet conference in the marbled mausoleum furnished them by an admiring republic. Chief Justice Fred Vinson assigned Associate Justice Tom Clark to write the opinion for a virtually unanimous court.

Thomas Campbell Clark was a distinguished son of the Lone Star State. Born in Dallas, Texas, in 1899, he had been educated at Virginia Military Institute and the University of Texas, where he received A.B. and LL.B. degrees. During World War I, he served in the 153rd Infantry, U. S. Army. Clark was admitted to the practice of law in Texas in 1922 and began a distinguished legal career which carried him first to the position of Civil District Attorney for Dallas County, Texas, and then to the position of Federal Assistant Attorney General from 1943 to 1945.

A splendid lawyer and administrator who was wise in the ways of the puzzle palaces along the Potomac, Clark was a favorite of President Harry Truman, who first appointed the former "Longhorn" to the position of Attorney General in 1945 and then named him Associate Justice of the Supreme Court in 1949. Clark served on the high tribunal until 1967, when he retired in order to facilitate the appointment of his son, William Ramsey Clark, as President Lyndon Johnson's Attorney General. At the time Justice Clark wrote the opinion in the Peerless case, he had labored on the court for approximately a year and was junior in service to all of the judges save Sherman Minton, whose appointment had followed his own by a few weeks.

Justice Clark stated in an opinion which is both clear and interesting that the question posed by the case was the "power

of a state to fix prices at the wellhead on natural gas produced within its borders and sold interstate" in the absence of action by the Federal Power Commission under the National Gas Act of 1938. Short shrift was given to appellant's arguments that the orders of the Oklahoma Corporation Commission violated the Due Process and Equal Protection Clauses of the Fourteenth Amendment. The majority of the court's rationale was addressed to the question of whether the state's action was a burden on interstate commerce, and, thus, barred by the Commerce Clause.

Clark noted the broad grant of power given Congress by the Commerce Clause and recognized that a strong national interest existed in natural gas problems. However, he pointed out that on balance it had not been shown that state regulation in the case at bar harmed the national interest. Citing several previous decisions of the U.S. Supreme Court which had allowed substantial state regulation of particular aspects of interstate commerce, *Cooley v. Port Wardens, Parker v. Brown, South Carolina Highway Department v. Barnwell Brothers, Milk Control Board v. Eisenberg, Nebbia v. New York*, and others, Clark restated the legal principle that a state price-fixing order is lawful if it is substantially related to a legitimate purpose. He further found that the Commission's order had sought to prevent physical and economic waste of natural gas in the field and that such a purpose was a legitimate exercise of the state's police power to protect the health, welfare, safety, and morals of its people.

Given the complex production situation in the Guymon-Hugoton field and the otherwise attendant waste of natural gas there, Clark found no clearly harmful effect upon interstate commerce. He then upheld the Commission's orders and, thereby, allowed as broad an application of a state's police power to interstate commerce as had been recorded in this country since World War II.

The case still stands as a landmark on the terrain of American Constitutional Law. The subsequent pre-emption by the Federal Power Commission of the function of setting the price of natural gas at the wellhead when the gas moves in interstate commerce has not diminished the impact of this remarkable case. It still stands as a rule of

constitutional law that, in the absence of federal activity, a state may impose substantial regulations even upon interstate commerce to correct or prevent a particularly odious situation that otherwise would escape government controls.

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#### REFERENCES

1. Article I, Section 8, Clause 3 of The Constitution of the United States.
2. *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, U. S. Supreme Court Rept. 340: 179 (1950).
3. J. A. CLARK, *The Chronological History of the Petroleum and Natural Gas Industries*, Clark Book Co., Houston, Texas, 1963, pp. 135 and 229.
4. OKLAHOMA CORPORATION COMMISSION, *Oklahoma Oil and Gas Conservation Laws*, Co-operative Publishing Co., Guthrie, Okla., 1959, pp. 344-345.