Oklahoma Law Review

Volume 40 | Number 1

1-1-1987

Constitutional Law: *Brown-Forman Distillers Corp.* --Can Oklahoma's Liquor Price Affirmation Statute Pass Constitutional Muster?

Gregory F. Pilcher

Constitutional Law: *Brown-Forman Distillers Corp.*—Can Oklahoma's Liquor Price Affirmation Statute Pass Constitutional Muster?

The commerce clause of the United States Constitution bestows upon Congress the power to regulate trade among the several states.[1] Even in the absence of a congressional exercise of this power, the commerce clause prevents the states from erecting barriers to the free flow of interstate commerce.[2] States may regulate activities concerning the health, safety, and welfare of their citizens only if such regulations do not impose an unreasonable burden upon interstate commerce.[3] State regulations generally must pursue a legitimate state interest, and the regulation must be rationally related to that legitimate interest.[4] Furthermore, the burden imposed on interstate commerce must be outweighed by the state's interest in enforcing its regulation.[5]

Section two of the twenty-first amendment to the United States Constitution[6] qualifies the commerce clause by allocating broad powers to the states to regulate intoxicating liquors.[7] Each state is vested with the authority to regulate the use, distribution, and consumption of liquor within its borders and may even completely ban all liquor trade.[8] Accordingly, the restraint im-

1. U.S. CONST. art. I, § 8, cl. 3 grants Congress the power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

2. *E.g.*, Raymond Motor Transp., Inc. v. Rice, 434 U.S. 429, 440 (1978) (invalidating Wisconsin statute prohibiting operation of vehicles over 55 feet long on highways within state). Cases such as *Raymond Motor*, involving state regulations that burden interstate commerce within an area in which Congress either has not acted or has enacted federal regulations that do not preempt state regulations, are known as "negative or dormant commerce clause" cases. Generally, state legislation that conflicts with a federal statute must give way to the federal law under the supremacy clause. U.S. CONST. art. 6, cl. 2. *See* Pennsylvania v. Nelson, 350 U.S. 497 (1956); Castle v. Hayes Freight Lines, Inc., 348 U.S. 61 (1954) (both cases discuss the operation of the supremacy clause when state and federal law conflict).

3. *E.g.*, Hughes v. Oklahoma, 441 U.S. 322 (1979); Edwards v. California, 314 U.S. 160 (1941).

4. *See Raymond Motor*, 434 U.S. at 440.

5. *Id.* at 441 (citing Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970) (invalidating Arizona statute prohibiting grower from transporting uncrated cantaloupes from its Arizona ranch to a nearby California city for packing and processing)).

6. U.S. CONST. amend. XXI, § 2 provides: "The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquor, in violation of the law thereof, is hereby prohibited."

7. *See, e.g.*, State Bd. of Equalization v. Young's Market Co., 299 U.S. 59, 62 (1936) (twenty-first amendment gives the states broad powers to regulate alcoholic beverages without violating the commerce clause).

8. *See* Bacchus Imports, LTD v. Dias, 468 U.S. 263 (1984); California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97 (1980); Joseph E. Seagram & Sons, Inc. v. Hostetter, 384 U.S. 35 (1966); Hostetter v. Idlewild Bon Voyage Liquor Corp., 377 U.S. 324 (1964); United States v. Frankfort Distilleries, 324 U.S. 293 (1945); Ziffrin, Inc. v. Reeves, 308 U.S. 132 (1939) (all cases discussing states' wide latitude to regulate intoxicating beverages pursuant to the twenty-first amendment).

For purposes of this note, the words "intoxicating liquors," "intoxicating beverages," posed by the commerce clause on states is modified when state regulations involve intoxicating beverages.[9] However, the extent of state control over the regulation of liquor under section two of the twenty-first amendment is not completely clear.[10] The parameters of the states' delegated authority under the ambiguous wording of section two is the most common issue in litigation involving state liquor regulations.

Early Supreme Court decisions largely deferred to state regulation of the importation and sale of liquor despite the burden placed on interstate commerce.[11] However, more recent cases have eroded the broad grant of state authority under section two of the twenty-first amendment.[12] The Court has begun to limit state control over alcohol in areas that are not directly related

---

"alcoholic beverages," "liquor," and "alcohol" are used interchangeably. These denominations include all intoxicants containing more than 3.2% alcohol by weight. *See* 37 OKLA. STAT. § 163.2 (1981).

9. See *supra* note 8.

10. *See generally* Lydick, *State Control of Liquor Advertising under the United States Constitution*, 12 BAYLOR L. REV. 43 (1960); Note, *The Effect of the Twenty-First Amendment on State Authority to Control Intoxicating Liquors*, 75 COLUM. L. REV. 1578 (1975); Note, *Retail Price Maintenance for Liquor: Does the Twenty-First Amendment Preclude a Free Trade Market?*, 5 HASTINGS CONST. L.Q. 507 (1978); Note, *California Retail Liquor Dealers Association v. Midcal Aluminum, Inc.: Federal Power Under the Twenty-First Amendment?*, 38 WASH. & LEE L. REV. 302 (1981).

The congressional debates concerning the effect of the twenty-first amendment on the commerce clause reveal two distinct positions. *See* 76 CONG. REC. 64-4172 (1933). The "absolutists" advocated total state control over alcohol in the belief that local responsibility was most effective. *Id.* at 64-4144. The "federalists" claimed that the intent of section 2 was to prevent federal restrictions under the commerce clause from unduly interfering with dry states' regulation of imported liquor. *Id.* at 64-4168. *See also* Note, *The Effect of the Twenty-First Amendment on State Authority to Control Intoxicating Liquors, supra*, at 1579-81.

Although unclear, it appears that section two of the twenty-first amendment was intended to delegate to the states the power to regulate intoxicants in a manner ordinarily forbidden by the commerce clause. Nonetheless, the Supreme Court has refused to inquire into the legislative history of the twenty-first amendment. *See* California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 107 n.10 (1980) (citing the amendment's ambiguous legislative history and the states' indecisiveness in ratification). *See generally* E. BROWN, RATIFICATION OF THE TWENTY-FIRST AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES (1970).

11. United States v. Frankfort Distilleries, 324 U.S. 293, 300 (1945) (Frankfurter, J., concurring) (state may erect any barrier to entry of intoxicating liquor; low, medium, or insurmountable); Carter v. Virginia, 321 U.S. 131, 140 (1944) (Frankfurter, J., concurring) (twenty-first amendment authorized circumvention of commerce clause); Indianapolis Brewing Co. v. Liquor Control Comm'n, 305 U.S. 391, 394 (1939) (right of state to prohibit or regulate importation of liquor is not limited by the commerce clause); State Bd. of Equalization v. Young's Market, 299 U.S. 59, 62 (1936) (state has broad power to regulate alcoholic beverages without violating the commerce clause).

12. Bacchus Imports, LTD v. Dias, 468 U.S. 263, 275 (1984) (it is clear that the twenty-first amendment did not entirely remove state regulation of alcoholic beverages from the ambit of the commerce clause); Craig v. Boren, 429 U.S. 190, 206 (1976) (commerce clause is not totally inoperative in liquor matters); Joseph E. Seagram & Sons, Inc. v. Hostetter, 384 U.S. 35, 42 (1966) (twenty-first amendment has not operated totally to repeal the commerce clause in the area of liquor traffic regulation). *Accord* United States Brewers Ass'n, Inc. v. Healy, 692 F.2d 275, 281 (2d Cir. 1982) (commerce clause has not totally been repealed in the area of regulation of traffic in liquor).

to the language in section two.[13] State authority has been limited in areas addressed by other constitutional provisions[14] and in areas of exclusive federal concern.[15] Recent Supreme Court decisions make it clear that the federal government retains an interest in the regulation of liquor through its commerce power.[16] However, the extent of state or federal control over the regulation of liquor depends upon the particular facts and circumstances surrounding a case.[17]

In Oklahoma, all regulations of the liquor industry are vested in the Oklahoma Alcoholic Beverage Control Act (ABC Act).[18] Pursuant to the provisions of the ABC Act, the Alcoholic Beverage Laws Enforcement Commission (ABLE Commission)[19] is the state policing agency empowered to enforce the Act and the rules and regulations promulgated thereunder.[20] As a result, the ABLE Commission has the duty to issue all liquor licenses[21] and ensure that all licensees comply with the provisions of the ABC Act.[22]

Under the liquor price affirmation statute in the Oklahoma ABC Act, no distiller may sell alcoholic beverages to an Oklahoma wholesaler at a "rate higher than the lowest rate" at which the distiller sells in any other state.[23]

13. See *infra* notes 14-15.

14. *See, e.g.*, Craig v. Boren, 429 U.S. 190 (1976) (invalidating statute prohibiting sale of 3.2% beer to males under twenty-one years of age and females under eighteen). In *Craig*, the Court intimated that a state's authority to regulate alcohol is limited when the regulation circumvents the due process and equal protection clauses of the fourteenth amendment. *Id.* at 206.

15. Areas of exclusive federal concern include regulation of commerce with foreign nations, *see* Hostetter v. Idlewild Bon Voyage Liquor Corp., 377 U.S. 324, 334 (1964) (twenty-first amendment did not grant states authority to regulate foreign commerce in alcohol); taxation of imports from foreign nations, *see* Department of Revenue v. James B. Beam Distilling Co., 377 U.S. 341, 346 (1964) (states lack power to regulate alcohol from abroad in violation of export-import clause); and federally owned installations, *see* Collins v. Yosemite Park & Curry Co., 304 U.S. 518, 538-39 (1938) (states may not regulate importation of alcohol for exclusive use in national park under federal jurisdiction).

16. See *supra* note 11.

17. *See, e.g.*, Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

18. 37 OKLA. STAT. §§ 501-599 (1981 & Supp. 1986). The purpose of the ABC Act is set out in section 503(A) as follows:

> The Oklahoma Alcoholic Beverage Control Act shall be deemed an exercise of the police power of the State of Oklahoma for the protection of the welfare, health, peace, temperance and safety of the people of the state, and all the provisions hereof shall be construed for the accomplishment of that purpose.

Legislative authority to regulate intoxicating liquors derives from the Oklahoma constitution. OKLA. CONST. art. XXVII, § 3 provides in part: "The Legislature shall enact laws providing for the strict regulation, control, licensing, and taxation of the manufacture, sale, distribution, possession, and transportation of alcoholic beverage, consistent with the provisions of this Amendment."

19. *See* 37 OKLA. STAT. § 506.1 (1981).

20. *Id.* § 514. The ABLE Commission also has the duty to adopt reasonable rules and regulations in addition to the statutory provisions of the ABC Act in order to ensure that the provisions of the Act are properly carried out. *See id.* § 514(2).

21. *Id.* § 518.

22. *Id.* § 514.

23. *Id.* § 536.1. This price affirmation statute will be examined in detail, *infra* notes 88-106 and accompanying text.

The articulated purpose of the price affirmation law is to "foster price competition among suppliers to Oklahoma wholesalers" making "price discrimination or favoritism against Oklahoma wholesalers unlawful."[24] Until recently, such price affirmation statutes have withstood constitutional attack on the grounds that the twenty-first amendment affords broad regulatory powers to the states.[25] However, the proliferation of conflicting affirmation laws into various states has begun to impede interstate liquor traffic.[26] Because some state affirmation laws are based on the "current month" lowest price and others on the "previous month" lowest price, it has become difficult for distillers to adjust prices in one state without violating the affirmation provision of another.[27]

In *Brown-Forman Distillers Corp. v. New York State Liquor Authority*,[28] the Supreme Court of the United States held that New York's liquor price affirmation statute violated the commerce clause. Justice Marshall, writing for the Court, declared that despite the twenty-first amendment, the commerce clause operates with full force when a state attempts to regulate the sale of alcoholic beverages in another state.[29] The heightened degree of scrutiny articulated by the *Brown-Forman* Court could present constitutional problems for many state liquor price affirmation statutes.[30]

In assessing the effect of the Supreme Court's decision in *Brown-Forman* on Oklahoma's liquor price affirmation statute, this note deals with four

24. *See* Joseph E. Seagram & Sons, Inc. v. Oklahoma Alcoholic Beverage Control Bd., 637 P.2d 88, 92 (Okla. 1981).

25. Liquor price affirmation statutes have been challenged on several constitutional grounds, including violation of the commerce, supremacy, due process, and equal protection clauses of the United States Constitution. *See, e.g.*, Joseph E. Seagram & Sons, Inc. v. Hostetter, 384 U.S. 35 (1966) (statute did not violate the commerce clause or supremacy clause nor deny due process or equal protection); Joseph E. Seagrams & Sons, Inc. v. Gazzara, 610 F. Supp. 673 (S.D.N.Y. 1985) (statute did not violate commerce clause); Laird & Co. v. Cheney, 196 Kan. 675, 414 P.2d 18 (1966) (statute did not violate the due process, equal protection, or commerce clauses). *But cf.* United States Brewers Ass'n, Inc. v. Healy, 692 F.2d 275 (2d Cir. 1982) (Connecticut beer affirmation statute placed unconstitutional burden on interstate commerce).

26. *See, e.g.*, Joseph E. Seagram & Sons, Inc. v. Gazzara, 610 F. Supp. 673, 675 n.3 (S.D.N.Y. 1985). This problem is discussed in more detail *infra* notes 30 & 56-60 and accompanying text.

27. *Id.* The problem occurs because of the difference in the time reference for the affirmation price. Some states require the distiller to set a price that is no higher than the lowest price charged "previously" anywhere in the United States. *See, e.g.*, ARIZ. REV. STAT. ANN. § 4-253(A) (Supp. 1985). Other states, like New York, require the affirmed price to be no higher than the lowest price that will be charged during the "current month." *See* N.Y. ALCO. BEV. CONT. LAW. § 101-b(3)(d) (McKinney 1976).

28. 106 S. Ct. 2080 (1986).

29. *Id.* at 2088.

30. The proliferation of state affirmation laws has greatly multiplied the likelihood that a seller will be subjected to inconsistent obligations in different states. *Id.* at 2087. At least thirty-eight states have liquor price affirmation statutes, eighteen of which are "control states" that purchase all liquor that will be distributed and consumed within their borders. *Id.* at 2083 n.1. The control states require distillers to warrant that the price charged is no higher than the lowest price offered anywhere else in the United States. *Id.*

subtopics. First, the *Brown-Forman* decision is analyzed. Other relevant cases are examined in light of the *Brown-Forman* decision in order to formulate the proper constitutional test to be applied in cases involving state regulation of intoxicating liquors. Second, the Oklahoma and New York liquor price affirmation statutes are compared. This section scrutinizes Oklahoma's price affirmation statute to determine its similarities to New York's affirmation statute that was invalidated in *Brown-Forman* as an impermissible burden on interstate commerce. The Oklahoma case law and Attorney General Opinions are examined to facilitate a proper understanding of the effects of Oklahoma's statute. In the third section of this note, the constitutionality of Oklahoma's affirmation provision is assessed. The constitutional analysis articulated in the *Brown-Forman* decision is applied to Oklahoma's affirmation statute in order to assess its encroachment upon interstate commerce. Finally, this note concludes by assessing the future of Oklahoma's affirmation law and proposing solutions.

Brown-Forman Distillers Corp.

In *Brown-Forman*, the appellant was a distiller selling several brands of liquor in New York and other states. In 1978, the appellant began offering promotional allowances to every wholesaler in every state that sold its products.[31] All states allowed the payments except New York. The New York State Liquor Authority determined that the state's Alcoholic Beverage Control Law[32] prohibited allowances because they lowered the "effective price" to out-of-state wholesalers, thus violating New York's liquor price affirmation law.[33] New York's affirmation law prohibited sales of liquor products to wholesalers in other states at prices lower than sales to New York wholesalers.[34]

The Liquor Authority calculated the "effective price" as the lowest price at which the appellant's products were sold in any state after appropriate

31. Brown-Forman Distillers Corp. v. New York State Liquor Auth., 106 S. Ct. 2080 (1986). Upon appellant's request, the Federal Bureau of Alcohol, Tobacco and Firearms ruled that such promotional allowances did not violate the Federal Alcohol Administration Act, 27 U.S.C. §§ 201-211 (1981). 106 S. Ct. at 2083 n.2.

32. N.Y. ALCO. BEV. CONT. LAW §§ 100-130 (McKinney 1976).

33. *See id.* § 101-b(2)(b) (prohibiting "any discount, rebate, free goods, allowance or other inducement of any kind" except for quantity and prompt-payment discounts of specified amounts). *See also Brown-Forman*, 106 S. Ct. at 2083 n.3.

34. N.Y. ALCO. BEV. CONT. LAW § 101-b(3)(d) provides in pertinent part:

> There shall be filed . . . an affirmation duly verified . . . that the bottle and case price of liquor to wholesalers set forth in such schedule is no higher than the lowest price at which such item of liquor will be sold by such brand owner . . . to any wholesaler anywhere in any other state of the United States or in the District of Columbia, or to any state (or state agency) which owns and operates retail liquor stores (i) at any time during the calendar month for which such schedule shall be in effect.

reductions had been made to reflect all promotional allowances.[35] Since New York prohibited these allowances, the "effective price" to its wholesalers was higher than the "effective price" to wholesalers in states that permitted the allowances. The Liquor Authority thus revoked the appellant's liquor license.

The appellant sought review in the state courts asserting that the affirmation law was arbitrary and directly regulated interstate commerce.[36] It argued that there was no single "effective price" because each wholesaler participating in the allowance program could pay a different effective price in a given month, depending upon the amount of allowance it received.[37] Moreover, other states did not treat the allowances as a discount. Forcing the appellant to reduce its New York prices to account for the allowances to other state wholesalers would result in violations of the affirmation laws of those states.[38] Unless other states changed their affirmation laws, New York's law would effectively force the appellant to discontinue its promotional allowance program in other states. It was contended that this interference directly violated the commerce clause.[39]

The Appellate Division of the New York Supreme Court found New York's liquor price affirmation law to be constitutional.[40] The New York Court of Appeals affirmed, holding that the affirmation law did not violate the commerce clause either in application or on its face.[41] The United States Supreme Court reversed, concluding that New York's liquor price affirmation statute on its face violated the commerce clause and was not a valid exercise of New York's powers under the twenty-first amendment.[42]

At the outset of the Supreme Court's opinion, Justice Marshall asserted that "if appellant has correctly characterized the effect of New York's price affirmation law, that law violates the Commerce Clause."[43] Justice Marshall began the analysis by subjecting the statute to the stricter commerce clause analysis,[44] rather than the wider latitude approach of twenty-first amendment liquor regulations applied in earlier cases.[45] In applying the stricter commerce clause analysis, Marshall reaffirmed that the federal government still retains

35. *See id.* § 101-b(3)(g) (in determining lowest price, "appropriate reductions shall be made to reflect all discounts . . . and all rebates, free goods, allowances and other inducements").

36. *Brown-Forman*, 106 S. Ct. at 2084.

37. The amount of a particular wholesaler's allowance was dependent on past purchases and projected future purchases. *Id.* at 2083.

38. *Id.* at. 2084.

39. *Id.*

40. 100 A.D.2d 55, 473 N.Y.S.2d 420 (N.Y. App. Div. 1984).

41. 64 N.Y.2d 479, 479 N.E.2d 764 (N.Y. 1985).

42. *Brown-Forman*, 106 S. Ct. at 2088.

43. *Id.* at 2085.

44. *See* City of Philadelphia v. New Jersey, 437 U.S. 617 (1978) (Court applied two-tiered approach in declaring a statute prohibiting importation of solid waste in violation of the commerce clause); Pike v. Bruce Church, Inc, 397 U.S. 137 (1970) (even when statute regulates evenhandedly and has only indirect effects on interstate commerce, must balance state's interest with burden on interstate commerce); Shafer v. Farmers Grain Co., 268 U.S. 189 (1925) (Grain Grading Act that directly regulates interstate commerce is per se invalid).

45. See *supra* note 12.

an interest in the control of intoxicating beverages in interstate traffic through its commerce clause powers.[46]

Marshall explained that the Court "has adopted what amounts to a two-tiered approach to analyzing state economic regulation under the Commerce Clause."[47] First, the "per se invalid" tier: a state statute that directly regulates or discriminates against interstate commerce or in effect favors in-state economic interests over out-of-state interests is generally struck down without further inquiry.[48] Second, the "balancing approach" tier: when a state statute regulates evenhandedly and affects interstate commerce only indirectly, the state's interests and local benefits must be balanced against the burden placed on interstate commerce.[49] There is no clear line separating the two categories, but the "critical consideration is the overall effect of the statute on both local and interstate activity."[50]

Employing the protectionist principles announced in *Baldwin v. G. A. F. Seelig, Inc.*,[51] Justice Marshall declared that the "mere fact that the effects of New York's ABC Law are triggered only by sales of liquor within the State of New York therefore does not validate the law if it regulates the out-of-state transactions of distillers who sell in-state."[52] In *Seelig*, the Supreme Court struck down New York's Milk Control Act, which set minimum prices for milk purchased from producers in New York and other states and banned the resale within New York of milk that had been purchased for a lower price.[53] Writing for the Court, Justice Cardozo recognized that no state may "establish a wage scale or a scale of prices for use in other states, and . . . bar the sale of the products . . . unless the scale has been observed."[54] By prohibiting distillers from reducing their prices in other states lower than the affirmed price in New York, New York's affirmation law effectively regulates out-of-state transactions in violation of the commerce clause.[55]

Justice Marshall also distinguished *Joseph E. Seagram & Sons, Inc. v. Hostetter*, in which the Court upheld the constitutionality of the predecessor

46. *See, e.g.*, California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 110 (1980) (federal government retains an interest in the control of alcoholic beverages in interstate commerce). See also *supra* note 11.

47. *Brown-Forman*, 106 S. Ct. at 2084.

48. *Id.* (citing Edgar v. MITE Corp., 457 U.S. 624 (1982) (plurality opinion); City of Philadelphia v. New Jersey, 437 U.S. 617 (1978); Shafer v. Farmers Grain Co., 268 U.S. 189 (1925)).

49. 106 S. Ct. at 2084 (citing Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970)).

50. *Id.* at 2084-85 (citing Raymond Motor Transp., Inc. v. Rice, 434 U.S. 429, 440-41 (1978)).

51. 294 U.S. 511 (1935). While a state may seek lower prices for its consumers, it may not insist that producers or consumers in other states surrender whatever competitive advantages they may possess. *See id.* at 528.

52. *Brown-Forman*, 106 S. Ct. at 2085.

53. *Seelig*, 294 U.S. at 512.

54. *Id.* at 528.

55. *Brown-Forman*, 106 S. Ct. at 2088.

to the current New York affirmation statute.[56] Marshall explained that the predecessor was "retrospective" in that it required a distiller to affirm that its prices in a given month in New York would be no higher than the lowest price at which the product had been sold in any other state during the "previous" month.[57] On the other hand, New York's current price affirmation law is "prospective" in that it requires a distiller to affirm that its prices in a given month in New York are no higher than the lowest price at which the product is sold in any other state during the "current" month.[58] Once a distiller has posted prices in New York, it is not free to change its prices elsewhere in the United States during that month.[59] "While New York may regulate the sale of liquor within its borders, and may seek lower prices for its residents, it may not 'project its legislation into [other states] by regulating the price to be paid' for liquor in those States."[60]

In effect, New York's affirmation law controlled liquor prices in other states.[61] This was due to New York's requirement that once a distiller's prices have been posted and affirmed, it must seek the approval of the New York State Liquor Authority before it may lower its prices.[62] Marshall claimed that it was not speculative to assume that the Liquor Authority would not permit appellant to reduce its New York price after the posted price had taken effect.[63] Thus, appellant could not reduce its prices in other states without be-

56. 384 U.S. 35 (1966).

57. *Brown-Forman*, 106 S. Ct. at 2085.

58. *Id.* at 2036.

59. *Id.* The Court declined to attach constitutional significance to the difference between a "prospective" statute and the "retrospective" statute at issue in *Seagram.*

> Indeed, one could argue that the effects of the statute in *Seagram* do not differ markedly from the effects of the statute at issue in the present case. If there is a conflict between today's decision and the *Seagram* decision, however, there will be time enough to address that conflict should a case arise involving a retrospective statute. Because no such statute is before us now, we need not consider the continuing validity of *Seagram.*

Id. at 2087 n.6. Moreover, the Court recognized that "the proliferation of state affirmation laws following this Court's decision in *Seagram* has greatly increased the likelihood that a seller will be subjected to inconsistent obligations in different States." *Id.* See also *supra* note 30 and accompanying text. Justice Blackmun in his concurring opinion suggested that there is no principled distinction between a prospective statute and the retrospective statute upheld in *Seagram*; both operate to affect out-of-state transactions in violation of the commerce clause. "We should face reality and overrule *Seagram.*" *Id.* at 2088 (Blackmun, J., concurring).

60. *Id.* at 2086 (quoting Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 521 (1935)).

61. *Id.*

62. N.Y. ALCO. BEV. CONT. LAW § 101-b(3)(a) (McKinney 1976) provides in part: "Such brand of liquor or wine shall not be sold to wholesalers except at the price and discounts then in effect unless prior written permission of the authority is granted for good cause shown and for reasons not inconsistent with the purpose of this chapter."

63. *Brown-Forman*, 106 S. Ct. at 2087:

> We would not solve the constitutional problems inherent in New York's statute by indulging the dissent's assumption that the Authority will be sensitive to Commerce Clause concerns. Certainly New York could not require an out-of-state company to receive a license from New York to do business in other States, even if we

ing in violation of New York's affirmation law. Moreover, the result of New York's definition of the "effective price" requires that either appellant abandon its allowance programs in states with a different definition, or requires those states to alter their own regulatory schemes in order to permit appellant to lower its New York prices without violating the affirmation laws of those states.[64] The practical effect is that New York's legislation is "projected into other states."[65]

Justice Marshall finally addressed the twenty-first amendment, asserting that it is "well settled that the Twenty-first Amendment did not entirely remove state regulation of alcohol from the reach of the Commerce Clause."[66] Rather, the twenty-first amendment and the commerce clause "each must be considered in light of the other and in the context of the issues and interests at stake in any concrete case."[67] The twenty-first amendment does afford wide latitude to the states, but that latitude extends only to regulation of intoxicating beverages within their borders.[68]

Marshall agreed that New York's affirmation law regulated evenhandedly between in-state and out-of-state distillers, and New York had a valid constitutional interest in regulating liquor within its boundaries.[69] However, these factors were irrelevant in the instant case because the affirmation law fell within the first tier of direct regulation of interstate commerce forbidden by the commerce clause.[70] The commerce clause operates in full force when one state attempts to regulate the sale of alcohol in another state and effectively disposes of the twenty-first amendment issue.[71]

> were quite sure that such licenses would be granted as a matter of course. Similarly, New York simply may not force appellant to seek regulatory approval from New York before it can reduce its prices in another state. The protections afforded by the Commerce Clause cannot be made to depend on the good grace of a state agency.

Id. n.5.

64. *Id.* at 2087.

65. *Id.* At least thirty-eight states, including Oklahoma, have liquor price affirmation statutes similar to New York's. See *supra* note 30. The affirmation laws in these other states may also be constitutionally invalid due to restrictions they place upon interstate commerce. However, the *Brown-Forman* Court confined its holding to New York's price affirmation statute.

The Supreme Court has yet to invalidate a retrospective price affirmation statute. However, the *Brown-Forman* Court noted that such retrospective statutes, coupled with the problems created by the proliferation of state liquor price affirmation statutes in general, may have "created so grave an interference with interstate commerce" as to make such regulations invalid under the commerce clause. *Id.* at 2087 (Stevens, J., dissenting). *See also id.* at 2091 n.6. The Court stated that there will be time enough to address the constitutionality of other state liquor price affirmation laws should a case arise. *Id.*

66. *Id.* (citing Bacchus Imports, LTD. v. Dias, 468 U.S. 263 (1984)). See also *supra* note 11.

67. *Id.* (citing Hostetter v. Idlewild Bon Voyage Liquor Corp., 377 U.S. 324, 332 (1964)).

68. *Id.* at 2087.

69. *Id.*

70. *Id.* at 2088.

71. *Id.*

In *Brown-Forman*, three Justices dissented.[72] Justice Stevens, joined by Justice White and Justice Rehnquist, raised three points. First, they believed the case to be indistinguishable from *Joseph E. Seagram & Sons, Inc. v. Hostetter*, which upheld the predecessor to New York's present affirmation statute.[73] As Justice Stewart explained in *Seagram*:

> The mere fact that section 9 is geared to appellants' pricing policies in other States is not sufficient to invalidate the statute. As part of its regulatory scheme for the sale of liquor, New York may constitutionally insist that liquor prices to domestic wholesalers and retailers be as low as prices offered elsewhere in the country.[74]

The dissenters argued that appellant had shown no evidence to prove that New York's affirmation law affected the price of its products in any other states, thereby directly regulating interstate commerce.[75] Such a conclusion was seen as merely conjecture and not sufficient to distinguish *Seagram*.[76]

Second, the dissenters argued that the Court's assumption that the New York State Liquor Authority would not allow appellant to reduce its New York prices was mere speculation.[77] In their view, the record did not support such a conclusion.[78]

Finally, the dissenters argued that *Baldwin v. G. A. F. Seelig, Inc.* was distinguishable.[79] The statute in *Baldwin* was designed to protect New York producers from out-of-state competition.[80] By contrast, the New York liquor price affirmation statute was designed to keep liquor prices down in order to give New York consumers the benefit of out-of-state competition.[81] Because of the twenty-first amendment, the dissenters asserted that the validity of New York's affirmation statute should not be examined in the same light as the constitutionality of a state statute governing the sale of milk.[82]

Most important, however, is that in the concluding paragraph the dissenters conceded that the proliferation of state affirmation statutes in general has begun to burden the flow of interstate commerce:

72. *Id.* Justice Brennan took no part in the consideration or decision of the case.

73. 384 U.S. 35 (1966).

74. *Brown-Forman*, 106 S. Ct. at 2088-89. (Stevens, J., dissenting) (citing Joseph E. Seagram & Sons, Inc. v. Hostetter, 348 U.S. 35, 43 (1966)).

75. *Brown-Forman*, 106 S. Ct. at 2089 (Stevens, J., dissenting).

76. *Id.*

77. *Id.*

78. *Id.*

79. 294 U.S. 511 (1935). See also *supra* notes 52-54 and accompanying text.

80. *Brown-Forman*, 106 S. Ct. at 2090 (Stevens, J., dissenting).

81. *Id.*

82. *Id.* at 2090-91 (citing Battipaglia v. New York State Liquor Auth., 745 F.2d 166, 168 (2d Cir. 1984)). The dissenters were arguing for a lesser degree of scrutiny than that applied by the majority of the Court. They believed that the statute should be examined under the wider latitude of twenty-first amendment liquor regulations, rather than under the stricter commerce clause analysis.

> It may well be true that the network of statutes that have spread across the nation since the Court's decision in *Seagram* has created "so grave an interference with" interstate commerce as to exceed the "wide latitude for [state] regulation" under the Twenty-first Amendment and to make "the regulation invalid under the Commerce Clause."[83]

Nonetheless, the dissenters thought that in the instant case appellant had failed to provide sufficient evidence to support this conclusion.

In sum, the Court in *Brown-Forman* applied the stricter two-tiered commerce clause analysis, rather than the wider latitude approach to twenty-first amendment liquor regulations. The Supreme Court found that New York's affirmation statute effectively regulated the appellant's pricing schemes in other states. Despite New York's broad regulatory powers under the twenty-first amendment, such a direct regulation of interstate liquor trade is a per se violation of the commerce clause.

Brown-Forman is representative of the current trend of review in cases involving state regulation of intoxicating beverages. The standard of review has shifted from a virtual absolutist position of deference[84] to a stricter degree of scrutiny involving a balancing of competing state and federal interests.[85] Although a state retains complete control over the regulation of liquor "within its own borders," any legitimate evidence illuminating the slightest burden on interstate commerce will trigger the stricter degree of scrutiny.[86] The constitutionality of the state statute is then scrutinized under the two-tiered approach as articulated by the Supreme Court in *Brown-Forman*.[87]

A Comparison with Oklahoma's Statute

Although certain differences exist, Oklahoma's price affirmation law is similar in substance to New York's affirmation law declared to be unconstitutional by the Supreme Court in *Brown-Forman*. Oklahoma's liquor price affirmation statute provides: "No distiller shall sell alcoholic beverages to a wholesaler licensed under the Oklahoma Alcoholic Beverage Control Act at a rate higher than the lowest rate at which such distiller sells in any other state."[88] The authority to adopt rules and regulations in order to enforce the

83. *Id.* at 2091.

84. See *supra* note 11.

85. See *supra* note 12. *See also* California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97 (1980) (declaring California's wine-pricing scheme to be in violation of the Sherman Act). "Although States retain substantial discretion to establish . . . liquor regulations, those controls may be subject to the federal commerce power in appropriate situations. The competing state and federal interests can be reconciled only after careful scrutiny of those concerns in a 'concrete case'." *Id.* at 110.

86. Once the challenger of the constitutionality of a state statute offers the appropriate evidence, the state then has a heavier burden to prove that local interests outweigh the burden on interstate commerce.

87. See *supra* notes 47-50 and accompanying text.

88. 37 OKLA. STAT. § 536.1 (1981). Section 536.1 of title 37 of the Oklahoma Statutes was

provisions of this statute was given to the ABLE Commission by the Oklahoma legislature.[89] Under this authority, the ABLE Commission has codified a set of rules and regulations in order to promulgate the intentions of the legislature.[90]

Although Oklahoma's price affirmation statute is vague, the rules and regulations of the ABLE Commission provide the explicit terms that govern Oklahoma distillers.[91] Similar to New York's law, the rules and regulations require all distillers[92] licensed to sell to Oklahoma wholesalers to register each month with the ABLE Commission all items of alcoholic beverages offered for sale in Oklahoma. All wholesale prices must be no higher than "the lowest price at which any such item is sold in any other state."[93] Like New York, Oklahoma's affirmation law is prospective. The affirmed price reflects the lowest price at which alcoholic beverages are sold anywhere in the United States in the "current month" for which the price schedule is to be in

---

passed by the Oklahoma legislature in 1971 and is commonly known as the Oklahoma Price Affirmation Law. "The purpose of this statute is to foster price competition among suppliers to Oklahoma wholesalers and to make any price discrimination or favoritism against Oklahoma wholesalers unlawful." 9 Op. Att'y Gen. 14, 15 (Okla. July 12, 1976).

89. 37 OKLA. STAT. § 514(2) (1981) provides that the ABLE Commission shall have the powers and duties to "promulgate rules and regulations, in the manner herein provided to carry out the purposes of the Oklahoma Alcoholic Beverages Control Act."

90. RULES AND REGULATIONS OF THE ALCOHOLIC BEVERAGE LAWS ENFORCEMENT COMMISSION, arts. 1-12 [hereinafter ABLE RULES].

91. While New York's affirmation statute explicitly states the terms governing New York distillers, Oklahoma's affirmation statute does not. Oklahoma's statute merely states that a distiller shall sell its liquor products in Oklahoma at a rate no higher than the lowest rate it sells in any other state. See *supra* note 88 and accompanying text. The Rules and Regulations of the ABLE Commission set out the explicit terms governing Oklahoma distillers.

92. Oklahoma's liquor price affirmation statute, 37 OKLA. STAT. § 536.1 (1981), refers only to "distillers." However, 37 OKLA. STAT. § 524 requires every out-of-state seller who sells alcoholic beverages to Oklahoma wholesalers to hold a nonresident seller's license rather than a distiller's license. The Oklahoma ABC Act defines distiller as:

> "Distiller" means any person who produces spirits from any source or substance, or any person who brews or makes mash, wort, or wash, fit for distillation or for the production of spirits (except a person making or using such material in the authorized production of wine or beer, or the production of vinegar by fermentation), or any person who by any process seprates alcoholic spirits from any fermented substance, or any person who, making or keeping mash, wort, or wash, has also in his possession or use a still.

37 OKLA. STAT. § 506(10) (1981). "Distiller" pertains to all persons dealing in "spirits," excluding beer and wine. *See* 9 Op. Att'y Gen. 14, 15 (Okla. July 12, 1976). Thus, "Section 536.1 must be read to accomplish the legislative intent to require price affirmation from all alcoholic beverage licensees who sell spirits to Oklahoma wholesalers." *Id.* at 16. *See also* Joseph E. Seagrams & Sons, Inc. v. Oklahoma Alcoholic Beverage Control Bd., 637 P.2d 88, 92 (Okla. 1981) ("distiller" includes all sellers selling alcoholic beverages to Oklahoma wholesalers, both resident and nonresident).

93. ABLE RULES, *supra* note 90, art. 3, § 21(a).

effect.[94] Furthermore, the affirmed price may not be changed except by approval of the ABLE Commission or its director for good cause shown.[95]

New York's affirmation law clearly prohibits "any discount, rebate, free goods, allowance or other inducement of any kind whatsoever" to New York wholesalers.[96] The statute also makes it clear that "appropriate reductions shall be made to reflect all discounts . . . rebates, free goods, allowances and other inducements" in determining the lowest effective price for which any item of liquor is sold anywhere else in the United States.[97] In Oklahoma, it is clear that distillers may not "grant, directly or indirectly, any discount, rebate, free goods, allowance or other inducement" to Oklahoma wholesalers.[98] However, it is not clear what factors are to be considered in determining the affirmed lowest price. There is no provision in the Oklahoma Statutes or the rules and regulations defining the lowest effective price.

In *Joseph E. Seagrams & Sons, Inc. v. Oklahoma Alcoholic Beverage Control Board*,[99] appellees were nonresident distillers who had challenged the ABC Board's rule requiring the affirmed price to include transportation, handling, and liquor stamp affixing costs. The Supreme Court of Oklahoma declared that the affirmed price should be the lowest F.O.B. price at which a distiller sells the same alcoholic beverage in any other state, "plus or minus any difference in transportation and handling costs demonstrated to the Board."[100] However, stamp affixing costs were to be included in the affirmed price.[101] In other words, distillers are allowed to increase the affirmed lowest price only by the amount that transportation and handling charges to

94. Interview with Lynn Barnett, General Counsel, ABLE Comm'n in Oklahoma City (Oct. 17, 1986). The rules and regulations are vague on this point. The price affirmation, similar to the requirement of New York's statute, is filed in conjunction with the monthly price schedule. The schedule must contain a precise description of the brand, price, size, and alcoholic content of each item the seller proposes to offer for sale to Oklahoma wholesalers. Article 3, section 4 of the rules and regulations requires all nonresident sellers to file a price schedule on the fifteenth day of each month. Registered prices are to become effective on the first day of the second month following and are to remain in effect and unchanged for not less than one month. However, the affirmation provision itself, article 3, section 21, does not mention for what period the prices are to be affirmed. By contrast, New York's affirmation provision specifically states that the prices are to be affirmed during the calendar month for which the schedule is in effect. N.Y. ALCO. BEV. CONT. LAW § 101-b(3)(d)(i) (McKinney 1976).

95. ABLE RULES, *supra* note 90, art. 3, § 4(a). Although this provision would allow the ABLE Commission to change a distiller's affirmed price if such price became burdensome on interstate commerce, the *Brown-Forman* Court determined that this alone would not save the constitutionality of the affirmation statute. See *supra* notes 62-63 and accompanying text.

96. N.Y. ALCO. BEV. CONT. LAW § 101-b(2)(b) (McKinney 1976).

97. *Id.* § 101-b(3)(g).

98. 37 OKLA. STAT. § 536(A)(2) (1981 & Supp. 1986). *See also* ABLE RULES, *supra* note 90, art. 3, § 12.

99. 637 P.2d 88 (1981). The Alcoholic Beverage Laws Enforcement Commission was previously known as the Alcoholic Beverage Control Board.

100. 637 P.2d at 90. "F.O.B." is the point of shipment wherein the seller places the goods on board a carrier without charge to the buyer.

101. *Id.*

Oklahoma wholesalers exceed those charges to the wholesaler in the state in which the lowest affirmed price is based.[102]

Although the *Seagrams* court did not specifically rule on any other factors, such as rebates or other inducements, it can be inferred from the decision that such factors are not to be considered when determining the lowest effective price under Oklahoma's affirmation statute. The court stated that "affirmation statutes of other states include express language defining the types of factors to be included in determining the affirmed price. Because our legislature has not specified factors to be included in the posted or affirmed price, we decline to add any terms to the statute."[103]

Furthermore, the Attorney General of Oklahoma has determined that rebates, allowances, or other such factors are not to be considered in determining the affirmed lowest price.[104] The Oklahoma ABC Act prohibits a licensed distiller from offering such inducements to Oklahoma wholesalers.[105] For an interpretation of Oklahoma's affirmation statute to be consistent with that intent, it must also preclude the consideration of such inducements in determining the lowest sales price.[106]

Constitutionality of Oklahoma's Price Affirmation Law

The constitutionality of Oklahoma's liquor price affirmation statute is questionable in light of the *Brown-Forman* decision. The first step of the analysis is to determine under which tier of the two-tiered approach Oklahoma's statute falls.[107] The critical inquiry is the overall effect of the statute on both local and interstate activity.[108] If the effect of the affirmation statute is to directly regulate or discriminate against interstate commerce, it

102. Oklahoma liquor tax is also not to be included in the affirmed price. It is interesting to note that article 3, section 21(b) of the rules and regulations provides: "The affirmed price at which any such item is being offered for sale or sold shall mean the lowest price at which such item is offered for sale by the same *or any other supplier.*" (Emphasis added.) A literal reading would require a distiller to sell its product to Oklahoma wholesalers at the lowest price that the product was offered anywhere, rather than at the lowest price such distiller offers its product in any state. Such a consideration would be contrary to the Oklahoma Supreme Court's holding in *Seagrams.* See *supra* note 100 and accompanying text. Furthermore, it would be contrary to the affirmation statute passed by the Oklahoma legislature. Section 536.1 requires only that a distiller sell its product at "the lowest rate at which *such distiller sells* in any other state." (Emphasis added.) See *supra* note 88 and accompanying text.

The former construction would require of a distiller the onerous tasks of discovering the lowest price at which its product is sold by any other distiller anywhere in the United States and determining the various factors considered in setting the effective price charged by all such distillers. Furthermore, if any single distiller selling anywhere in the United States adjusted its price below the affirmed price, all distillers selling the same product to Oklahoma wholesalers would be forced to follow suit.

103. 637 P.2d at 91.

104. 20 Op. Att'y Gen. 525 (Okla. Mar. 20, 1984).

105. 37 OKLA. STAT. § 536(A)(2) (1981 & Supp. 1986).

106. 20 Op. Att'y Gen. 525 (Okla. Mar. 20, 1984).

107. See *supra* notes 47-50 and accompanying text.

108. *Id.*

falls within the first tier and is per se unconstitutional.[109] However, if its effect is only incidental to interstate commerce and it regulates evenhandedly, it falls within the second tier.[110] In that case, Oklahoma's legitimate interest in regulating liquor traffic must be balanced against any burden placed on interstate commerce by such regulation.[111]

Oklahoma's affirmation statute does regulate evenhandedly by requiring resident as well as nonresident distillers to affirm prices to Oklahoma wholesalers.[112] Furthermore, the statute purports to effectuate a legitimate state interest. The articulated objective of the statute is to foster price competition.[113] However, under the *Brown-Forman* analysis, these factors are irrelevant if the actual effect of the affirmation statute is to directly regulate prices charged by distillers in other states, thus invalidating the statute under the per se invalid tier of the two-tiered analysis.[114]

Applying Justice Marshall's analysis in *Brown-Forman*, Oklahoma's liquor price affirmation statute is per se invalid for two reasons. First, once a nonresident distiller has affirmed its Oklahoma prices, it is not allowed to change those prices without approval.[115] However, if a distiller wishes to reduce its prices in other states, it must also reduce its Oklahoma prices so as not to violate the affirmation law. Thus, a distiller may not lower its liquor prices in other states without first seeking approval from the ABLE Commission. The *Brown-Forman* Court stated that such a situation constitutes a direct regulation of prices charged in other states and is per se invalid under the two-tiered approach.[116]

Second, neither Oklahoma's affirmation statute[117] nor the rules and regulations[118] explicitly state what factors are, or are not, to be accounted for when determining the lowest effective price to be affirmed. However, Oklahoma case law and Attorney General Opinions clearly indicate that inducements to other state wholesalers are not to be considered when determining the affirmed price to Oklahoma wholesalers.[119] Thus, the situation might

109. See *supra* note 48.
110. See *supra* note 49.
111. *Id.*
112. See *supra* note 92.
113. See *supra* note 88. *See also* Joseph E. Seagrams & Sons, Inc. v. Oklahoma Alcoholic Beverage Control Bd., 637 P.2d 88, 92 (Okla. 1981) (purpose of the affirmation is to foster price competition among suppliers to Oklahoma wholesalers and make price discrimination or favoritism against wholesalers unlawful).
114. See *supra* notes 69-70 and accompanying text.
115. ABLE RULES, *supra* note 90, art. 3, § 4(a) provides:

> All Nonresident Sellers' prices shall become effective on the first day of the second month following such registration and shall remain in effect and unchanged for a period of not less than one month. No change in said period shall be permitted except on an application therefor in writing showing good cause and then only with written permission of the commission or Director.

116. See *supra* notes 61-65 and accompanying text.
117. See *supra* note 88 and accompanying text.
118. *See* ABLE RULES, *supra* note 90, art. 3, § 21.
119. See *supra* notes 99-106 and accompanying text.

arise where another state's affirmation statute prohibits rebates or other inducements to its wholesalers, but requires inducements to other state wholesalers to be incorporated into its affirmed lowest price.[120] A distiller offering inducements to wholesalers in many states, including both Oklahoma and the hypothetical state, would be placed in a similar position as the distiller in *Brown-Forman.*

Neither Oklahoma nor the hypothetical state allow inducements to its wholesalers. However, Oklahoma's effective price would be higher than the hypothetical state's effective price since Oklahoma's statute prohibits inclusion of inducements in the affirmed lowest price. The distiller would be in violation of Oklahoma's statute since it offers the same products to wholesalers in the hypothetical state at a lower effective price than its products are offered to Oklahoma wholesalers. In order to maintain sales in Oklahoma, the distiller would be forced to discontinue its inducement programs in all states where those programs are legal in order to equalize the "effective" affirmed prices. As the Court asserted in *Brown-Forman,* such action constitutes a direct interference with interstate commerce in violation of the commerce clause.[121]

Conclusion

The conflict between the federal government's power under the commerce clause and the states' power under the twenty-first amendment is the subject of much litigation. One area that exemplifies this power struggle concerns state liquor price affirmation laws, which require a liquor distiller or manufacturer to affirm that the price of its liquor product in a particular state is no higher than the lowest price charged in any other state. In *Brown-Forman Distillers Corp. v. New York State Liquor Authority,*[122] the Supreme Court reaffirmed the federal role in the regulation of interstate liquor traffic.[123] Applying the stricter two-tiered commerce clause analysis, the Court declared New York's price affirmation statute to be a clear violation of the commerce clause.[124]

The *Brown-Forman* decision presents problems for Oklahoma's liquor price affirmation statute. Because Oklahoma's statute appears to be unconstitutional and is overly vague in its wording, it should be redrafted. Two subsections should be added to the present statute in order to give the ABLE Commission explicit guidelines and to effectuate the legislature's strong intention to comply with the principles of the commerce clause.

First, a subsection should be added that explicitly states that the price to be

120. Indeed, this is exactly what was required by the New York affirmation statute challenged in *Brown-Forman.*

121. *Brown-Forman,* 106 S. Ct. at 2080, 2087 (legislation projected into other states directly regulating commerce therein).

122. *Id.* at 2080.

123. See *supra* note 45 and accompanying text.

124. See *supra* notes 31-71 and accompanying text.

affirmed is the lowest price at which a distiller sells its product in any state before all discounts, rebates, free goods, allowances, or other inducements. This would make it clear that such inducements are not to be included in determining the affirmed price. Furthermore, this subsection should state that distillers do not violate this section by selling the same products in states that account for inducements in their affirmed price while prohibiting such inducements to their own wholesalers. In other words, the effective price to be affirmed is the lowest price before inducements are figured in, whether or not a state receives inducements. This amendment would give the ABLE Commission a clear guideline for computing the effective price to be affirmed and would prevent situations such as those in *Brown-Forman.*

Second, a subsection should be added that provides that a distiller selling to Oklahoma wholesalers may at any time change its prices in other states without violating the Oklahoma price affirmation law, provided that (1) the resulting price is not lower than the price affirmed to Oklahoma wholesalers, or (2) if the resulting price is lower than the price affirmed to Oklahoma wholesalers, the distiller must subsequently make prompt application to the ABLE Commission for approval to reduce its prices to Oklahoma wholesalers accordingly. This amendment will allow distillers to reduce liquor prices in other states without first having to seek approval from the ABLE Commission. Furthermore, it will effectuate the intention of the legislature to facilitate the interests of interstate commerce.

The future of state liquor price affirmation statutes is uncertain. As the *Brown-Forman* dissenters stated, the proliferation of state affirmation statutes may well have "created so grave an interference with interstate commerce as to exceed the wide latitude for state regulation under the twenty-first amendment," thus making such statutes invalid under the commerce clause.[125] Although the future of Oklahoma's affirmation law is uncertain, the changes proposed in this note should pass constitutional muster in light of the present state of the law.[126]

C. Brad Henry

Oil and Gas: H.B. 1221: Protection of Correlative Rights in the Absence of Waste

In May 1983, enrolled House Bill 1221[1] was signed into law providing generally for ratable sharing of gas revenues between all interest owners of

125. 106 S. Ct. at 2091 (Stevens, J., dissenting).

126. For a general discussion of the conflict between the commerce clause and the twenty-first amendment, see sources cited *supra* note 10.

1. 52 OKLA. STAT. §§ 541-547 (Supp. 1986).

producing gas wells.[2] The Act is expressly intended to protect the "rights and correlative rights of all interest owners"[3] by ensuring that all such owners have an equal opportunity to extract and sell their fair share of gas and "to protect such owners against discrimination in purchases in favor of one owner as against another."[4] The Act is significant because it introduces fundamental changes in the rights and duties of mineral owners, operators, and producers of natural gas.

Almost since its inception the constitutionality of the Act has been questioned by both litigants[5] and commentators.[6] Among the Act's alleged infirmities are:

1. that the state's authority to regulate the purchase of natural gas in interstate commerce has been preempted by the Natural Gas Act of 1938[7] and the Natural Gas Policy Act of 1978,[8] which grant exclusive jurisdiction to the Federal Energy Regulatory Commission, successor to the Federal Power Commission;

2. that H.B. 1221 infringes upon the exclusive power to regulate interstate commerce granted to Congress by the commerce clause of the United States Constitution;[9]

3. that H.B. 1221 impairs the obligation of contracts in violation of the contract clause of the United States Constitution;[10] and

2. Before enactment of H.B. 1221, conservation of oil and gas and protection of the correlative rights of oil and gas interest owners had historically been accomplished in Oklahoma through ratable taking. See *infra* notes 31, 32 and accompanying text. Ratable taking refers to the process whereby each producer is assured of the opportunity to produce the gas underlying his reserves. It is achieved in a variety of ways, the most common being the control of production through ratable take statutes and proration of allowables and control of purchases through common purchaser statutes, which require pipeline companies to purchase ratably and without discrimination against any producer. For a good general discussion of the concept, see Dickensen, *Ratable Taking of Natural Gas*, 11 Sw. L.J. 358 (1957).

H.B. 1221 represents a novel approach to natural gas regulation. The Act does not directly control purchasing or production. Instead, the Act provides that all interest owners in a well are entitled to share ratably in the proceeds received from sales of production to the extent of their net revenue interests. As stated by the Oklahoma Supreme Court in Seal v. Corporation Comm'n, 725 P.2d 278, 285 (Okla. 1986), *app. dismissed sub nom.* Amerada Hess Corp. v. Corporation Comm'n, 55 U.S.L.W. 3567 (U.S. Feb. 23, 1987) (No. 86-943), "The Act differs with all previous legislation in that it is directed towards producers rather than purchasers and towards co-owners within a single well as opposed to owners of interests between wells in a common source of supply." Specific provisions of the Act are discussed *infra* at note 43.

3. The concept of correlative rights is discussed *infra* at notes 28-33 and accompanying text.

4. 52 OKLA. STAT. § 541 (Supp. 1986).

5. *See, e.g.*, Seal v. Corporation Comm'n, 725 P.2d 278 (Okla. 1986), *app. dismissed sub nom.* Amerada Hess Corp. v. Corporation Comm'n, 55 U.S.L.W. 3567 (U.S. Feb. 23, 1987) (No. 86-943).

6. *See, e.g.*, Chamberlain, *A New Dimension in the Ratable Taking of Natural Gas in Oklahoma: Enrolled House Bill 1221*, 20 TULSA L.J. 77 (1984).

7. 15 U.S.C. §§ 717-717W (1976).

8. 15 U.S.C. §§ 3301-3432 (Supp. IV 1980).

9. U.S. CONST. art. I, § 8, cls. 1 & 2.

10. *Id.* § 10, cl. 1.

4. that H.B. 1221 constitutes the taking of private property without due process of law in violation of the fourteenth amendment.[11]

The constitutionality of H.B. 1221 was recently before the Oklahoma Supreme Court in *Seal v. Corporation Commission*.[12] The court held constitutional both H.B. 1221 and substantially all of the rules promulgated thereunder by the Oklahoma Corporation Commission.[13] *Seal* is significant because it apparently represents the first time that any court has held that the doctrine of correlative rights extends to the mutual obligations of owners of a single well.[14] Moreover, *Seal* represents the first time that the Oklahoma Supreme Court has upheld the exercise of the state's police power for the protection of correlative rights in the absence of waste.[15] This note analyzes *Seal*'s seemingly expansive definition of correlative rights and discusses whether the state may validly exercise its police power to protect correlative rights when waste is not involved. Additionally, this note considers whether H.B. 1221 is preempted by federal legislation that grants exclusive jurisdiction to the Federal Energy Regulatory Commission to regulate purchases of natural gas by interstate pipeline companies.

The Need for Regulation of Oil and Gas Production

Because of the liquid and migratory nature of oil and gas, one landowner cannot produce oil and gas from a common source of supply without displacing or draining some of the oil and gas underlying his neighbor's land.[16] Moreover, because it is not possible to identify any particular molecule of oil and gas and trace it through its migrations, the common law maxim *cujus est solum, ejus est usque ad coelum et ad inferos*,[17] which vested the landowner with title to both the surface of his land and everything above and below it,[18] was inadequate for dealing with the ownership of oil and gas contained within a common source of supply.[19] As one court aptly noted, "Petroleum gas and oil are substances of a peculiar character, and decisions in ordinary cases of mining, for coal and other minerals which have a fixed

11. *Id.* amend. XIV.

12. 725 P.2d 278 (Okla. 1986), *app. dismissed sub nom.* Amerada Hess Corp. v. Corporation Comm'n, 55 U.S.L.W. 3567 (U.S. Feb. 23, 1987) (No. 86-943).

13. The Act expressly empowers the Corporation Commission to "promulgate rules and regulations by which the purpose of this act shall be administered, including the power to establish and enforce penalties for violation thereof." 52 OKLA. STAT. § 547 (Supp. 1986).

14. See *infra* note 58 and accompanying text.

15. See note 75 *infra*.

16. Ohio Oil Co. v. Indiana, 177 U.S. 190, 201 (1900). *See also* 1 E. KUNTZ, OIL AND GAS §§ 2.2, 2.3 (1962) (general discussion of the physical characteristics of oil and gas).

17. "To whomsoever the soil belongs, he owns also to the sky and to the depths. The owner of a piece of land owns everything above and below it to an indefinite extent." BLACK'S LAW DICTIONARY 341 (5th ed. 1979).

18. *See, e.g.*, Toth v. Bigelow, 1 N.J. 399, 64 A.2d 62, 64 (1949); Amphitheatres, Inc. v. Portland Meadows, 184 Or. 336, 198 P.2d 847, 850 (1948).

19. *See generally* 1 W. SUMMERS, OIL AND GAS § 62 (1954); 1 E. KUNTZ, *supra* note 16, at § 4.1.

situs, cannot be applied to contracts concerning them without some qualifications."[20]

Consequently, the early court adopted the law of capture to govern oil and gas property rights.[21] Under the law of capture, a landowner has the right to use reasonable means to extract oil or gas from under his land.[22] He does not violate the rights of adjacent or nearby landowners who own land overlying the common source of supply even though the oil and gas he produces may actually be drained from beneath the land of his neighbors.[23] In fact, such a landowner may reduce to his possession all of the reserves contained within the common source of supply so long as he does not injure the common reservoir.[24]

However, as each barrel of oil and gas is produced, the volume of oil and gas remaining in the common reservoir is proportionately reduced. Therefore, as a result of the migratory nature of oil and gas reserves, every extractive operation necessarily affects the economic welfare of adjacent or nearby owners of land overlying the common source of supply.[25] Since the law of capture grants each owner the right to capture oil and gas from the common source of supply, each must exercise his right with due regard for the rights of the

20. Brown v. Spilman, 155 U.S. 665, 669-70 (1895).

21. *See, e.g.*, Westmoreland & Cambria Nat. Gas Co. v. DeWitt, 130 Pa. 235, 18 A. 724 (1889); Brown v. Humble Oil & Ref. Co., 126 Tex. 296, 83 S.W.2d 935 (1935).

22. *See generally* 1 E. KUNTZ, *supra* note 16, at §§ 4.1, 4.2.

23. *See, e.g.*, Rich v. Doneghey, 71 Okla. 204, 177 P. 86 (1918). In *Rich* the court stated that oil and gas constitutes "a sort of subterranean ferrae naturae," meaning that the owner of the land overlying the oil and gas reserves does not have an absolute right or title to the oil and gas lying below. *Id.* at 206, 177 P. at 89. However, he does have the exclusive right to explore for oil and gas by drilling wells and reducing to possession that which he finds. *Id.* at 206, 177 P. at 89. Once he reduces such oil and gas to possession, he acquires absolute title. *Id.* at 207, 177 P. at 89-90.

24. *See, e.g.*, Ohio Oil Co. v. Indiana, 177 U.S. 190, 208 (1900); Alphonzo E. Bell Corp. v. Bell View Oil Syndicate, 24 Cal. App. 2d 587, 76 P.2d 167, 175 (Cal. Ct. App. 1938).

25. One commentator summarized some of the adverse effects of the law of capture as follows:

> Since one overlying landowner could legally reduce an entire reservoir to his possession, the only viable remedy to adjacent landowners was to drill wells of their own and attempt to "capture" as much oil and gas as possible. As a result, many more wells were drilled than necessary to efficiently develop producing formations. The cost of these unnecessary wells resulted in higher production costs which were ultimately passed on to consumers in the form of higher prices. In addition to excessive drilling costs, the rush to produce often resulted in supplies of oil and gas far in excess of market demand. This surplus caused prices to fall so that those who invested in the oil and gas fields, as well as royalty owners, actually got fewer dollars and less oil and gas than if the fields had been scientifically developed. Since excess natural gas could not be stored it was often simply vented into the atmosphere, rapidly exhausting underground reservoir energy. . . .Producers with no market or storage facilities were forced to store their production in gullies, creeks, and earthen reservoirs until demand increased or until storage tanks could be built. Evaporation, seepage and run-off took a heavy toll.

Chamberlain, *supra* note 6, at 79-80.

others.[26] The reciprocal rights and duties that exist between such owners are commonly referred to as "correlative rights." Professor Kuntz has summarized the correlative rights of owners in a common source of supply as:

1. "the right against waste of extracted substances,"
2. the right "against spoilage of the common source of supply,"
3. the right "against malicious depletion of the common source of supply," and
4. "the right to a fair opportunity to extract oil or gas."[27]

The doctrine of correlative rights had its genesis in the law of capture and is a direct result of the peculiar physical characteristics of oil and gas.[28] It was adopted to regulate the rights of surface owners of land overlying a common source of supply and to ensure that unbridled application of the law of capture would not result in waste and injury to the common source, thereby impairing the rights of other owners.[29] The doctrine was succinctly summarized by one court as follows:

> "Correlative rights" [is] a convenient term for indicating that each owner of land in a common source of supply of oil and gas has legal privileges as against other owners of land therein to take oil and gas therefrom by lawful operations conducted on his own land, limited, however, by duties to other owners not to injure the source of supply and by duties not to take an undue proportion of the oil and gas.[30]

Oklahoma's policy with regard to the production of oil and gas has long been to protect the public interest through conservation and to protect the correlative rights of all oil and gas interest owners.[31] Historically, these policies have been effected in Oklahoma by mandating ratable taking through a myriad of ratable take statutes.[32] Despite such attempts, the gas industry was plagued

26. Ohio Oil Co. v. Indiana, 177 U.S. 190, 209-10 (1900). *See also* 1 E. Kuntz, *supra* note 16, at § 4.3.

27. 1 E. Kuntz, *supra* note 16, at § 4.3.

28. 1 W. Summers, *supra* note 17, at § 63. Professor Summers provides an illuminating look at the genesis of the law of capture. He recognizes that the doctrine of correlative rights was a necessary result of the law of capture in order to prevent injury to the common source of supply and to ensure that no owner took an undue proportion. However, Professor Summers argues that the doctrine's true genesis lies with the peculiar physical characteristics of oil and gas as recognized by the early courts.

29. Professor Kuntz notes that the doctrine of correlative rights is merely complementary to the law of capture and serves only to provide the refinements necessary to ensure fair play. *See* 1 E. Kuntz, *supra* note 16, at § 4.4.

30. Kingwood Oil Co. v. Corporation Comm'n, 396 P.2d 1008, 1010 (Okla. 1964).

31. Cities Serv. Gas Co. v. Peerless Oil & Gas Co., 203 Okla. 35, 220 P.2d 279, 284 (1950), *aff'd*, 340 U.S. 179 (1950).

32. Beginning in 1913, various statutes have been enacted in Oklahoma to protect the public interest and to preserve correlative rights. *See, e.g.*, 52 Okla. Stat. §§ 23-25 (1981) (enacted in 1913) (creates status of common purchaser and common carrier and requires ratable taking

in the early 1980s with discriminatory practices resulting from excess deliverability of natural gas.[33] The pipeline companies found themselves burdened with contractual obligations to take gas far in excess of market demands.[34] Consequently, when acquiring new gas reserves, the pipeline companies would contract with only some of the producers, thereby leaving other working interest owners in the same well without markets for their share of the well's production.[35] This enabled the pipeline companies to take as much gas as they needed from a well while being contractually obligated only to favored producers.[36]

Due to the surplus gas supply, many owners were unable to obtain gas purchasing contracts.[37] Gas balancing agreements then came into vogue in an attempt to protect the rights of the noncontracted owners. Generally, the gas balancing agreements provided that the noncontracted owners would be compensated for their pro rata share of gas upon depletion of the reservoir.[38] However, as a practical matter, the agreements left much to be desired. Until the well was depleted the noncontracted owners were denied use of the proceeds from the sale of their gas.[39] Moreover, there was no guarantee that the contracted owners would be financially capable of reimbursing the noncontracted owners upon depletion of the reservoir.[40]

Thus was the state of the natural gas industry prior to enactment of H.B. 1221. House Bill 1221 was an effort to eliminate these widespread discriminatory practices. Specifically, the Act is intended "to protect the rights and correlative rights of all interest owners of natural gas wells producing casinghead gas and to afford all such owners an equal opportunity to extract their fair share of gas and to sell and be paid in proportion to their interest therein."[41] Additionally, the Act is expressly intended "to protect such owners against discrimination in purchases in favor of one owner against another."[42] The Act seeks to accomplish these objectives by providing for immediate cash

---

without discrimination in favor of one producer as against another); 52 OKLA. STAT. §§ 232-235 (1981) (enacted in 1913) (requires any person taking gas from a gas field to take ratably from each owner of the gas in proportion to his interest in said gas); 52 OKLA. STAT. §§ 236-247 (1981) (enacted in 1915) (grants the Oklahoma Corporation Commission authority to promulgate rules and regulations to regulate the taking of natural gas so as to prevent waste, protect the public interest, and to prevent unreasonable discrimination in favor of any one common source of supply as against another).

33. Seal v. Corporation Comm'n, 725 P.2d 278, 285 (Okla. 1986), *app. dismissed sub nom.* Amerada Hess Corp. v. Corporation Comm'n, 55 U.S.L.W. 3567 (U.S. Feb. 23, 1987) (No. 86-943).

34. *Id.*

35. *Id.*

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.*

41. 52 OKLA. STAT. § 541 (Supp. 1986).

42. *Id.*

balancing of all proceeds received from the sale of production from a single well.[43]

Seal v. Corporation Commission

In *Seal v. Corporation Commission*,[44] Amerada Hess Corporation challenged the constitutionality of both the Act and the rules promulgated thereunder by the Oklahoma Corporation Commission.[45] Amerada grounded its case on two arguments:

1. that the Act is not a valid exercise of the state's police power and, therefore, constitutes the taking of private property without due process of law; and

43. Section 542 of the Act provides that whenever a well is placed into production, all interest owners shall be entitled to share ratably in the revenues from the sale of production. *Id.* § 542(A). Prior to the date of first production, the operator must offer each owner of the well an election whereby the operator shall seek to market that owner's ratable share of gas production, or a portion thereof. *Id.* § 542(B). If the owner so elects, the operator must seek to market that owner's share of production at the best price and terms available in the area, but not at a price or terms less favorable than that received by the operator. *Id.* Each electing owner has thirty days to reject any resulting offer. Failure of an owner to reject an offer constitutes acceptance thereof. *Id.* If an owner does not exercise the election, he is not obligated to deliver his ratable share for sale nor is the operator obligated to market such share. *Id.* § 542(C). The Act expressly provides the "[n]othing in this act shall be construed to prevent any owner or owners from taking their share of production in kind or separately disposing of their share." *Id.* § 542(D).

Section 543 provides that any owner who receives a contract for sale of only his portion of the gas production from the well must share the revenue from such contract ratably with the other owners to the extent of their net revenue interest. *Id.* § 543(A). Each owner receiving such a contract must send written notice to all other net revenue interest owners not having a contract. *Id.* § 543(B).

Section 544 provides that the amount of gas produced daily from a well, regardless of which owner produces the gas, is owned by each owner in proportion to each owner's interest in the well. *Id.* § 544. Each owner who produces and separately sells or disposes of gas must account to the other owners not selling or disposing of gas and compensate them for their proportionate part of the gas disposed of or sold. *Id.*

Section 545 provides that distribution of revenues shall be made pursuant to 52 OKLA. STAT. § 540 (1981). *Id.* § 545. Additionally, any owner receiving revenues directly from the purchaser must forward such revenues directly to the party responsible for distribution. *Id.*

Section 546 provides that the Act shall not be construed as setting or restricting the price or conditions under which a purchaser takes production from a well, that the Act shall not be construed as requiring any purchaser to connect any well that such purchaser is not already obligated to connect, and that the Act shall not be construed as altering or changing the legal definitions of common purchaser or common carrier. *Id.* § 546.

Section 547 empowers the Corporation Commission to promulgate rules and regulations for implementing the Act, including the right to establish and enforce penalties for violations thereof. *Id.* § 547. Additionally, section 547 provides that any owner who is injured by a violation of the act has the right to recover treble damages, costs, and attorneys fees. *Id.*

44. 725 P.2d 278 (Okla. 1986), *app. dismissed sub nom.* Amerada Hess Corp. v. Corporation Comm'n, 55 U.S.L.W. 3567 (U.S. Feb. 23, 1987) (No. 86-943).

45. Okla. Corp. Comm'n Order No. 250466, Rules 6-100 through 6-113.

2. that the Act violates the contract clauses of the United States[46] and Oklahoma[47] constitutions by interfering with the obligation of contracts.[48]

Although it is well settled that the state may exercise its police power to adopt reasonable regulations aimed at preventing waste and protecting the correlative rights of owners in a common source of supply,[49] Amerada argued that H.B. 1221 does not protect correlative rights and that, therefore, H.B. 1221 is not a valid exercise of the state's police power.[50] Amerada grounded this argument on a definition of correlative rights first propounded by the United States District Court for the Western District of Oklahoma in *United Petroleum Exploration, Inc. v. Premier Resources, Ltd.*[51] and subsequently adopted by the Oklahoma Supreme Court in *Tenneco Oil Co. v. El Paso Natural Gas Co.*[52] *Premier* defined correlative rights as

> those rights which one owner possesses in a common source of supply in relation to those rights possessed by other owners in the same common source of supply. At this point, it must be emphasized that *a common source of supply in which the owners of mineral interests possess correlative rights is the underlying geological strata from which the oil and gas is produced, rather than the well through which the oil and gas is reduced to possession.*[53]

Amerada interpreted the emphasized language as excluding the rights of owners within a single well from the scope of correlative rights and concluded, based on *Premier*, that correlative rights could never exist between such owners.[54]

The *Seal* court rejected Amerada's interpretation, opted instead for a broader definition of correlative rights, and held that H.B. 1221 was a lawful exercise of the state's police power because it protected each working interest owner's correlative right to a fair opportunity to produce gas from the com-

46. U.S. CONST. art. I, § 10, cl. 1 ("No State shall. . .pass any. . .Law imparing the Obligation of Contracts.").

47. OKLA. CONST. art. 2, § 15 ("nor any law impairing the obligation of contracts, shall ever be passed").

48. Seal v. Corporation Comm'n, 725 P.2d 278, 283 (Okla. 1986), *app. dismissed sub nom.* Amerada Hess Corp. v. Corporation Comm'n, 55 U.S.L.W. 3567 (U.S. Feb. 23, 1987) (No. 86-943).

49. *Id.* at 286. *See also* Cities Serv. Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179, 185 (1950).

50. Seal v. Corporation Comm'n, 725 P.2d 278, 286 (Okla. 1986), *app. dismissed sub nom.* Amerada Hess Corp. v. Corporation Comm'n, 55 U.S.L.W. 3567 (U.S. Feb. 23, 1987) (No. 86-943).

51. 511 F. Supp. 127 (W.D. Okla. 1980).

52. 687 P.2d 1049, 1053 n.11 (Okla. 1984).

53. United Pet. Explor., Inc. v. Premier Resources, Ltd., 511 F. Supp. 127, 129 (W.D. Okla. 1980) (emphasis added).

54. Seal v. Corporation Comm'n, 725 P.2d 278, 286 (Okla. 1986), *app. dismissed sub nom.* Amerada Hess Corp. v. Corporation Comm'n, 55 U.S.L.W. 3567 (U.S. Feb. 23, 1987) (No. 86-943).

mon source of supply.[55] Simply stated, the court reasoned that "unless all owners in a well have equal opportunity to sell gas from the well, they are not afforded the opportunity to produce their just and equitable share of the gas."[56] In so holding, the court expressly stated that protecting correlative rights was a legitimate end for justifying the exercise of the state's police power.[57]

Seal is significant because the court's seemingly expansive definition of correlative rights apparently represents the first time any court has recognized the existence of such rights between owners of a single well. Indeed, *Seal* may represent the first time the question has ever been adjudicated.[58] Moreover, *Seal* represents the first time that the Oklahoma Supreme Court has upheld the exercise of the state's police power for the protection of correlative rights in a common source of supply where no waste is involved.[59] The balance of this note discusses the propriety of the court's holding regarding the scope of correlative rights and the state's exercise of the police power to protect such rights. Additionally, consideration is given to whether the Act is preempted by the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978, which grant the Federal Energy Regulatory Commission exclusive jurisdiction to regulate purchases of natural gas in interstate commerce.

Correlative Rights

In *Seal*, Amerada argued that H.B. 1221 was an invalid exercise of the police power because it did not in fact concern correlative rights. Relying on the definition of correlative rights first espoused in *United Petroleum Exploration, Inc. v. Premier Resources, Ltd.*,[60] Amerada contended that correlative rights exist only between owners of interests in a common source of supply and specifically exclude the rights of owners in a single well.[61] Amerada's argument is erroneous and stems generally from a misunderstanding of the scope of correlative rights and specifically from a misinterpretation of *Premier*.

Premier involved a dispute between leasehold interest owners in a single natural gas well regarding the proper method of accounting between such owners when one owner produces and sells more than his proportionate share of the well's production. The plaintiff, United, owned a leasehold interest

55. *Id.* at 288.

56. *Id.*

57. *Id.*

58. Perhaps the question has not arisen before because prior to the early 1980s demand for natural gas generally exceeded supply. Accordingly, pipeline companies usually purchased all available natural gas from any given well so the balancing problem between contracted and noncontracted owners never arose.

59. See *infra* note 75.

60. 511 F. Supp. 127 (W.D. Okla. 1980). See *supra* text accompanying notes 51-54.

61. Seal v. Corporation Comm'n, 725 P.2d 278, 286 (Okla. 1986), *app. dismissed sub nom.* Amerada Hess Corp. v. Corporation Comm'n, 55 U.S.L.W. 3567 (U.S. Feb. 23, 1987) (No. 86-943).

in a natural gas well. The defendant, also a leasehold interest owner, was the operator. Each party had entered into separate contracts with different pipeline companies for the sale of his respective share of production. However, United's purchaser failed to make a connection to the well until approximately six months after the owner-operator's purchaser had begun taking production. Consequently, during the intervening six-month period, the owner-operator sold the well's entire production.[62]

The owner-operator offered to account to and compensate United for United's fair share of the gas sold by offering an immediate cash balancing calculated at the price actually received by the owner-operator. United refused the owner-operator's tender and demanded balancing in kind instead.[63] Since the owner-operator had offered to cure the imbalance by offering an immediate cash balancing, which method was the only means available since United's purchaser had failed to make a connection to the well, the court concluded that the alleged imbalance was "in large measure, a fiction."[64] Moreover, the court stated that the owner-operator's actions in reducing a quantity of gas to possession had not infringed upon United's ability to conduct its own operation to produce gas from the common source of supply.[65]

In other words, United's correlative rights were neither impaired nor were correlative rights even remotely at issue. Instead, the dispute centered on whether a part owner of a producing gas well can disclaim title to his proportionate share of production while he is physically unable to take possession because of his failure to make a connection to the well, and assert instead absolute ownership to a mathematically balanced volume of production after possession capability is provided.[66] The court concluded that United could

62. This is the classic scenario causing a well to become out of "balance." Generally, when the lessees fail to market their respective shares of production ratably, they create an "imbalance." At common law three methods are commonly used to bring the well back into balance:

1. "Balancing in kind" entails balancing in volumes by allowing the underproduced party to take a certain proportion of the overproduced party's gas until the imbalance has been eliminated.

2. "Periodic cash balancing" requires the overproduced party to compensate the underproduced party by paying cash for the underproduced party's share of production when the imbalance occurs, thereby immediately bringing the well into balance.

3. "Cash balancing upon reservoir depletion" requires the overproduced party to compensate the underproduced party for the underproduced party's share only after the well is depleted.

At common law, the appropriate method of balancing when the parties have not entered into a balancing agreement depends upon the equities of each case. *See generally* Beren v. Harper Oil Co., 546 P.2d 1356 (Okla. Ct. App. 1975); United Pet. Explor., Inc. v. Premier Resources, Ltd., 511 F. Supp. 127 (W.D. Okla. 1980).

63. Ordinarily, an underproduced party might prefer immediate cash balancing to balancing in kind because of the time value of money, especially when the underproduced party is unable to take his share in kind, which would occur, for example, when the underproduced party does not have a market outlet. Here, however, United preferred balancing in kind rather than cash balancing because United had obtained a contract to sell its share of production at a price in excess of that received by the owner-operator.

64. United Pet. Explor., Inc. v. Premier Resources, Ltd., 511 F. Supp. 127, 132 (W.D. Okla. 1980).

65. *Id.* at 130.

66. *Id.*

not disclaim title to its share of production and held that equitable considerations compelled immediate cash balancing rather than balancing in kind.[67] Therefore, since correlative rights were not at issue, *Premier*'s definition of correlative rights, which purportedly limits application of the doctrine to the rights existing between owners of interests in a common source while excluding the rights existing between owners of a single well, is mere dicta. Accordingly, Justice Hargrave's conclusion in his dissenting opinion in *Seal* that "our definition of [correlative rights] expressly negates the premise that correlative rights refers to the mutual obligations of owners of a single wellhole"[68] is not supported by the case law.

On the contrary, while the Oklahoma Supreme Court's interpretation of correlative rights reveals that such rights do indeed refer to the mutual obligations of the separate owners of a common source of supply, a close reading of *Premier* and its progeny does not support the proposition that the doctrine of correlative rights does not apply to the mutual obligations of owners of a single well.[69] The definition of correlative rights articulated in *Premier* simply recognizes that correlative rights are derived from one's ownership of an interest in a common source of supply rather than from his ownership in a single well hole.[70] The owners of a well that taps a common source of supply each have, by virtue of their interests in the common source of supply, correlative rights with respect to that common source. Thus, each owner of the well has a right to the opportunity to produce his fair share of gas.[71]

Viewed in this light, correlative rights were not at issue in *Premier*. The *Premier* court expressly noted that the owner-operator had done nothing to infringe upon United's right to produce from the common source.[72] More important, United's correlative right to its fair share of production was affirmatively protected by the owner-operator's offer of an immediate cash balancing. Had the owner-operator in *Premier* refused to account to United for United's fair share of production, United's correlative rights would undoubtedly have been impaired and at issue. Specifically, United's right to a fair opportunity to produce from the common source of supply would have been impaired because of United's lack of a market in which to dispose of its share of gas. Indeed, as Professor Summers declares:

> The mere opportunity of a landowner to take his share of the oil and gas in a common source of supply does not provide complete

67. *Id.* at 132.

68. Seal v. Corporation Comm'n, 725 P.2d 278, 299 (Okla. 1986) (Hargrave, J., dissenting), *app. dismissed sub nom.* Amerada Hess Corp. v. Corporation Comm'n, 55 U.S.L.W. 3567 (U.S. Feb. 23, 1987) (No. 86-943).

69. *See, e.g.*, Samson Resources Co. v. Corporation Comm'n, 702 P.2d 19 (Okla. 1984) (adopting *Premier*'s definition of correlative rights); Tenneco Oil Co. v. El Paso Nat. Gas Co., 687 P.2d 1049 (Okla. 1984).

70. See *supra* text accompanying notes 22-30.

71. See *supra* note 28.

72. United Pet. Explor., Inc. v. Premier Resources, Ltd., 511 F. Supp. 127, 130 (W.D. Okla. 1980).

> protection of his property rights in them. If others produce and market, he must also produce and market or lose much of his share through drainage and the exhaustion of reservoir energy. He cannot produce and market unless a market outlet is available.[73]

Thus, owners of a well do have correlative rights as between themselves derived from their interests in the common source of supply. Therefore, the only remaining issue is whether the state can lawfully exercise its police power for the sole purpose of ensuring that all owners in a well have equal opportunity to sell their share of gas.

Police Power

The Oklahoma Supreme Court held in *Seal* that H.B. 1221 was a valid exercise of the state's police power because its purpose was to protect correlative rights.[74] This represents the first time that the court has upheld the exercise of the state's police power for the protection of correlative rights when waste was not involved.[75] In so holding, the court joins at least two other states.[76]

It is well settled that the state may exercise its police power to adopt reasonable regulation aimed at protecting correlative rights and preventing waste in a common source of supply.[77] The language used in such cases tends to be very broad. For example, in *Bandini Petroleum Co. v. Superior Court*,[78] it was said: "If the statute be viewed as one regulating the exercise of the correlative rights of surface owners with respect to a common source of supply of oil and gas, the conclusion that the statute is valid on its face . . . is fully supported by the decisions of this Court."[79] Nevertheless, the validity of state regulation for the purpose of protecting correlative rights when waste is not

73. 1A W. SUMMERS, *supra* note 18, § 103.1, at 132.

74. Seal v. Corporation Comm'n, 725 P.2d 278, 288 (Okla. 1986), *app. dismissed sub nom.* Amerada Hess Corp. v. Corporation Comm'n, 55 U.S.L.W. 3567 (U.S. Feb. 23, 1987) (No. 86-943).

75. The court has upheld exercise of the state's police power for the protection of correlative rights on numerous occasions; however, in each case one of the considerations for the state's action was the prevention of waste. *See, e.g.*, Choctaw Gas Co. v. Corporation Comm'n, 295 P.2d 800 (Okla. 1956); Cities Serv. Gas Co. v. Peerless Oil & Gas Co., 220 Okla. 279, 220 P.2d 279 (1950), *aff'd*, 340 U.S. 179 (1950).

76. *See, e.g.*, Northern Nat. Gas Co. v. State Corp. Comm'n, 188 Kan. 355, 362 P.2d 599 (1961), *rev'd on other grounds*, 372 U.S. 84 (1963); Transcontinental Gas Pipeline Corp. v. State Oil & Gas Bd., 457 So. 2d 1298 (Miss. 1984), *rev'd on other grounds*, 106 S. Ct. 709 (1986).

77. *See, e.g.*, Ohio Oil Co. v. Indiana, 177 U.S. 190 (1900) (upheld state statute prohibiting waste of natural gas); Bandini Pet. Co. v. Superior Court, 284 U.S. 8 (1931) (same); Cities Serv. Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179 (1950) (upheld order of the Oklahoma Corporation Commission setting minimum price for gas taken from a common field and requiring purchasers to take gas ratably from all producers as a proper exercise of the state's police power for preventing waste).

78. 284 U.S. 8 (1931).

79. *Id.* at 22.

involved has never been decided by the United States Supreme Court and is, at least, questionable considering some of that Court's decisions.[80]

One such decision relied upon by Amerada in attacking the validity of H. B. 1221 is *Thompson v. Consolidated Gas Co.*[81] *Thompson* involved a proration order allegedly issued to protect the correlative rights of owners in a common source of supply. The plaintiffs sought to have the order invalidated on the ground that the order constituted the taking of private property without due process of law. The plaintiffs owned wells in a Texas gas field and had constructed a pipeline to transport the gas and market it in another state. There was no other market outlet from the field. Consequently, owners of other wells in the field were unable to produce gas from their wells.

The Texas Railroad Commission issued a proration order pursuant to its statutory authority to prorate gas production from each common reservoir for the protection of public interests and the adjustment of correlative rights.[82] The order limited production from the plaintiff's wells to an amount below their market requirements under existing contracts, below their current production, and below the capacity of their transportation and marketing facilities. Therefore, the effect of the order was to force plaintiffs to purchase gas from other owners in the field in order to meet their market demands.

Before issuance of the order, the plaintiffs had been operating without waste. Moreover, due to an anomaly in the field, there was higher pressure under plaintiff's leases than in other sections of the field causing drainage away from plaintiff's wells. Consequently, the order effectively operated to further accelerate the already existing drainage from plaintiff's land. Therefore, the Court concluded that the sole purpose of the order was to compel those who had markets for their gas to share their markets with those who had none,[83] and held the order void as a deprivation of property without due process of law.[84]

In *Seal*, Justice Hargrave argued in his dissenting opinion that *Thompson* compelled the finding that H.B. 1221 was unconstitutional.[85] He reasoned that, like the proration order in *Thompson*, H.B. 1221 was not a valid exercise of the state's police power because it was designed to regulate private contractual relationships for the benefit of certain parties owning an interest in a single well hole.[86]

Thompson should not be so broadly read. *Thompson* rested on the Court's finding that neither waste nor correlative rights were involved:

80. *See generally* Note, *Oil and Gas: Ratable Taking: Correlative Rights in a Common Field Where No Waste Involved*, 1 OKLA. L. REV. 304 (1948).

81. 300 U.S. 55 (1937).

82. TEX. STAT. ANN. art. 6008, § 10 (Vernon 1962).

83. Thompson v. Consolidated Gas Co., 300 U.S. 55, 77 (1937).

84. *Id.* at 76-79.

85. Seal v. Corporation Comm'n, 725 P.2d 278, 300 (Okla. 1986) (Hargrave, J., dissenting), *app. dismissed sub nom.* Amerada Hess Corp. v. Corporation Comm'n, 55 U.S.L.W. 3567 (U.S. Feb. 23, 1987) (No. 86-943).

86. *Id.* at 299.

> We assume that the prohibition of any wasteful conduct, whether primarily in behalf of other owners of gas in the common reservoir, or because of the public interests involved, is consistent with the Constitution of Texas and that of the United States, and that to prevent waste production may be prorated. *We assume, also, that the State may constitutionally prorate production in order to prevent undue drainage of gas from the reserves of well owners lacking pipe line connections.*[87]

Correlative rights were not involved because the drainage was away from plaintiff's wells. Therefore, the order protected no rights of the other well owners though it did impair the rights of the plaintiff by forcing him to share his market. Since the order did not in fact protect correlative rights or serve to prevent waste, the Court concluded that the order was a "glaring instance of the taking of one man's property and giving it to another."[88] Since correlative rights were not involved, *Thompson* is distinguishable from *Seal* and is not determinative of whether the state may lawfully protect correlative rights in the absence of waste.

Perhaps the best indication of the scope of the state's police power in protecting correlative rights is given by *Cities Service Gas Co. v. Peerless Oil & Gas Co.*[89] Peerless owned gas wells and certain oil and gas leases on lands located in the Guymon-Hugoton Gas Field. Peerless had no pipeline outlet of its own and its wells were not connected to any other pipeline. Cities Service also owned gas wells and certain oil and gas leases in the field in addition to operating a pipeline connected to the field. Cities Service's wells were located in an area in which the gas pressure was considerably lower than that beneath Peerless' wells. Consequently, production from Cities Service's wells caused drainage from the Peerless section of the field.

In order to protect its reserves, Peerless offered to sell the potential output of its wells to Cities Service. However, Peerless and Cities Service were unable to come to terms, prompting Peerless to request the Oklahoma Corporation Commission to (a) order Cities Service to make a connection with Peerless' wells and purchase gas ratably therefrom, and (b) fix the price to be paid by all purchasers of natural gas from the field.

At a hearing on the proposed order, the Commission heard testimony that existing monopolistic conditions in the field had resulted in unfair prices that were low and discriminatory and which, if allowed to persist, would deplete, destroy, and exhaust the field.[90] Based on this and other evidence, the Commission concluded that the taking of gas at the prevailing prices resulted in economic and physical waste, loss to producers and royalty owners, loss to the state in gross production taxes, inequitable taking of gas from the common source of supply, and discrimination against various producers in the

87. Thompson v. Consolidated Gas Co., 300 U.S. 55, 76-77 (1937) (emphasis added).
88. *Id.* at 79.
89. 203 Okla. 35, 220 P.2d 279 (1950), *aff'd*, 340 U.S. 179 (1950).
90. *Id.*, 220 P.2d at 282.

field.[91] Thereupon, the Commission issued two orders under the authority granted to the Commission by statute.[92] The first set a minimum price for gas taken from the field and the second directed Cities Service to make a connection with Peerless' wells and to take ratably therefrom.[93]

Cities Service attacked the validity of the orders on numerous grounds, including allegations that the orders violated due process and contravened the commerce clause.[94] The Oklahoma Supreme Court rejected Cities Service's arguments, stating that:

> [T]he due process and equal protection provisions of the Federal and State Constitutions do not preclude the State, in the exercise of its power to preserve the rights of producers of natural gas from a common pool, for requiring one either to shut down its wells or take ratably from the other producer who has no outlet under such terms as the parties may agree upon.[95]

The court concluded that such regulation is simply "a practical or feasible alternative consistent with production by both to protect the one from drainage by the other."[96]

The United States Supreme Court affirmed the decision in all respects, stating that the "Due Process and Equal Protection" issues raised by Cities Service "are virtually without substance."[97] The Court noted that it is undeniable that a state "may adopt reasonable regulation to prevent economic and physical waste of natural gas" and stated that the appropriate test is whether such regulations are "substantially related to a legitimate end sought to be attained."[98] Once a legitimate purpose is found to exist, the Court stated that the state has broad discretion in determining the type of regulatory device best suited for achieving that end. As stated by the Court, "It is of no concern of ours that other regulatory devices might be more appropriate, or that less extensive measures might suffice."[99]

Thus, under the test espoused in *Peerless*, it seems that H.B. 1221 is a valid exercise of the state's police power. The express purpose of the Act is

91. Cities Serv. Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179, 183 (1950). Evidence indicated that low prices make enforcement of conservation difficult, retard exploration and development, and result in early abandonment of wells. Moreover, there was evidence that low prices contribute to economic waste of gas by promoting inferior uses.

92. 52 OKLA. STAT. §§ 231-233 (Supp. 1983). Section 233 provides in pertinent part that any person taking gas from a gas field "shall take ratably from each owner of the gas in proportion to his interest in said gas, upon such terms as may be agreed upon between said owners and the party taking such, or in case they cannot agree at such price and upon such terms as may be fixed by the Corporation Commission after notice and hearing."

93. Cities Serv. Gas Co. v. Peerless Oil & Gas Co., 203 Okla. 35, 220 P.2d 279, 282 (1950), *aff'd*, 340 U.S. 179 (1950).

94. *Id.*, 220 P.2d at 282-84.

95. *Id.*, 220 P.2d at 285.

96. *Id.*, 220 P.2d at 285-86.

97. 340 U.S. 179, 185 (1950).

98. *Id.* at 185-86.

99. *Id.* at 186.

to protect the correlative rights of the owners of the common source of supply.[100] Although the Court stopped short of holding that protection of correlative rights in the absence of waste is a valid exercise of the police power, clearly such a purpose is a "legitimate end sought to be attained."[101] As stated by one court, "The true and entirely legitimate local interest here implicated is fairness. . . .We regard fairness as among the more noble purposes of the state. It is a fundamental component of the idea of justice."[102]

By allowing noncontracted working interest owners the right to participate in revenues without affecting purchasers, H.B. 1221 provides an ideal solution to the acknowledged unfairness of allowing one or more owners to contract for the sale of all production to the exclusion of the remaining owners. The statutory requirement that contracted owners share the proceeds of any sale with those co-owners who elect to participate is fair and just. Additionally, in cases where noncontracted parties are tenants in common in minerals by virtue of their leases of undivided mineral interests, the sharing provisions are but an extension of the long-established right of tenants in common to share in the net profit from their common venture.[103]

Federal Preemption

In *Seal*, the court did not address the question of whether H.B. 1221 has been preempted by the Natural Gas Act of 1938 (NGA)[104] or the Natural Gas Policy Act of 1948 (NGPA).[105] The federal preemption issue merits consideration because the NGA and the NGPA grant exclusive jurisdiction to the Federal Energy Regulatory Commission (FERC), successor to the Federal Power Commission (FPC), to regulate or affect purchases of natural gas by interstate pipeline companies.

The jurisdiction of the FPC extends to:

> [1.] the transportation of natural gas in interstate commerce, [2.] the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and [3.] natural-gas companies engaged in such transportation or sale, *but shall not apply to . . . the production or gathering of natural gas.*[106]

At first glance, it would appear that H.B. 1221 falls within the emphasized language excepting from the FPC's jurisdiction those matters relating to "the

100. 52 OKLA. STAT. § 541 (Supp. 1986).

101. Cities Serv. Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179, 185-86 (1950).

102. Transcontinental Gas Pipeline Corp. v. State Oil & Gas Bd., 457 So. 2d 1298 (Miss. 1984), *rev'd on other grounds*, 106 S. Ct. 709 (1986).

103. *See* Prairie Oil & Gas Co. v. Allen, 2 F.2d 56 (8th Cir. 1924); Teel v. Public Serv. Co., 57 OKLA. B.J. 30 (Jan. 4, 1986); Earp v. Mid-Continent Pet. Corp. 167 Okla. 86, 27 P.2d 855 (1933).

104. 15 U.S.C. §§ 717-717w (1976).

105. 15 U.S.C. § 3301-3432 (1982).

106. 15 U.S.C. § 717(b) (1976) (emphasis added).

production or gathering of natural gas" and, thus, would not be preempted because H.B. 1221 regulates only operators and producers. However, the United States Supreme Court has consistently held that " 'production' and 'gathering' are terms narrowly confined to the physical acts of drawing the gas from the earth and preparing it for the first stages of distribution."[107] In fact, in *Phillips Petroleum Co. v. Wisconsin*,[108] the Supreme Court extended the FPC's jurisdiction to producers who sell gas to interstate pipeline companies on the ground that Congress intended to regulate wholesales of natural gas for resale in interstate commerce.[109]

Nevertheless, *Phillips* does not compel the conclusion that H.B. 1221 is preempted by the NGA. *Phillips* involved a dispute over whether the FPC could regulate sales in interstate commerce by a natural gas producer. The Court held that the FPC did have such authority because protection of the ultimate consumer against exploitation by the natural gas companies was the primary aim of the NGA, and the rates charged by such producers might directly and substantially affect the price paid by the ultimate consumers.[110] *Phillips* is distinguishable from the situation presented by H.B. 1221 because the Act does not involve direct regulation of wholesales for resale in interstate commerce; instead, it is aimed directly at producers and operators.

Perhaps the best indication of the extent of federal preemption in the natural gas area is given by the Supreme Court's recent decision in *Transcontinental Gas Pipeline Corp. v. State Oil & Gas Board* (Transco).[111] In *Transco*, the Court found that a Mississippi regulation requiring an interstate pipeline company to purchase gas ratably from all owners in a common gas pool was unconstitutional as having been preempted by the NGA and the NGPA. The Court rested its holding on the fact that the Mississippi regulation was aimed at purchasers as opposed to producers. Although section 1(b) of the NGA expressly exempts producers from the provisions of the Act,[112] the Court noted that the Mississippi regulation was "unmistakably and unambiguously directed at *purchasers* who take gas. . .for resale after transportation in interstate commerce."[113] The orders in question shifted to interstate purchasers the burden of performing the complex task of balancing the output of thousands of natural gas wells within the state. Additionally, the Court was concerned that any readjustment of purchasing patterns that such orders might require of purchasers who previously took unratably might seriously impair FERC's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other states.[114]

107. Northern Nat. Gas Co. v. State Corp. Comm'n, 372 U.S. 84, 90 (1963).
108. 347 U.S. 672 (1954).
109. *Id.* at 682.
110. *Id.*
111. 106 S.Ct. 709 (1986).
112. See *supra* text accompanying note 106.
113. Transcontinental Gas Pipeline Corp. v. State Oil & Gas Bd., 106 S.Ct. 709, 715 (1986) (quoting Northern Nat. Gas Co. v. State Corp. Comm'n, 372 U.S. 84, 92 (1963)) (emphasis added).
114. 106 S.Ct. 709 (1986).

Furthermore, *Transco* was expressly grounded on the finding that the Mississippi regulation "directly undermines Congress' determination in enacting the NGPA that the supply, demand, and price of high-cost gas be determined by market forces."[115] The Court noted that the Mississippi regulation would result in higher prices to the consumer, thereby frustrating Congress' goal in enacting the NGA and the NGPA, which was to ensure low prices.[116]

Since none of these factors are involved in enforcement of H.B. 1221, it does not appear that it has been preempted by the NGA or the NGPA.[117] H.B. 1221 affects only the sharing of actual proceeds received by producers and sellers. The Act in no way affects the purchasers or the price they may pay. The purchasers still may contract with any owner of any interest in a well on any terms acceptable to both parties. In fact, as the Oklahoma Supreme Court observed in *Seal*:

> The Act differs with all previous legislation in that it is directed towards producers rather than purchasers and towards co-owners within a single well as opposed to owners of interests between wells in a common source of supply. Moreover, the Act entitles each owner to share ratably in the revenues generated by the sale of production and creates a type of cotenancy property interest in such proceeds.[118]

Conclusion

Correlative rights are derived from one's ownership in a common source of supply rather than from his ownership in a single well. Accordingly, co-owners in a well that taps a common source of supply have, by virtue of their interests in the common source, correlative rights as between themselves. Thus each owner has the right to a fair opportunity to produce his proportionate share of gas.

House Bill 1221 affirmatively protects this right by providing for ratable sharing of gas revenues between all owners of producing gas wells. The Act recognizes that complete protection of a landowner's rights in a common source of supply can be accomplished only by ensuring that each owner has an available market outlet for his share of gas. Prior to enactment of H.B. 1221, Oklahoma's natural gas industry was plagued by widespread discriminatory practices. By allowing noncontracted working interest owners the right to participate in revenues, H.B. 1221 provides an ideal solution to the acknowledged unfairness of allowing gas purchasers to purchase from favored producers to the exclusion of other working interest owners. In

115. *Id.* at 716-17.
116. *Id.* at 715.
117. *But see* Chamberlain, *supra* note 6, at 86-91.
118. Seal v. Corporation Comm'n, 725 P.2d 278, 285 (Okla. 1986), *app. dismissed sub nom.* Amerada Hess Corp. v. Corporation Comm'n, 55 U.S.L.W. 3567 (U.S. Feb. 23, 1987) (No. 86-943).