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FEDERAL REGULATION OF NATURAL GAS — THE INDEPENDENT PRODUCERS' STATUS

by

*Edward L. Atkinson**

THE United States Supreme Court's decision in *Phillips Petroleum Co. v. Wisconsin*¹ and subsequent judicial and administrative decisions have given the Natural Gas Act wide application. The effect of these decisions has been to bring virtually every independent producer and gatherer² of natural gas who engages in an interstate transportation or a jurisdictional sale of natural gas within the act's definition of a natural gas company, thus subjecting these producers and gatherers to federal regulation. This Article will present the statutory provisions, presently effective rules and regulations, and judicial and administrative decisions which have effected the regulatory position of independent producers and gatherers of natural gas.

TABLE OF CONTENTS

- I. Historical Background Of The Natural Gas Act
- II. Jurisdiction Of The Federal Power Commission
 - A. Statutory Provisions
 - B. The Production And Gathering Exemption
 - 1. Prior to June 7, 1954
 - 2. Subsequent to June 7, 1954
 - a. Producer Sales for Resale
 - b. Production and Gathering Facilities
 - c. Processing Plants
 - d. Commingled Gas
 - e. Direct Sales
 - C. Rules And Regulations
 - D. Duration And Abandonment
 - 1. Duration of Certificate Authorization
 - 2. Abandonment

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¹ 347 U.S. 672 (1954).

² The commission's regulations define the term "independent producer" as any person "who is engaged in the production or gathering of natural gas and who transports natural gas in interstate commerce or sells natural gas in interstate commerce for resale, but who is not primarily engaged in the operation of an interstate pipeline." 18 C.F.R. § 154.91(a).

III. Rate Regulation

- A. General Considerations
- B. Statutory Provisions
- C. Changes In Rate
- D. Rules And Regulations
- E. Relationship Between The Act And Contractual Rights
- F. Method Of Rate Regulation
 - 1. The Rate Base Method
 - 2. Transportation Rate Cases
 - 3. Natural Gas Rate Cases—Field Sales
 - a. Pipeline Cases
 - b. Independent Producer Cases

IV. Conditional Certificates Of Public Convenience And Necessity

I. HISTORICAL BACKGROUND OF THE NATURAL GAS ACT

At an early date the states regulated two important segments of the natural gas industry; state regulation of natural gas production was necessary as a conservation measure, and state regulation of local distribution of natural gas was essential because of the monopolistic nature of the business.

Since the states possess the power to regulate the price charged the consuming public for gas, it would appear that the states could effectively protect the ultimate consumer. When determining the lawfulness of rates charged by the distributing companies, however, the distributing companies must be allowed the cost of purchased gas as an operating expense; failure to allow this expense item would constitute an unconstitutional deprivation of property. For effective rate regulation it is therefore necessary to control the wholesale price of natural gas; hindering state control of wholesale prices is the fact that most of the natural gas distributed in the larger consuming states is produced in other states and imported into the consumer states.

Prior to 1935, powerful holding companies developed integrated gas systems which produced or purchased natural gas in the field, transported gas from the field to the consuming areas, and sold gas to the ultimate consumer or distributing companies. Subsidiary companies were established to hinder effective state regulation. In many instances it was impossible for state agencies to ascertain the actual cost of gas incurred by the local distributing companies and other

information needed to regulate effectively the price paid by the ultimate consumer. Consequently, the states attempted to regulate the sales by the interstate transmission companies to the distributing companies, but the states failed before the United States Supreme Court when the validity of state regulation of wholesale rates was tested.³ The Supreme Court held that the interstate transportation of natural gas and the sale of natural gas produced in one state to a distributing company in another state constituted interstate commerce. The interstate commerce clause of the United States Constitution is a limitation upon the authority of the several states, and state action which operates as a direct burden upon, or obstruction to, interstate commerce is unlawful even in the absence of federal regulation over the subject matter.⁴ The decisions do permit, however, state regulation of "burner tip" or direct sales to the consumer even in those instances where the sales are made by an interstate transmission company. The effectiveness of state regulation was therefore limited to those instances where the source and ultimate consumption of natural gas were confined to a single state and where an interstate transmission company sold gas directly to the ultimate consumer.

Due to the inability of state agencies to control prices demanded by interstate transmission companies, there was an appeal for congressional action. A Senate resolution ordered the Federal Trade Commission to initiate an investigation of the natural gas industry.⁵ After finding that the practices of the industry tended to result in excessively high cost to the consumer and that the independent producers and consumers were in a precarious position due to the influence exerted by the transmission companies, the resulting report advocated the extension of federal power to remedy the situation.⁶ During the following session of Congress, the Natural Gas Act⁷ was passed without opposition.

The Natural Gas Act declares that the natural gas industry is

³ *State Corp. Comm'n v. Wichita Gas Co.*, 290 U.S. 561 (1934); *Missouri v. Kansas Natural Gas Co.*, 265 U.S. 298 (1924). See *Public Utilities Comm'n v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927). See also *Pennsylvania v. West Virginia*, 262 U.S. 553 (1923); *Pennsylvania Gas Co. v. Public Service Comm'n*, 252 U.S. 23 (1920); *Public Utilities Comm'n v. Landon*, 249 U.S. 236 (1919); *Oklahoma v. Kansas Natural Gas Co.*, 221 U.S. 229 (1911).

⁴ *Wabash, S.L. & P. Ry. v. Illinois*, 118 U.S. 557 (1886).

⁵ S. Res. No. 83, 70th Cong., 1st Sess., 69 Cong. Rec. 3054 (1928).

⁶ S. Doc. No. 92, 70th Cong., 1st Sess., pt. 84-A (1936).

⁷ Act of June 21, 1938, c. 556, 52 Stat. 821, as amended, 15 U.S.C.A. § 717.-717w. (1938) (hereinafter cited as 15 U.S.C.A. § 717.-717w.).

affected with the public interest and that federal regulation is necessary in the public interest.⁸

The legislative history indicates that Congress intended federal regulation to be confined to the interstate transportation of natural gas and those sales which the Supreme Court declared the states did not have the power to regulate.⁹ Federal regulation was to complement the power of the states and produce a harmonious and comprehensive system of regulation; neither state nor federal regulatory bodies were to encroach upon the jurisdiction of the other, and it was not the intention or purpose of Congress to usurp the authority of the state regulatory commissions.¹⁰ The Federal Power Commission was charged with the administration of the act and was given the necessary administrative power to enforce the act, including the power to prescribe rules and regulations.¹¹

II. JURISDICTION OF THE FEDERAL POWER COMMISSION

A. *Statutory Provisions*

The principal point of controversy arising under the Natural Gas Act concerns the jurisdiction of the Federal Power Commission. Section 1 (b) of the act provides:

The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption, for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.¹²

Section 7 of the act prescribes the method by which the commission is to assert its jurisdiction. Section 7 (c) provides:

No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall

⁸ 15 U.S.C.A. § 717.(a) (1948).

⁹ H.R. Rep. No. 2651, 74th Cong., 2d Sess. (1936); S. Doc. No. 92, 70th Cong., 1st Sess., pt. 84-A (1936); H.R. Rep. No. 709, 75th Cong., 1st Sess. (1937). See H.R. Rep. No. 2192, 72d Cong., 2d Sess. (1933); H.R. Rep. No. 827, 73d Cong., 2d Sess. (1935); Comment, Legislative History of the Natural Gas Act, 44 Geo. L.J. 695 (1956).

¹⁰ FPC v. East Ohio Gas Co., 338 U.S. 464 (1950); FPC v. Panhandle Eastern Pipe Line Co., 337 U.S. 498 (1949); Interstate Natural Gas Co. v. FPC, 331 U.S. 682 (1947); Panhandle Eastern Pipe Line Co. v. Public Service Comm'n 332 U.S. 507 (1947); FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944); Public Utilities Comm'n v. United Fuel Gas Co., 317 U.S. 456 (1943); Lightfoot v. City of Springfield, 361 Mo. 659, 236 S.W.2d 348 (1951).

¹¹ 15 U.S.C.A. § 717o. (1948).

¹² 15 U.S.C.A. § 717.(b) (1948).

engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations¹³

Applications for certificates of public convenience and necessity must be in writing and verified under oath, and the commission must set the matter for hearing and give notice to interested parties.¹⁴ In a certificate proceeding the burden of proof is on the applicant, and section 7(e) of the act provides that a certificate shall be issued to any qualified applicant, authorizing the whole or any part of the sale or service “. . . if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity. . . .”¹⁵ In the absence of the statutory showing, the application must be denied.

When the commission has granted a certificate of public convenience and necessity and the applicant accepts the certificate or commences deliveries thereunder, the natural gas company may not terminate or abandon the sale or service involved merely because it has the contractual right to take such action. Section 7(b) of the act prohibits the abandonment of jurisdictional facilities or any service rendered by means of these facilities without the permission of the commission granted at the conclusion of an appropriate hearing.¹⁶

A literal interpretation of section 1(b) would indicate that the Federal Power Commission was granted jurisdiction over: (1) the transportation of natural gas in interstate commerce; (2) the sale of natural gas in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or sale. The commission was expressly denied the authority to regulate: (1) any other transportation or sale of natural gas; (2) the local distribution of natural gas; (3) the facilities used for local distribution; and (4) the production and gathering of natural gas. The decisions have held

¹³ 15 U.S.C.A. § 717f.(c) (1948).

¹⁴ See *Northeastern Gas Transp. Co. v. FPC*, 195 F.2d 872 (3rd Cir. 1952).

¹⁵ 15 U.S.C.A. § 717f.(e) (1948).

¹⁶ 15 U.S.C.A. § 717f.(b) (1948).

that these exemptions should be strictly construed as a restriction upon the primary grant of authority.¹⁷

It should be noted that the act does not define "production or gathering" or "local distribution," but that interstate commerce is defined as "commerce between any point in a State and any point outside thereof, or between points within the same State but through any place outside thereof, but only insofar as such commerce takes place within the United States."¹⁸ Judicial interpretation of the act indicates that this definition of "interstate commerce" is coextensive with the Supreme Court's definition of the term.¹⁹

Soon after the statute was enacted, various tests, based upon such factors as the point of sale and the gas pressures maintained at a particular point, were developed to determine when the product went from intrastate commerce into interstate commerce and back again to intrastate commerce.²⁰ These mechanical considerations, however, are no longer controlling to determine for regulatory purposes the interstate or intrastate character of the sale or service.²¹ The "continuous flow" doctrine is now the test; thus natural gas is in interstate commerce when it is produced in a continuous flow and destined for, and committed to, interstate transportation or sale from the moment of its production.²² Therefore, purely mechanical conditions, as variations in pipeline pressure, are not the criteria of federal and state regulatory powers.

As previously stated, Congress intended to exercise federal regulation only in those areas which the states were denied the power to regulate. Only the interstate transportation of natural gas, the interstate sale of natural gas for resale, and "natural-gas companies" were to be subject to the jurisdiction of the commission; federal control was not to be exclusive but concurrent with state regulation. Thus, state control of natural gas companies engaged in interstate operations was not precluded by the act where the company's opera-

¹⁷ *Interstate Natural Gas Co. v. FPC*, supra note 10; *Panhandle Eastern Pipe Line Co. v. Public Service Comm'n*, supra note 10; *Panhandle Eastern Pipe Line Co. v. FPC*, 324 U.S. 635 (1945); *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581 (1945); *FPC v. Hope Natural Gas Co.*, supra note 10; *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942); *J. M. Huber Corp. v. FPC*, 236 F.2d 550 (3rd Cir. 1956).

¹⁸ 15 U.S.C.A. § 717a.(7) (1948).

¹⁹ *Interstate Natural Gas Co. v. FPC*, supra note 10.

²⁰ See the discussion and cases cited in *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*, 314 U.S. 498 at 504-05 (1942).

²¹ *Interstate Natural Gas Co. v. FPC*, supra note 10; *Panhandle Eastern Pipe Line Co. v. Public Service Comm'n*, supra note 10; *Colorado-Wyoming Gas Co. v. FPC*, 324 U.S. 626 (1945); *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*, supra note 20.

²² See the discussion of the *Deep South* case at pp. 438-39 *infra*.

tions were not exclusively interstate.²³ Regulation of production, gathering, and local distribution was to be exclusively a state function, but this was soon changed by the decisions without regard to the express provisions of section 1(b) of the act.²⁴

B. *The Production And Gathering Exemption*

1. *Prior to June 7, 1954*

Section 1(b) of the act expressly provides that the provisions of the act shall not apply to the production or gathering of natural gas.²⁵ To understand more fully the *Phillips* case and the extension of federal regulation to independent producers and gatherers of natural gas despite this statutory provision, a review of several cases involving the production and producing properties of interstate transmission companies is appropriate.

In *FPC v. Hope Natural Gas Co.*,²⁶ the Supreme Court upheld a decision of the commission which extended the scope of its regulation to include the production and producing properties of an interstate transmission company. The company was not allowed, as an expense, the fair field value of gas which it produced and delivered into its system, but the company's investment in producing properties was included in its overall investment or rate base for a return which was determined by the traditional method employed to regulate the transportation business. Hope did not object to the use of the rate base method or the inclusion of producing properties in the rate lease but as its principal argument protested the method of ascertaining the rate base. The validity of the commission's policy

²³ See *Central States Elec. Co. v. City of Muscatine*, 324 U.S. 138 (1945); *Memphis Natural Gas Co. v. McCanless*, 183 Tenn. 635, 194 S.W.2d 476 (1946).

²⁴ For example, in *FPC v. East Ohio Gas Co.*, 338 U.S. 464 (1950), federal regulation was extended to a wholly intrastate natural gas company. The company received natural gas in the state of Ohio from interstate transmission companies and transported the gas through high pressure pipelines for delivery to local distributing companies. The Court had previously held that interstate transmission ends when the gas enters the distribution system of the local utilities; the Court employed this principle to conclude that the wholly intrastate movement in the high pressure pipelines constituted both interstate transportation and commerce, and the intrastate company was a "natural gas company" within the purview of the act. Wholly intrastate companies, however, were freed from federal control by further congressional action. Act of March 27, 1954 (Hinshaw Amendment), c. 115, 68 Stat. 36, 15 U.S.C.A. 717.(c). The amendment removes from the application of the act a company that receives natural gas produced out of state, at the state line, or within the consumer state and confines its operations to sales or services within the consumer state. The *East Ohio Gas Co.* case brought about needless duplication of federal and state regulation and increased the regulatory expenses of companies which were required to comply with the orders of state and federal agencies. The commission favored the amendment, pointing to the fact there is no need for federal regulation in addition to that provided by state law where only one state is affected. 1954 U.S. Code Cong. & Adm. News, pp. 2101-05.

²⁵ 15 U.S.C.A. § 717b. (1948).

²⁶ 320 U.S. 591 (1944).

was questioned in *Colorado Interstate Gas Co. v. FPC*,²⁷ and the essence of the Supreme Court's majority opinion upholding the commission's decision is as follows:

No exclusion of property used or useful in production of natural gas was made by the Act. That type of property was not singled out for special treatment; it was treated the same as all other property. We must read § 1 (b) in the context of the whole Act. It must be reconciled with the explicit provisions which describe the normal conventions of rate-making. . . . Since there is no provision in the Act which would require the Commission to value the gas at the price urged by Canadian, the problem on review would be whether the end result was unjust and unreasonable. . . . These considerations lead us to conclude that § 1 (b) does not prevent the Commission from taking into account the production properties and gathering facilities of natural gas companies when it fixes their rates.²⁸

The Court was not unanimous in this decision. Chief Justice Stone and Justices Roberts, Reed, and Frankfurter dissented, stating that the commission exceeded its authority under the statute. The dissent emphasized the clarity of section 1(b) in including transportation and sale for resale and exempting production and gathering.²⁹ The dissenters denied the commission the power to integrate the producing properties in the rate base or apply the standards of valuation and rate of return which are applicable to the regulated business; the legislative history of the act was reviewed to discredit the majority opinion which condoned the commission's order under the authority of a rate provision of the act.³⁰

Federal power over producing properties was limited by *FPC v. Panhandle Eastern Pipe Line Co.*³¹ Panhandle Eastern planned to transfer leases covering 97,000 acres of land plus working capital to a newly formed company; the new company was to deliver all of its stock to Panhandle Eastern for distribution to Panhandle Eastern's stockholders. Attempting to prevent the transfer, the commission contended that the leases had been dedicated to the production of natural gas which was to be used in the performance of Panhandle Eastern's public utility obligations, and the leases could not be relinquished without the consent of the commission. The Court rejected the commission's arguments as inviting expansion of federal power

²⁷ 324 U.S. 581 (1945).

²⁸ *Id.* at 602-04. See also *Panhandle Eastern Pipe Line Co. v. FPC*, *supra* note 17; *State Corp. Comm'n v. FPC*, 206 F.2d 690 (8th Cir. 1953); *Cities Service Gas Co. v. FPC*, 155 F.2d 694 (10th Cir. 1946).

²⁹ 324 U.S. at 618.

³⁰ *Id.* at 619-22.

³¹ 337 U.S. 498 (1949).

into a forbidden area. Thus, the commission failed in its attempt to control effectively physical properties used in the production of natural gas which are committed to the service requirements of the transmission company and included in its rate base. This decision made it possible for interstate transmission companies to liquidate their production holdings rather than to maintain these properties for the return allowed by the commission.

The decision rendered in *Colorado Interstate Gas Co. v. FPC*,³² which extended the commission's jurisdiction to the producing properties of interstate transmission companies applied only in those instances where the transmission company produced, transported, and sold the production from its own wells in interstate commerce for resale. The production and gathering exemption was regarded as precluding federal regulation of the rates charged where a transmission company purchased gas from an independent producer or sold gas to another transmission company, provided that the transaction involved was at "arm's length." These unregulated field prices were governed by gas purchase contracts, some of which had been consummated many years prior to the enactment of the Natural Gas Act. If the transaction was not at arm's length, as, e.g., in the case of sales to an affiliate, the commission could investigate the reasonableness of the price paid by the purchasing company. However, this situation was changed by two important cases. The *Phillips* case extended the commission's jurisdiction to sales from a producer to an interstate transmission company, and *Interstate Natural Gas Co. v. FPC*³³ extended the commission's jurisdiction to sales by an interstate transmission company to another transmission company.

*Interstate Natural Gas Co. v. FPC*³⁴ was the first decision to sustain federal regulation of natural gas sales conducted at arm's length in the gas field. Interstate owned a pipeline extending from northern Louisiana into Mississippi and back into Louisiana, where the gas was sold; Interstate admitted it was a natural gas company within the meaning of the act and that this portion of its business was subject to regulation by the commission. In addition to these facilities, Interstate owned producing properties in a field near Monroe, Louisiana, at which point the above described pipeline originated. Some of Interstate's production and gas purchased from other producers in the field was transmitted through Interstate's pipeline and sold to

³² *Supra* note 27.

³³ 331 U.S. 682 (1947).

³⁴ *Ibid.*

distributing companies. A large portion of the production, however, was sold to three pipeline companies after gathering; each purchaser transported natural gas to states other than Louisiana for resale. Interstate was an affiliate of one purchaser, but the sales to the other two purchasers were apparently at arm's length. The price paid by all three purchasers was standard for the field. The unique feature of the case was the fact that Interstate had previously avoided regulation by the State of Louisiana due to its interstate character.

Resisting federal regulation, Interstate contended that the sales of its production to the pipeline purchasers were not interstate sales nor subject to federal control due to the production and gathering exemption of section 1(b) of the act. The Court promptly dispensed with the first contention by employing the statutory definition of "interstate commerce" and the "continuous flow" theory. As to the second contention, the Court found the production and gathering process had been completed at the time the sales were consummated and that the regulation of these sales was predominately a national rather than a local problem. Interstate sales made during the course of production and gathering were held to be non-jurisdictional provided that such sales were closely connected with the local incidents of that process and that regulation by the commission was inconsistent, or substantially interfered, with the exercise of state regulatory functions.

Three important conclusions can be drawn or inferred from the Court's opinion: (1) a sale of natural gas in the field which is destined to a continuous interstate flow is a sale in interstate commerce; (2) the contractual relationship between the parties apparently is immaterial; and (3) so long as the federal regulation does not substantially interfere with state regulation it may encompass sales to a transmission company by an independent producer as well as by another transmission company. The independent producers were disturbed by the general terminology employed in the *Interstate* case. To clarify the situation the Kerr Bill³⁵ was passed by Congress and the commission issued Order 139; each removed arm's length sales by independent producers from federal regulation. The Kerr Bill was vetoed,³⁶ however, and the commission rescinded Order 139. The rescinding order, Order 154, announced the commission's policy against the investigation of producers and gatherers generally, but stated investigations would be conducted where the sales materially affected interstate commerce and the rates appeared excessive.

³⁵ H.R. 1758 & S. 1498, 81st Cong., 1st Sess. (1949).

³⁶ 96 Cong. Rec. 5304 (1950).

Prior to the issuance of Order 154 the commission's policy had continuously been to refrain from exerting its jurisdiction over the independent producer. This jurisdictional question was first presented to the commission in the case of *In the Matter of Columbian Fuel Corp.*³⁷ After considering the legislative history, the commission refused to extend federal regulation to the independent producer. The commission found that it was not consonant with congressional intent to regulate all persons whose only sales in interstate commerce were made as an incident to, and immediately upon the completion of, the production and gathering process. In at least seventeen other instances the commission adhered to this position and refused to exercise its regulatory powers in such cases.³⁸

Consistent with the policy announced in Order 154, the commission instituted an investigation of Phillips Petroleum Company, the largest independent producer of natural gas in the nation, to determine whether Phillips was a natural gas company within the purview of the act, and, if it was subject to federal regulation, whether its rates were just and reasonable. After a lengthy investigation and hearing the commission found that the sales under consideration, which were consummated at the tail gates of processing plants, were non-jurisdictional and terminated the proceeding.³⁹ The commission was of the opinion that the decisions of the Supreme Court precluded federal regulation of incidents connected with, and actively related to, production and gathering. The commission entered an express finding that regulation by a federal agency would substantially interfere with the regulatory functions of the state agencies. Upon review the decision of the commission was reversed by the District of Columbia Court of Appeals,⁴⁰ and the Supreme Court granted certiorari.

The Supreme Court upheld the reversal of the commission's order by its decision issued June 7, 1954, in *Phillips Petroleum Co. v. Wisconsin*.⁴¹ The majority opinion not only upheld the decision of the court of appeals, but also went further. The all-inclusive nature

³⁷ 2 F.P.C. 200 (1940).

³⁸ Jacobs, *Governmental Regulation of Gas Production*, Louisiana State Univ. Fourth Annual Institute on Mineral Law 43, 45 (1956); Jacobs, *Problems Incident to the Marketing of Gas*, Southwestern Legal Foundation Fifth Annual Institute on Oil & Gas L. & Tax. 271, 281 (1954).

³⁹ *In the Matter of Phillips Petroleum Co.*, 10 F.P.C. 246 (1951).

⁴⁰ *State of Wisconsin v. FPC*, 205 F.2d 706 (D.C. Cir. 1953).

⁴¹ 347 U.S. 672 (1954). See also *Champlin Ref. Co. v. Corporation Comm'n*, 286 U.S. 210, 86 A.L.R. 403 (1932), where it was held that production of oil and gas is essentially a mining operation and, therefore, not a part of interstate commerce even though the product is immediately shipped in such commerce.

of the majority's opinion may best be illustrated by the following excerpts:

. . . we believe that the legislative history indicates a congressional intent to give the Commission jurisdiction over the rates of all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company⁴². . . . We are satisfied that congress sought to regulate wholesales of natural gas occurring at both ends of the interstate transmission system⁴³. . . . Regulation of the sales in interstate commerce for resale made by a so-called independent natural-gas producer is not essentially different from regulation of such sales when made by an affiliate of an interstate pipeline company. In both cases, the rates charged may have a direct and substantial effect on the price paid by the ultimate consumers. Protection of consumers against exploitation at the hands of natural-gas companies was the primary aim of the Natural Gas Act.⁴⁴

When the Court refused to recognize any distinction between an integrated transmission company and an independent producer, regardless of size, the resulting expansion of federal power was vast.

To negative the express findings of the commission that Phillips' sales were a part of production and gathering and that federal control would substantially interfere with state regulation (which are apparently findings of fact conclusively binding upon the reviewing court) the majority merely stated that the commission's findings were "without adequate basis at law" and production and gathering had been completed before the sales occurred.⁴⁵ The majority attempted to justify its position by relying upon the *Interstate* case, but it should be noted that the *Interstate* opinion refused to consider the principal jurisdictional question raised by the *Phillips* case. Further, the *Interstate* decision was based in part on the fact that the states involved did not oppose federal regulation. In the *Phillips* case, however, the producing states vigorously protested the lower court's action, yet the Supreme Court partially repudiated the *Interstate* decision by the following: ". . . the jurisdiction of the Federal Power Commission was not intended to vary from state to state, depending upon the degree of state regulation and of state opposition to federal control."⁴⁶

The *Phillips* case held that the production and gathering exemption of section 1 (b) does not preclude the regulation of natural gas sales by

⁴² 347 U.S. at 682.

⁴³ *Id.* at 694.

⁴⁴ *Id.* at 685.

⁴⁵ *Id.* at 678.

⁴⁶ *Id.* at 681.

independent producers and gatherers. However, the Supreme Court specifically reaffirmed its prior decisions in the *Panhandle Eastern* and *Colorado Interstate* cases, holding that producing and gathering facilities are exempt from the commission's jurisdiction by stating that:

In *Federal Power Com. v. Panhandle Eastern Pipe Line Co.* 337 US 498, 505, 93 L ed 1499, 1505, 69 S Ct 1251, we observed that the "natural and clear meaning" of the phrase "production or gathering of natural gas" is that it encompasses "the producing properties and gathering facilities of a natural-gas company." Similarly, in *Colorado Interstate Gas Co. v. Federal Power Com.* 324 US 581, 598, 89 L ed 1206, 1220, 65 S Ct 829, we stated that "transportation and sale do not include production or gathering," and indicated that the "production or gathering" exemption applies to the physical activities, facilities, and properties used in the production and gathering of natural gas. *Id.*, 324 US at 602, 603. See also *Federal Power Com. v. Hope Natural Gas Co.* 320 US 591, 612-615, 88 L ed 333, 350-352, 64 S Ct 281; *Peoples Natural Gas Co. v. Federal Power Com.* 75 App DC 235, 127 F2d 153; *cf. United States v. Public Utilities Com.* 345 US 295, 307-311, 97 L ed 1020, 1033-1035, 73 S Ct 706.⁴⁷

Thus, the express exemption of section 1(b) of the act was reduced to an exemption of the physical activities, facilities and properties used or useful in the production and gathering of natural gas.

Mr. Justice Clark, dissenting, argued that the majority opinion was contrary to the intention of Congress and the understanding of the states and the commission itself. He analyzed the cases which opened the "gap" which Congress intended to close by the act and found that these cases had nothing to do with sales to interstate pipelines by wholly independent, unintegrated, and unaffiliated producers and gatherers. Mr. Justice Clark's opinion reviewed the act's legislative history, concluding that Congress only intended integrated transmission companies to be subject to federal regulation. The opinion stated that the final report of the Federal Trade Commission on malpractices in the natural gas industry indicated that the independent producers, as well as consumers, were the victims of monopolistic practices by the pipelines.

The dissenting opinion of Mr. Justice Douglas regarded the *Columbian Fuel Corp.* case⁴⁸ and subsequent commission decisions as correctly interpreting the legislative intent. Reversal of these decisions, he stated, should be initiated by Congress and not by the Court. Mr. Justice Douglas' opinion recognized the far-reaching effects of the majority opinion upon production, conservation, and

⁴⁷ *Id.* at 678.

⁴⁸ *Supra* note 37.

other matters of importance; furthermore, it set forth this writer's belief that the Court knew little of the problems involved and thus was incompetent to deal with them.

A critique of the majority opinion may be summarized by the following statement of former Senator Price Daniel: "Too often in recent years our highest court reflects the notions of 'policy' of a majority of its members rather than the findings as to what the law and the policy was intended by Congress."⁴⁹ It is the author's belief that the principal question involved in the *Phillips* case was a political one and that the Court substituted its "policy" for the intention of Congress and for the expert opinion of the agency charged with the administration of the act. This resulted in a state of chaos from which the industry and the commission have not recovered during the past five years.

2. Subsequent to June 7, 1954

a. *Producer Sales for Resale*.— The sales involved in the *Phillips* case occurred at the tail gate of the processing plants, and the Court held that the production and gathering exemption was not applicable to the sales since the production and gathering process had been completed at this point. Subsequently, the producers attempted to consummate gas sales at a point that would clearly bring the sale within the production and gathering exemption of section 1 (b). However, the more recent decisions have relied upon the broad language employed in the *Phillips* opinion to extend the commission's jurisdiction to the wellhead, and these decisions have permitted the regulation of sales consummated prior to the completion of the production or gathering process.

*Deep South Oil Co. v. FPC*⁵⁰ was the first judicial decision to extend the *Phillips* decision substantially. Deep South owned both oil wells and gas wells in the field under consideration. The gas sales contract provided that title to casinghead gas and gas-well gas would pass to the purchaser at the outlet side of separators and dehydrators, respectively. Deep South did not remove the liquid hydrocarbons, but the purchaser processed Deep South's production after it was commingled with other gas purchased in the field. After processing, the purchaser sold the residue gas to an interstate transmission company. Thus, the sales in question were consum-

⁴⁹ Address by Hon. Price Daniel, What Happened to the Harris-Fulbright Amendment to the Natural Gas Act, presented to the Mineral Law Section, American Bar Ass'n, August 28, 1956.

⁵⁰ 247 F.2d 882 (5th Cir.), 7 Oil & Gas Rep. 1539 (1957).

mated a few feet from the wellhead prior to gathering, and the purchaser was not an interstate transmission company but a middle man. The transmission company which purchased the gas from the gatherer-processor sold a portion of the gas in interstate commerce and the remainder in intrastate commerce. The United States Court of Appeals for the Fifth Circuit held that the producer was engaged in a sale for resale within the purview of the act since at least some portion of the gas was resold to consumers outside the state where it was produced. The fact that a sale is consummated at the wellhead prior to gathering is no longer pertinent, as the court concluded that the point at which title and custody pass to the purchaser, without arresting its movement to an ultimate interstate destination, does not affect the interstate nature of the transaction.⁵¹ The producer's brief was quoted to show that there was a "continuous flow" of gas from the well into interstate and intrastate commerce, and the court emphasized that fact that the gas had "commenced its journey in interstate commerce" when it was sold by the producer to the gatherer-processor. After a review of the legislative history of the act, the *Interstate* case and the *Phillips* case, the Court concluded that the express exemption of Section 1(b) ". . . merely means that the physical activities, facilities and properties used by petitioner in the production and gathering of natural gas are not within the Commission's power of regulation."⁵² Further, the opinion states:

. . . there is nothing in the Act which suggests, either expressly or by implication, that by the exemption of production and gathering, Congress intended that the wholesales of natural gas in interstate commerce which are consummated before the gas has been gathered or processed should not be regarded as sales in such commerce over which the Commission was granted exclusive jurisdiction.⁵³

Prior to the *Deep South* decision many producers contended that raw casinghead gas was not "natural gas" within the meaning of the act and that sales to a middleman who resold the production to an interstate transmission company were not subject to the commission's jurisdiction. The *Deep South* opinion repudiated both of these contentions and necessitated additional certificate and rate schedule filings by producers.

⁵¹ This rule was also announced in *Continental Oil Co. v. FPC*, 247 F.2d 904 (5th Cir. 1957); *Humble Oil & Ref. Co. v. FPC*, 247 F.2d 903 (5th Cir.), 7 Oil & Gas Rep. 1561 (1957); *Shell Oil Co. v. FPC*, 247 F.2d 900 (5th Cir.), 7 Oil & Gas Rep. 1562 (1957).

⁵² 247 F.2d at 889.

⁵³ *Ibid.*

In *Saturn Oil & Gas Co. v. FPC*⁵⁴ the producer's counsel formulated a unique argument. Saturn's contract provided that the point of delivery would be within the christmas tree and title would pass to the purchaser at this point. The producer did not own any facilities above the surface of the earth other than the christmas tree. Saturn's counsel contended that the producer owned no gas which moved horizontally, interstate, or otherwise. Although the commission and the court ruled adversely to the producer and held the sale was jurisdictional, the court's opinion contains the following language which partially clarifies one controversial issue:

Until there is a sale of the natural gas by such operations and installations in interstate commerce for resale, they (operations and facilities) are exempt. In the event of such a sale the jurisdiction of the Commission applies, but only to the extent the Natural Gas Act confers jurisdiction.⁵⁵

Since the term "sale" imputes delivery, the commission's jurisdiction apparently does not attach until deliveries are commenced or the producer accepts a certificate. Therefore, a producer who has the contractual right to withdraw from a proposed sale can exercise his right to cancel the sales contract and withdraw his certificate and rate filings prior to the initial delivery of gas thereunder provided, however, the producer has not obligated himself to commence the sale in proceedings before the commission.⁵⁶

In *the Matter of Continental Oil Co.*⁵⁷ also dealt with a sales contract which provided for the transfer of title within the christmas tree. The purchasing interstate transmission company was allowed to regulate the rate of flow, but the contract provided that such action was subject to control by the producer. The presiding examiner found that the sale was not jurisdictional and did not recommend the issuance of a certificate; however, the commission reversed the examiner and issued the certificate. The first opinion primarily relied upon the *Phillips* case to defeat the producer's contention that the sale was non-jurisdictional since the sale occurred before production was completed and gathering had commenced. Further, the commission held that control of the rate of flow does not necessarily carry with it the producing connotation, particularly when the pro-

⁵⁴ 250 F.2d 61 (10th Cir. 1957), affirming *In the Matter of Saturn Oil & Gas Co.*, 16 F.P.C. 461, 6 Oil & Gas Rep. 905 (1956).

⁵⁵ 250 F.2d at 68.

⁵⁶ See *Atlantic Ref. Co. v. Public Service Comm'n*, 360 U.S. 378 (1959); Order issued November 19, 1958, *In the Matter of Sunray Mid-Continent Oil Co.*, Docket No. G-4916.

⁵⁷ 18 F.P.C. 296 (1957).

ducer reserves the right to control the action of the purchaser. Thus the commission took the position that the arrangement was merely one of convenience and did not affect its authority.

The opinion issued by the commission in response to the producer's application for rehearing⁵⁸ goes much farther. To substantiate its position the commission interpreted the *Phillips* case to mean that a sale in interstate commerce for resale, which occurs during the production process, is nevertheless subject to the commission's jurisdiction. Furthermore, the commission concluded that its jurisdiction attached the instant the gas was reduced to possession. After finding that "natural gas becomes a subject of commerce when it is reduced to possession" and the producer necessarily obtained possession at some point at or near the point of delivery, the commission held the sale was jurisdictional due to the producer's possession and the sale in interstate commerce for resale.⁵⁹

At the present time it is generally conceded that, with few exceptions, all sales of natural gas in interstate commerce for resale consummated during production, gathering, processing, or transmission will be held by the commission and the courts to be jurisdictional. The commission has been very successful in upholding its decisions upon judicial review, and there is no indication that this will change in the foreseeable future. The exceptions that are generally recognized involve sales of leases,⁶⁰ sales of natural gas in place, direct sales, and sales by companies that may qualify under the Hinshaw Amendment.⁶¹ During the next few years, however, other exceptions may be created and recognized by the courts.

b. *Production and Gathering Facilities.*—As previously stated, the decisions have reduced the express exemption of section 1(b) of the act to mean that only the producers' physical facilities, properties, and activities related to the production and gathering of natural gas are not subject to the commission's regulation. Therefore, the question soon arose as to which production and gathering facilities are exempt under section 1(b), and which are jurisdictional facilities subject to the provisions of section 7 of the act. If a facility is non-

⁵⁸ In the Matter of Continental Oil Co., 18 F.P.C. 528 (1957).

⁵⁹ The United States Court of Appeals for the Fifth Circuit recently affirmed the commission's decision: *Continental Oil Co. v. FPC*, 266 F.2d 208 (5th Cir. 1959). However, the majority opinion is directed to the regulatory status of the producer's facilities.

⁶⁰ See In the Matter of Texas Eastern Transmission Corp., ___F.P.C.____ (1959), Opinion No. 322, issued June 23, 1959, Docket Nos. G-12446, wherein the pipeline purchased leases from independent producers and did not request authorization to make the acquisition; the commission stated that it did not have the authority to certificate the acquisition, and it denied intervenor's request which would require the introduction of cost evidence to support the sales price.

⁶¹ *Supra* note 24.

jurisdictional, an independent producer or gatherer may acquire, construct, install, operate, and abandon the facility without authorization from the commission; if a facility is jurisdictional, a producer or gatherer must comply with the requirements of section 7 prior to engaging in any of these activities.

It is the commission's position that the references in section 7(c) to "facilities therefor" and "such facilities" apply to those facilities which serve the function of effecting a jurisdictional sale or transportation of natural gas.⁶² An early abandonment case supports the commission's position; there the court relied on the *Phillips* case to hold that the facilities which require certification by the commission are those facilities that are used to effectuate a jurisdictional sale.⁶³

Although there are various facilities between the wellhead and the point of delivery that are essential to make a connection with the purchaser's system, essential facilities are not necessarily "sales facilities." The necessity of a facility is not the criteria, but the principal consideration is the use and service of the facility. The directness and immediacy of the facility to the sale are factors which the commission may consider. The commission has employed the principle that only "sales facilities" are jurisdictional in order to control the essential facilities while avoiding the administrative burden of regulating those facilities that are not important for regulatory purposes. Which production and gathering facilities, then, are considered by the commission to be "sales facilities"?⁶⁴

The *Continental* case⁶⁵ discussed in the preceding section also con-

⁶² In the Matter of Continental Oil Co., 18 F.P.C. 296, 18 F.P.C. 528 (1957); In the Matter of Argo Oil Corp., 15 F.P.C. 601 (1956); In the Matter of Continental Oil Co., 16 F.P.C. 417, 16 F.P.C. 1 (1956).

⁶³ J. M. Huber Corp. v. FPC, supra note 17.

⁶⁴ A problem regarding facilities is usually not presented when a producer files a certificate application with the commission requesting authorization to make a sale at or near the wellhead and the producer does not propose a jurisdictional transportation. The commission has a standard clause which it inserts in orders authorizing producer sales to assert its authority over jurisdictional facilities. This clause provides that the sale is authorized "together with the construction and operation of any facilities, subject to the jurisdiction of the Commission, used for the sale of natural gas in interstate commerce." The commission is apparently not concerned when production facilities are installed prior to the issuance of the certificate even though such facilities may be used to effect the sale of gas. In this connection, at least one case has held that all production facilities are exempt until there is a jurisdictional sale and the act of sale in interstate commerce for resale commits the facilities which are necessary to effectuate the sale to regulation by the commission. *Saturn Oil & Gas Co. v. FPC*, supra note 54. It is apparent that the commission desires to have at least one jurisdictional facility at or near each point of delivery to perfect its jurisdiction, particularly for the purposes of section 7 (b), although the provisions of section 7 (c) have not been strictly enforced against independent producers. The problem of jurisdictional facilities is of considerable importance when a gatherer intends to engage in a jurisdictional transportation as the gatherer's operations are similar to the operations of a transmission company and the act was designed to regulate this type of service.

⁶⁵ In the Matter of Continental Oil Co., supra note 62.

cerned production facilities and the production and gathering exemption of section 1(b). Where a facility serves two functions (effecting sales and producing or gathering natural gas), the commission held that the affirmative grant of power in section 7(c) is dominant and its jurisdiction is not defeated by the production and gathering exemption. Therefore, when the point of delivery is within the christmas tree, which is a part of the well and technically a production facility, it is immaterial that the christmas tree serves some function other than effecting the sale. The United States Court of Appeals for the Fifth Circuit affirmed the commission's decision;⁶⁶ however, the court's opinion is not as extensive as the commission's decision. Instead, the court took the christmas tree apart piece-by-piece to find that one valve was a sales facility and that "production" (within the meaning of the act and not within common usage in the industry) was completed before the gas passed through that particular valve. The opinion then states:

. . . we are faced primarily with the unambiguous and clear intent as construed by the Supreme Court in the Phillips case to regulate these interstate sales. Since it is in line with ordinary nontechnical usage, we must give to the terms the meaning that will effectuate and not the one that would frustrate the purpose of the law.⁶⁷

The court therefore concluded that the producer owned and operated sales facilities which are subject to the jurisdiction of the commission without expressly ruling that production facilities may also be jurisdictional sales facilities.

*In the Matter of Continental Oil Co.*⁶⁸ presented to the commission a typical factual situation. The producer owned and operated the following facilities between the wellhead and the point of delivery: line from wellhead to heater, heater, line to separator, separator, line to compressor, compressor, line to point of delivery, and an adjustable choke. All facilities located between the outlet side of the separator and the point of delivery, including the choke, were classified as "sales facilities" subject to the commission's regulation. The remaining facilities were held to be production and gathering facilities within the exemption of section 1(b). The sales facilities were said to be immediately and directly concerned with the consummation of the sale, as the commission found that their "distinctive function" was to effectuate the sale of natural gas.

The commission has developed a similar rule in those instances

⁶⁶ Continental Oil Co. v. FPC, supra note 59.

⁶⁷ 266 F.2d at 212.

⁶⁸ 16 F.P.C. 417, 16 F.P.C. 1 (1956).

where a natural gas company does not produce or even purchase natural gas in a given field but owns and operates a gathering system. In such cases the commission considers the facilities located between the wellhead and the central point at which the production enters a single line to be gathering facilities within the purview of section 1 (b). Thus the gathering process has been completed when the gas reaches the central point for delivery into a single line. Consequently, all facilities owned by the gatherer between the central point of "final commingling" and the point of delivery to the purchasing interstate transmission company are jurisdictional and require certification under the commission's interpretation of section 7 (c). If production from a single well is involved and there is no commingling before the gas is introduced into the facilities of the interstate transmission company, it is the commission's position that all gathering facilities used to transport the production from the wellhead to the point of delivery are jurisdictional.⁶⁹

c. *Processing Plants*.—The commission has asserted its jurisdiction over processing plants upon the assumption that processing is necessary to make natural gas marketable and transportable and is therefore an essential element of the natural gas business.⁷⁰ The courts have sustained the commission's decisions and condoned the extension of federal regulation to this segment of the industry.⁷¹

In *Shell Oil Co. v. FPC*⁷² the principal question before the court was whether a sale pursuant to a "standard casinghead contract" was a sale for resale within the meaning of the act. A "standard casinghead contract" effectuates a sale to a processor or plant owner with the transfer of title to wet gas at some point on the upstream side of the processing plant. In the usual situation the plant owner agrees to extract all recoverable liquid hydrocarbons and deliver a percentage of such products to the producer. The processor further agrees to sell all surplus gas remaining after processing and to pay the producer a designated percentage of the proceeds derived from the sale of residue gas attributable to the producer's properties.

After the commission asserted its jurisdiction over the sale by Shell to the processor, Shell petitioned the Fifth Circuit to review the commission's order. The court upheld the commission's action and

⁶⁹ In the Matter of Barnes Transportation Co., 18 F.P.C. 369, 7 Oil & Gas Rep. 1527 (1957); In the Matter of Texas Gas Corp., 18 F.P.C. 397 (1957).

⁷⁰ City of Columbus v. United Fuel Gas Co., 5 F.P.C. 279 (1946); In the Matter of Cities Service Gas Co., 3 F.P.C. 459 (1943); In the Matter of Hope Natural Gas Co., 3 F.P.C. 150 (1942).

⁷¹ Deep South Oil Co. v. FPC, 247 F.2d 882 (5th Cir.), 7 Oil & Gas Rep. 1539 (1957); Shell Oil Co. v. FPC, supra note 51; Cities Service Gas Co. v. FPC, supra note 28.

⁷² Supra note 51.

held that the sale at or near the wellhead under the terms of a standard casinghead contract was jurisdictional.⁷³ The producer's interest in the sale of the residue gas and the processing operations would therefore be subjected to federal regulation. The court further stated that the question of jurisdiction is not to be determined by the parties use of the term "manufacture" in the sales contract but upon the actual disposition of the gas. In *Deep South Oil Co. v. FPC*⁷⁴ the court went further and held that gas processing was not "manufacturing" but "merely a part of the business of transporting and marketing gas in interstate commerce" since the product had commenced its journey in interstate commerce at the time of the sale and the processing did not interrupt the interstate journey. In *the Matter of Continental Oil Co.*⁷⁵ held that an interstate transmission company acted as agent or trustee for the producer in the operation of a processing plant *pro tanto* or to the extent that the producer contributed to the total stream of gas processed by the pipeline company's plant.

The commission has regulated the processing operations of interstate transmission companies by the traditional rate base method, with profits above the return allowed the processor being appropriated to the benefit of the consumer of the residue gas. Disposition of excess earnings has been made in this manner in cases where the processing operations were conducted by a transmission company or a third party and where such operations were or were not actually necessary to make the gas marketable and transportable.⁷⁶

The commission has not announced a policy regarding the processing facilities and operations of independent producers; thus the applicability of sections 4, 5, and 7 of the act in such cases is not clear at this date. Moreover, in at least two cases the commission has held that processing plants are non-jurisdictional although located on jurisdictional pipelines, apparently attempting to change its prior policy in the *Panhandle Eastern* case.⁷⁷

Some authorities advocate treating all plant operations and facilities as jurisdictional except those directly related to the business of ex-

⁷³ 247 F.2d at 902.

⁷⁴ *Supra* note 71.

⁷⁵ 16 F.P.C. 417, 16 F.P.C. 1 (1956).

⁷⁶ Jacobs, *Governmental Regulation of Gas Production*, Louisiana State Univ. Fourth Annual Institute on Mineral Law 43, 51 (1956).

⁷⁷ See Jacobs, *Problems Incident to the Marketing of Gas*, Southwestern Legal Foundation Fifth Annual Institute on Oil & Gas L. & Tax. 271, 298 (1954). In the *Matter of Panhandle Eastern Pipe Line Co.*, —F.P.C.— (1954) held that processing was non-jurisdictional as processing was unnecessary to produce marketable gas, but the commission was reversed in *City of Detroit v. FPC*, 230 F.2d 810 (D.C. Cir. 1955), because of the lack of adequate evidence to support its findings.

tracting liquids. Under this procedure there would be a division of plant property and expenses. That portion of the plant investment related to making gas merchantable and transportable would be included in the rate base for a return, but absorbers and other extraction facilities would be excluded. The processor would receive a return by the traditional method on jurisdictional operations, but the profit or loss resulting from the extraction business would be received or borne by the processor. Since the extraction of liquids shrinks the volume and lowers the BTU content of the gas stream, these authorities contend that an adjustment should be made to shift the economic burden of these two incidents of processing to the extraction business.

d. *Commingled Gas*.—A controversy may easily arise when a natural gas company is engaged in both jurisdictional and non-jurisdictional businesses on a single pipeline or lateral. One line of cases hold that the commingling of jurisdictional and non-jurisdictional gas will result in the extension of federal regulation to the non-jurisdictional business.⁷⁸ In *Panhandle Eastern Pipe Line Co. v. FPC*⁷⁹ the Supreme Court condoned the confiscation of the pipeline's profit above the 6½% return realized from a non-jurisdictional direct sale and the appropriation of such profit to reduce the rates of jurisdictional sales. The Court admitted that the act does not give the commission authority to disregard the jurisdictional lines that Congress has drawn between interstate wholesales and direct industrial sales to level the profits between the two classes of business; nevertheless, the Court upheld the commission's order stating that in the exceptional circumstances under consideration—the small investment required to make the direct sale, the incremental nature of such sale, the lack of a practical means of segregating the cost and property, and the failure of the company to insist on segregation or allocation in its petition for rehearing—the commission did not exceed the limits of its discretion when it allocated to the regulated business the earnings over the return derived from a non-jurisdictional transaction.

This result is clearly contrary to the congressional intent, and it is submitted that the commission should be required to segregate the jurisdictional from the non-jurisdictional business when actual segregation is possible and to employ a suitable allocation formula

⁷⁸ *Pennsylvania Water & Power Co. v. FPC*, 343 U.S. 414 (1952); *Panhandle Eastern Pipe Line Co. v. FPC*, 232 F.2d 467 (3rd Cir. 1956); *State Corp. Comm'n v. FPC*, supra note 28.

⁷⁹ 324 U.S. 635 (1945).

in other instances. A number of cases have recognized the identity of non-jurisdictional sales as separate and distinct transactions even where the subject matter of these sales is commingled with jurisdictional gas. These cases require the commission to segregate or allocate joint costs and investments.⁸⁰ A separation or allocation of property, capital, expenses, and revenue is essential in order to confine the commission's regulation to the jurisdictional functions of the natural gas company. Accordingly, when the commission utilizes a particular allocation formula, the courts have stated that the commission is exercising a legislative function and thus have accepted the allocation formula employed by the commission so long as the formula does not contravene the statutory scheme of regulation.⁸¹

Segregation or allocation of the various items of expense and investment is particularly important in independent producer cases since the producer may be engaged in farming, ranching, manufacturing, hard rock mining, or other businesses as well as operations related to the production of oil and other liquid hydrocarbons. Thus far the commission has respected the non-jurisdictional nature of the producers' operations that do not involve a jurisdictional sale or transportation of natural gas and activities immediately related thereto. With respect to producer sales, however, the decisions discussed previously indicate it is the position of the commission and the courts that so long as a portion of the commingled gas stream is sold in interstate commerce for resale, the entire subject matter of the producer's sale is subject to federal regulation. Therefore, in a case where the purchasing transmission company transports and sells only 10% of the production in interstate commerce, the total volume of gas sold by the producer is subject to federal rate regulation, and there is no segregation or allocation to restrict the commission's regulation to the undivided 10% of the production which is ultimately introduced into interstate commerce.

Recently the commission recognized that jurisdictional and non-jurisdictional sales may be segregated by the contract between the

⁸⁰ *North Dakota v. FPC*, 247 F.2d 173 (8th Cir. 1957); *City of Hastings v. Kansas-Neb. Gas Co.*, 221 F.2d 31 (D.C. Cir. 1954); *Colorado Interstate Gas Co. v. FPC*, 183 F.2d 357 (3rd Cir. 1950). See *Humble Oil & Ref. Co. v. Texas & Pac. Ry. Co.*, 155 Tex. 483, 289 S.W.2d 547 (1955).

⁸¹ See *Colorado-Wyoming Gas Co. v. FPC*, 324 U.S. 626 (1945); *Panhandle Eastern Pipe Line Co. v. FPC*, 324 U.S. 635 (1945); *State Corp. Comm'n v. FPC*, 206 F.2d 690 (8th Cir. 1953); *Alabama-Tenn. Natural Gas Co. v. FPC*, 203 F.2d 494 (3rd Cir. 1953); *Mississippi River Fuel Corp. v. FPC*, 163 F.2d 433 (D.C. Cir. 1947); *Cities Service Gas Co. v. FPC*, 155 F.2d 694 (10th Cir. 1946); *Colorado Interstate Gas Co. v. FPC*, 142 F.2d 943 (10th Cir. 1944).

parties and by the treatment accorded the transactions. A producer commingled jurisdictional and non-jurisdictional gas during gathering and processing; but the commission held that gas destined for intrastate consumption does not become subject to its jurisdiction merely because it is commingled with jurisdictional gas during a portion of its transmission.⁸² On the basis of this decision, a producer may maintain the identity of a non-jurisdictional sale by proper lease dedication, separate measurement, and accurate accounting with respect to each sale, and may utilize a single gathering system to transport the commingled stream of gas. However, this situation should be avoided when economically feasible due to the judicial decisions which refuse to recognize the severability of the two transactions.

e. *Direct Sales*.—The act effectuates the power of Congress to regulate the transportation of natural gas in interstate commerce, its sale in interstate commerce for resale, and natural gas companies engaged in such transportation or sale. Sales by an interstate transmission company directly to an industrial consumer are exempted from the application of the act, and the commission has no authority to regulate the price charged these customers.⁸³ Direct sales to the ultimate consumer are subject to state regulation, which is not precluded by the fact that the product is sold or transported in interstate commerce.⁸⁴ In *Panhandle Eastern Pipe Line Co. v. Public Service Commission*⁸⁵ the Supreme Court held that direct sales were sales in interstate commerce, but it upheld state control solely because Congress had not provided federal regulations over such sales. "To any other . . . sale" in section 1(b) means that the act shall not apply to any sale other than a sale for resale. Direct sales are excluded from the jurisdiction of the commission whether they are for domestic, commercial, industrial, or any other use.⁸⁶ Where the sales are made for resale to an industrial consumer, such sales are

⁸² In the Matter of Houston Natural Gas Prod. Co., —F.P.C.— (1959), issued March 31, 1959, Docket No. G-9046.

⁸³ FPC v. Interstate Natural Gas Co., 336 U.S. 557 (1949); Panhandle Eastern Pipe Line Co. v. Public Service Comm'n, 332 U.S. 507 (1947); Panhandle Eastern Pipe Line Co. v. FPC, supra note 78; City of Hastings v. Kansas-Neb. Gas Co., supra note 80; State Corp. Comm'n v. FPC, supra note 81; Natural Gas Pipeline Co. of America v. FPC, 141 F.2d 27 (8th Cir. 1944); Panhandle Eastern Pipe Line Co. v. Michigan Public Service Comm'n, 328 Mich. 650, 44 N.W. 2d 324 (1950). But see Panhandle Eastern Pipe Line Co. v. FPC, supra note 81.

⁸⁴ Panhandle Eastern Pipe Line Co. v. Michigan Public Service Comm'n, 341 U.S. 329 (1947); Colorado Interstate Gas Co. v. FPC, 324 U.S. 581 (1945); Illinois Natural Gas Co. v. Central Illinois Public Service Co., 314 U.S. 498 (1942); Lone Star Gas Co. v. Texas, 304 U.S. 224 (1938); Pennsylvania Gas Co. v. Public Service Comm'n, 252 U.S. 23 (1920).

⁸⁵ 332 U.S. 507 (1947).

⁸⁶ Id. at 516-17.

subject to the jurisdiction of the commission;⁸⁷ however, the commission does not have the authority to suspend rate increases where the sale for resale is made for industrial use only.⁸⁸

The commission does not have the power to regulate direct sales or the rates charged thereunder; thus a producer may sell his production directly to the ultimate consumer and avoid federal *rate regulation* over the field sale, but this does not mean commission supervision is entirely lacking in such cases. To the contrary, the commission retains its jurisdiction over the transmission company and the interstate transportation of the natural gas delivered to the direct customer. The transmission company must secure the necessary authorization for the transportation of such gas and the construction and operation of the required facilities. Therefore, the commission is given the opportunity to consider the plans and specifications, the economic feasibility, and the effect of the proposed project on present services to existing customers. Regulation of the transportation of natural gas has been held to be completely independent of rate regulation;⁸⁹ hence the commission may regulate the transportation charge received by an interstate transmission company when a producer sells natural gas directly to the ultimate consumer and the transmission company merely receives a fee for transmission.

*In the Matter of Transcontinental Gas Pipe Line Corp.*⁹⁰ involved a pipeline's request for authorization to transport gas purchased by Consolidated Edison Company of New York from producers in Texas for use as boiler fuel in Consolidated Edison's generating plants. The commission denied the application principally on the grounds that such transportation would pre-empt transmission facilities which would otherwise be available for more beneficial uses⁹¹ and that the direct sales in the field would eventually result in higher field prices. The commission's staff opposed the project, contending that it was not in the public interest since the commission's regulation over the field prices would be avoided. In this connection the commission's opinion states:

⁸⁷ Colorado Interstate Gas Co. v. FPC, supra note 84, at 596.

⁸⁸ 15 U.S.C.A. § 717c. (e) (1948). See *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956).

⁸⁹ *Panhandle Eastern Pipe Line Co. v. FPC*, supra note 78.

⁹⁰ 21 F.P.C. 138 (1959).

⁹¹ The commission stated that the use to be made of the transported gas is relevant in determining whether the transportation of such gas is required by the public convenience and necessity. See *National Coal Ass'n v. FPC*, 191 F.2d 462 (D.C. Cir. 1951). But see *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

The impact of large demand on relatively limited supply is certain enough to raise rates and field prices if only one bidder is bringing that demand to bear on the supply. How much more serious is that impact when it is in the form of multiple bidders, each attempting to reserve to itself a firm supply. Inevitably, there would be upward pressure on rate levels in the fields. We do not believe we ought to encourage such when it is unnecessary.⁹²

Thus, the commission announced the policy of employing its jurisdiction over interstate transportation to discourage non-jurisdictional direct sales in an attempt to prevent increases in field prices. Consolidated Edison has petitioned the Third Circuit to review the commission's order.

C. Rules And Regulations.

Since the act did not expressly provide for the regulation of independent producers or gatherers, it was essential that the commission formulate rules and regulations under the authority of section 16 of the act⁹³ to prescribe the method and procedure of such regulation. The commission issued its No. 174 series of orders requiring independent producers and gatherers, which are "natural gas companies" by virtue of the *Phillips* decision, to file certain materials. The regulations require certain producers to make certificate and rate filings to provide the basis for federal regulation over the producing industry.

The initial regulations required the independent producers to continue all jurisdictional sales and services in effect on June 7, 1954, unless permission to abandon was obtained from the commission. All independent producers who were engaged in a jurisdictional transportation or sale on June 7, 1954, were required to file certificate applications requesting authorization to continue such sale or service. Independent producers may not engage in a new jurisdictional sale or service prior to the issuance of a certificate authorizing such sale or service.⁹⁴ The regulations prescribe the form and contents of producer certificate applications.⁹⁵

Pursuant to the provisions of section 7(c) of the act, the commission's regulations prescribe the circumstances in which a producer may obtain a temporary authorization to engage in a jurisdictional sale or service. The regulations authorize jurisdictional sales and operations without a certificate for a period not to exceed sixty days

⁹² 21 F.P.C. at 141.

⁹³ 15 U.S.C.A. § 717o. (1948).

⁹⁴ 18 C.F.R. § 157.23 (1958 Supp.).

⁹⁵ 18 C.F.R. §§ 157.24 - 157.26 (1958 Supp.).

when imminent danger to life or property can be eliminated by such sale or transportation. In such cases the producer must notify the commission immediately by telegram or letter briefly stating the circumstances which constitute the emergency, and the producer must file a statement under oath within ten days setting forth the purpose and character of the sale or transportation, the rate charged, the facts warranting invocation of the emergency provisions, and the anticipated period of danger.⁹⁶

In the event an emergency arises which does *not* involve imminent danger to life or property, *e.g.*, drainage, loss of a lease, flaring of gas, or economic hardship, the producer may request temporary authorization to commence the sale or transportation necessary to remedy the situation immediately by separate filing of the request or by including such request in the certificate application. To invoke this section of the regulations, the proposed sale or service must not necessitate the termination of any other sale or service, and the proposed date for initial deliveries must be within thirty days from the date of filing. The contract covering the proposed sale or service must be on file with the commission, and the producer's request must identify the contract and set forth the facts that constitute the emergency. After receiving notice of the issuance of the temporary authorization, the proposed sale or transportation may be commenced and continued, pending a final determination in the regular certificate proceeding. A producer may not secure temporary authorization for a jurisdictional sale unless the purchaser has been authorized to construct the facilities necessary to make the connection or such facilities do not require certification by the commission.⁹⁷ A producer is not entitled to a temporary authorization when the sale or service has been commenced and is being continued without the authorization of the commission.⁹⁸

At an early date it became apparent that the commission would be forced to devise some method to regulate independent producers and gatherers more efficiently because of the enormity and complexity of the undertaking and the limited resources and personnel available to the agency. Hence, the question arose as to which transactions in the gas fields should come under the commission's direct supervision since direct supervision of all transactions decreed to be jurisdictional by the *Phillips* case was clearly impossible.

The regulations define "independent producer" as "any person as

⁹⁶ 18 C.F.R. § 157.29 (1958 Supp.).

⁹⁷ 18 C.F.R. § 157.28 (1958 Supp.).

⁹⁸ See *Algonquin Gas Transmission Co. v. FPC*, 201 F.2d 334 (1st Cir. 1953).

defined in the Natural Gas Act who is engaged in the production or gathering of natural gas and who transports natural gas in interstate commerce or sells natural gas in interstate commerce for resale, but who is not primarily engaged in the operation of an interstate pipe line."⁹⁹ The regulations proceed to define and prescribe which "independent producers" are denied the right, given the option, and required to make certificate and rate filings.

The most common problems in this area arise in those situations where several producers enter into an agreement for the development and operation of jointly-owned leases or units. The operating agreements appoint one of the producers as the "operator" of the property and provide that the non-operators may take their share of production in kind, and, if a non-operator fails to take or dispose of his share of production, the operator may sell the non-operator's production and account to the owner for the proceeds. If the operator is a signatory party to the gas sales contract the commission's regulations require him to make all required filings for himself and for co-owners who elect to sell gas under his contract and who are denied the right to, or elect to refrain from, making the required filings on their own behalf.¹⁰⁰ In addition to the usual certificate and rate filings, the operator must file, as a part of his certificate application, the following: (1) a copy of the contract of sale; (2) the names and percentum of ownership of co-owners whose production is to be delivered to the purchaser under the terms of such contract; and (3) a copy of the operating agreement or a sales authorization showing the operator's authority to sell production owned by co-owners who did not execute the contract of sale. The operator must also file an annual statement indicating any changes in ownership of the working interests occurring subsequent to the filing of the previous statement.¹⁰¹

Notwithstanding such filings by the operator, non-operators who are signatory parties to the contract of sale have an election to make, or to refrain from making, certificate and rate filings.¹⁰² Non-operators who are not signatory parties to the contract of sale are denied the right to make certificate and rate filings; thus, a non-signatory party may not maintain a rate schedule even in those cases where the operator fails or refuses to comply with the requirements of the act and regulations. Where a non-signatory party has reserved the right

⁹⁹ 18 C.F.R. § 154.91(a) (1958 Supp.).

¹⁰⁰ 18 C.F.R. § 154.91(b)(1) (1958 Supp.).

¹⁰¹ 18 C.F.R. § 154.91(b)(2)(3) (1958 Supp.).

¹⁰² *Supra* note 100.

to take in kind, however, he may exercise such right after obtaining authorization to abandon the existing sale of his share of production by the operator and authorization to commence the proposed new sale. Only after complying with the requirements of section 7(b) and section 7(c) of the act and filing a rate schedule pursuant to section 4(c) can a non-signatory party enforce his right to take in kind, to dispose of his share of production and to maintain a separate rate schedule covering the new sale.¹⁰³ In the event that the operator has not made initial deliveries to the purchaser or the operator has commenced deliveries without purporting to deliver natural gas attributable to the non-signatory party's undivided interest, section 7(b) would apparently be inapplicable (since the operator's action would not constitute a jurisdictional "sale" of the non-signatory party's share of production).¹⁰⁴

When a producer sells natural gas to the operator of a processing plant at a price which represents a percentage of the proceeds derived from the resale of residue gas, the plant operator must make the required filings and submit additional information similar to the additional material which an operator of a producing unit or lease would normally file.¹⁰⁵ When the operator is an interstate transmission company and the operator introduces the production into its transmission system, the transmission company must file a statement giving the names and percentum of ownership of the co-owners, and all co-owners must make the required certificate and rate filings.¹⁰⁶

In the event the unit, lease, or plant operator is not a signatory party to the contract of sale, each signatory party is responsible for making the required filings; however, filings may be made by one signatory co-owner to cover all or a part of the other signatory co-owners. The party (or parties) who files the certificate application must give the additional information which the operator would ordinarily include in his certificate application.¹⁰⁷

Thus, the regulations provide that, in certain instances, a producer is not required to obtain a certificate before commencing a jurisdictional sale of his undivided interest in a commingled stream of gas. If a producer is not a signatory party to the contract of sale, he may not make the usual filings; if a producer is a signatory non-operator, he may elect to refrain from making such filings. This does not mean

¹⁰³ 18 C.F.R. § 154.91(d) (1958 Supp.).

¹⁰⁴ See authorities cited note 56 supra.

¹⁰⁵ 18 C.F.R. § 154.91(e) (1958 Supp.).

¹⁰⁶ 18 C.F.R. § 154.91(c)(2) (1958 Supp.).

¹⁰⁷ 18 C.F.R. § 154.91(c)(1) (1958 Supp.).

the interstate sale for resale is non-jurisdictional. The jurisdictional transaction and the natural gas company remain subject to the commission's regulation; however, the commission asserts its certification and rate powers in an indirect manner. The operator's rate schedule reflects the legally effective rate applicable to the sale of gas by the operator and the non-operators who do not make the necessary filings and are covered by the operator's rate schedule. The commission authorizes the sale by the operator and such other parties by the issuance of the certificate to the "Operator *et al.*" On the other hand, signatory non-operators who elect to make the required filings, obtain authorization to engage in the sale of their undivided interest, and file separate rate schedules applicable to such sales are regulated by the commission's supervision over their own rate schedules.

The orders and decisions of the commission indicate that it is the commission's policy to apply orders issued pursuant to sections 7(c), 4(c), 4(d), and 4(e) to the operator and all producers covered by the operator's rate schedule, but to apply orders issued pursuant to section 7(b) to the operator only. Therefore, a non-operator who desires to abandon a sale authorized by the operator's certificate must file an application to abandon such sale or join in the operator's abandonment application. On the other hand, should the commission assert its rate review powers under section 4 of the act over the sale by the operator *et al.*, a rate proceeding would be instituted against the operator pursuant to section 4 (e) of the act, and the rates of all parties covered by the operator's rate schedule would be affected by the final order of the commission. It is generally believed that the commission will determine a just and reasonable rate for the operator, and the non-operators will receive the rate allowed the operator. As a result of this procedure, the non-operators would not be necessary parties to the rate proceeding, but they could intervene to protect their interests. However, the commission's staff has taken the position in a proceeding presently before an examiner that the operator and the non-operators should not receive the indential rate although they are covered by the same rate schedule. If the staff succeeds in this connection, parties other than the operator may eventually be required to present evidence in support of the increased rate.

Since the issuance of Order 190 the commission has issued numerous orders which, in essence, state that a non-operating working interest owner has no standing to file a certificate application seeking authorization for a sale pursuant to a contract to which he is not a signatory party. The commission has vacated virtually all certificates

granted non-signatory co-owners prior to the issuance of Order 190. In the *Cotton Valley* case¹⁰⁸ the Cotton Valley Operators Committee conducted a field-wide unitization and pressure maintenance program under the terms and provisions of one of the earlier field-wide unitization agreements. This agreement did not appoint one of the eighty-eight producers as the operator but established a committee of the producers' representatives to operate the unitized area in accordance with the terms of the agreement. The original agreement authorized the committee to execute gas sales contracts, but the agreement was later amended to revoke this authority. Subsequently, the producers executed sales contracts which prescribed jurisdictional sales. Prior to the amendment the committee entered into a contract for the sale of gas to an interstate transmission company, which sale became subject to the commission's regulation effective June 7, 1954. The commission held that: (1) the agent (committee) was a natural gas company subject to the provisions of the act; and (2) the agent was required to file a certificate application and a rate schedule applicable to the sale pursuant to the contract executed by the committee. The principals' (producers') certificates and rate schedules were vacated and rejected; and the commission ordered the refund of a sum of money collected by the principals (subject to refund) under the rejected rate schedules. The commission has granted rehearing and stayed its order; considerable time will probably elapse before this case reaches the courts.

*Sun Oil Co. v. FPC*¹⁰⁹ represents the only judicial decision to pass on the validity of Order 190. The United States Court of Appeals for the Fifth Circuit upheld the order as a valid exercise of the commission's rule-making power; the court emphasized the fact that the producer failed to show injury as a result of the rejection of its rate schedule and the cancelation of its certificate. The court considered Order 190 to be merely a procedural rule that does not affect the producers' substantive rights. However, when the effect of Order 190 is considered together with the trend in producer cases to regulate rates on the basis of cost and investment, it is submitted that Order 190 should be set aside. The "non-signatory rule," coupled with the rate base method, will result in confiscation in many cases. Confiscation could result in the event a producer's rate is fixed on the basis of another producer's cost and investment; furthermore, the purpose of Order 190 is partially defeated if each co-owner is required to present evidence in the rate proceeding.

¹⁰⁸ In the Matter of Midstates Oil Corp., 20 F.P.C. 70 (1958).

¹⁰⁹ 256 F.2d 233 (5th Cir. 1958).

D. Duration And Abandonment

1. Duration of Certificate Authorization

Section 7(c) of the act provides that no natural gas company shall engage in a jurisdictional sale or transportation, or undertake the construction, extension, acquisition, or operation of jurisdictional facilities unless the company has obtained a certificate of public convenience and necessity authorizing such acts or operations.¹¹⁰ This section also contains two provisos. The first is a grandfather clause which provides for the continuance of services being rendered on the effective date of the act, and the second proviso authorizes the commission to issue temporary certificates without notice and hearing.

Section 7(e)¹¹¹ of the act authorizes the commission to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require,¹¹² and sets forth the statutory requirements imposed upon an applicant in a certificate case. When an applicant meets these statutory requirements, section 7(e) provides that a certificate shall be issued to any qualified applicant "authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application. . . ." Thus, a literal interpretation of the act indicates that a producer must file a certificate application in which he proposes to perform certain acts or operations, and the commission, after notice and hearing, may issue a permanent certificate authorizing all or any portion of the acts or operations proposed by the applicant.

Certificate applications filed by the majority of the producers request authorization to engage in a sale of natural gas pursuant to a particular gas sales contract. The sales contract is either attached to the application as an exhibit or incorporated by reference to the commission files. The typical sales contract provides a specific or determinable date on which it will expire by its own terms or by notice. Considering the above provisions of section 7(e), it would appear that the certificate application is a proposal to sell certain volumes of gas for a period of limited duration, and that the commission could authorize the proposed sale in whole or in part but could not validly issue a certificate authorizing the sale after the expiration date of the gas sales contract or require the producer to deliver a volume of gas in excess of the contract quantity. However, the commission has tak-

¹¹⁰ 15 U.S.C.A. § 717f.(c) (1948).

¹¹¹ 15 U.S.C.A. § 717f.(e) (1948).

¹¹² See pp. 497-505 *infra*.

en the position that the abandonment provisions of section 7 (b) are controlling and that all certificates are for an unlimited period of time unless the commission expressly authorizes the termination of services at a future date. The commission has therefore concluded that a certificate of limited duration is in effect only in those cases where the producer has applied for a conditional certificate under section 7(e) and the commission has granted the condition with its issuing order providing that the certificate shall remain in full force and effect for a designated period. In this manner, the commission has shifted the burden of proof to the producer to prove that a qualified or limited certificate is required by the public convenience and necessity. When a sale is authorized by the usual or unlimited certificate, the producer must continue the sale until the commission authorizes the abandonment at the conclusion of a section 7 (b) proceeding.

The commission has held that the issuance of certificates of limited duration is contrary to the public interest and has refused to issue qualified certificates in several instances.¹¹³ The commission's policy in these cases has been expressed as follows:

. . . the extent of the service the company must ultimately render will be determined at some future time if and when it seeks permission to abandon service, a matter which we cannot . . . attempt to anticipate in this (certificate) case.¹¹⁴

We agree with the presiding examiner that the service here certificated should not be abandoned except with our permission and for good cause shown after appropriate proceedings . . . in which all interested parties will have an opportunity to participate and to protect their interests.¹¹⁵

Should the commission issue a certificate limited to the term of the gas sales contract, it is generally believed that the producer could enter into a new sale upon the termination of the contract and dedicate his reserves to the same or another purchaser without securing permission from the commission to abandon the first sale. Of course, the producer must apply for additional authorization if the second sale is to be a jurisdictional sale.

¹¹³ In the Matter of Pan Am. Petroleum Corp., ___ F.P.C. ___ (1959), issued June 19, 1959, Docket No. G-4063; In the Matter of Sunray Mid-Continent Oil Co., 19 F.P.C. 1107 (1958); In the Matter of Continental Oil Co., 16 F.P.C. 1 (1956); order issued December 15, 1958, In the Matter of Sunray Mid-Continent Oil Co., Docket No. G-2975; order issued August 8, 1958, In the Matter of Sunray Mid-Continent Oil Co., Docket No. G-8286.

¹¹⁴ In the Matter of Sunray Mid-Continent Oil Co., 19 F.P.C. 1107, 1108 (1958).

¹¹⁵ Order Issued December 15, 1958, In the Matter of Sunray Mid-Continent Oil Co., Docket No. G-2975.

In *Sunray Mid-Continent Oil Co. v. FPC*¹¹⁶ the commission contended that it did not have the authority to issue certificates of limited duration. The United States Court of Appeals for the Tenth Circuit held, *inter alia*, that the commission has the authority to issue certificates limited to a specific period of time. The Supreme Court affirmed this portion of the opinion in a *per curiam* decision.¹¹⁷

In another *Sunray*¹¹⁸ case the Tenth Circuit held that a producer may not provide for the cessation or discontinuance of a sale on a specified future date simply by so providing in the gas sales contract and a jurisdictional sale cannot be terminated until the commission authorizes the abandonment in a proceeding initiated under section 7(b). In effect, the court ruled that the commission has the authority to issue a certificate requiring the sale of larger quantities of gas over a longer period of time than required by the gas sales contract without receiving evidence or entering findings to the effect that the additional taking for public use is required by the public convenience and necessity.¹¹⁹

In the *Gwinville* cases¹²⁰ the court reviewed five certificate applications which requested authorization to make a particular sale of gas pursuant to a gas sales contract prescribing a ten-year term. In four of these cases the commission issued the producer a permanent certificate which authorized the sale "as more fully described in the application and exhibits." The producers argued that the contracts and the certificates expired simultaneously upon the dates provided by the contracts. However, the Fifth Circuit held that the certificate authorization was not only for the sale of gas pursuant to the contract but "pursuant to and subject to the provisions of the Act and regulations pursuant thereto by the Commission."¹²¹ The court recognized that the commission has the authority to grant certificates limited to the life of the contract, but the opinion states that the court saw nothing to indicate that the producers applied for, or the commission granted, certificates of limited duration. This decision indicates that when a producer makes a jurisdictional sale and enters into a completely new contract upon the expiration of the initial one, the second contract

¹¹⁶ 239 F.2d 97 (10th Cir.), 6 Oil & Gas Rep. 914 (1956).

¹¹⁷ *Sunray Mid-Continent Oil Co. v. FPC*, 353 U.S. 944 (1957).

¹¹⁸ *Sunray Mid-Continent Oil Co. v. FPC*, 267 F.2d 471 (10th Cir. 1959).

¹¹⁹ The court stated that the commission must have this power if the public is to be provided adequate, reasonable, and continuous service. 267 F.2d at 473.

¹²⁰ *Sun Oil Co. v. FPC*, 266 F.2d 222 (5th Cir. 1959); *Richardson v. FPC*, 266 F.2d 233 (5th Cir. 1959); *Humble Oil & Ref. Co. v. FPC*, 266 F.2d 235 (5th Cir. 1959); *Magnolia Petroleum Co. v. FPC*, 266 F.2d 234 (5th Cir. 1959); *Hunt Oil Co. v. FPC*, 266 F.2d 232 (5th Cir. 1959).

¹²¹ 266 F.2d at 225-26.

does not prescribe a new, separate, and distinct "sale" within the meaning of section 1(b) of the act. Thus, the producer is not required to obtain additional certificate authority in this instance.

2. *Abandonment*

The controversial abandonment provision of the act is set forth in section 7(b) which provides:

No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience and necessity permit such abandonment.¹²²

Although several years may elapse before the full impact of the above section is determined, several decisions concerning abandonments have been rendered which are worthy of comment.

Section 7(b) of the act requires natural gas companies to obtain permission from the commission prior to the abandonment of ". . . all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities . . ." Although section 7(b) does not expressly require commission approval prior to the abandonment of a jurisdictional "sale" of natural gas, the decisions have extended the provisions of section 7(b) to producer sales.

With respect to production facilities, it is the commission's position that "sales facilities" may not be abandoned unless the producer complies with the provisions of section 7(b) but the producer need not file an application to abandon other production facilities. As a practical matter, however, producers have not requested permission to abandon when production or sales facilities are removed or replaced and the sale is continued; there has been no indication that the commission would welcome abandonment applications in such cases. Moreover, the great majority of the producers have either failed or refused to file abandonment applications when their producing properties are depleted and the sale is discontinued.

Numerous controversies arose over abandonments pursuant to escape clauses which allowed the producer to cancel the contract of sale when federal regulation was extended to independent producers. Efforts to terminate sales in such cases generally have been unsuccessful.

¹²² 15 U.S.C.A. § 717f.(b) (1948).

ful. Service to the public has been said to be the foundation of gas purchase contract operation; having relied upon such service through the years, the public is entitled to its continuance. To permit the commission's power over sales to be nullified by the abandonment of those sales at the will of the producers has been held to be contrary to the public interest.¹²³

In *J. M. Huber Corp. v. FPC*¹²⁴ the commission had previously held that certain gathering facilities were used to effect the sale of natural gas in interstate commerce. The Third Circuit said that this finding was supported by the record and that these facilities are "sales facilities" under the *Phillips* decision. The court therefore concluded that such facilities, which effected a jurisdictional sale, came within the provisions of section 7(c) and 7(b) and are subject to the jurisdiction and regulation of the commission. Although the sale had been commenced prior to June 7, 1954, and continued thereafter, the producer had stated that it was not willing to accept the certificate or comply with the requirements of section 7(e). However, the court held that the certificate was proper and binding on the company as the "jurisdictional sections of the act, 1(b) and 7(b), obviously do not rely upon the certificate provisions of 7(c)."¹²⁵ Thus, once a sale of natural gas in interstate commerce for resale is commenced, the sale cannot be abandoned without authorization from the commission even though the commission has not authorized the sale and the producer refuses to comply with the requirements of the act and the commission's rules and regulations thereunder. Therefore, it is apparent that jurisdiction attaches because of *deliveries* and the commission's jurisdiction is not dependent upon the issuance of a certificate of public convenience and necessity. Certain language in the Supreme Court's recent *CATCO* decision supports this conclusion.¹²⁶

In the *Gwinville* cases,¹²⁷ the producers entered into new contracts with the same purchaser and the new contracts were to become effective upon the expiration of the initial contracts. The ultimate question before the court was whether the second contract prescribed a new and separate "sale" within the meaning of section 1(b) of the act and, as an incident thereto, whether the commission must authorize the abandonment of the initial sale before a certificate could be

¹²³ *J. M. Huber Corp. v. FPC*, 236 F.2d 550, 558 (3rd Cir. 1956).

¹²⁴ *Id.* See *In the Matter of Argo Oil Corp.*, 15 F.P.C. 601, 5 Oil & Gas Rep. 824 (1956); *In the Matter of Dixie Pipe Line Co.*, —F.P.C.—, 4 Oil & Gas Rep. 1837 (1955), Opinion No. 285 issued September 9, 1955.

¹²⁵ 236 F.2d at 557.

¹²⁶ *Atlantic Ref. Co. v. Public Service Comm'n*, 360 U.S. 378 (1959).

¹²⁷ Cases cited note 120 *supra*. See *Shank v. FPC*, 236 F.2d 830 (5th Cir. 1956); *Lee v. FPC*, 236 F.2d 835 (5th Cir. 1956).

issued and a rate schedule accepted covering the second sale. The producers contended that section 7(b) was not applicable because (1) their initial certificates had expired, (2) they were simply engaged in sales of gas, and (3) they did not render any "service" nor own or operate any facilities subject to the jurisdiction of the commission. The court ruled that the second contract was merely a "change" in rate schedule under section 4 of the act, and, in effect, held that both transactions constituted one "sale" under section 1(b). Consequently, there was no abandonment.

The applicability of section 7(b) to sales authorized by temporary authorizations has not been finally determined. Section 7(c) of the act authorizes the commission to issue "temporary certificates" in certain cases for certain purposes "pending the determination of an application for a certificate. . . ." Under this language of the statute, a temporary certificate is only to be effective until the application for a permanent certificate has been granted or denied. Section 7(e) of the act requires the commission to issue a permanent certificate if the applicant makes the statutory showing; otherwise the application is to be denied. If the certificate is granted but deliveries have not been commenced, the producer-applicant may refuse to accept the permanent certificate.¹²⁸ If deliveries have commenced under a temporary authorization, the courts may find that section 7(b) is controlling and may require the producer to accept the permanent certificate and to continue the sale until abandonment is authorized in a section 7(b) proceeding. However, the act does not expressly authorize the commission to issue a temporary certificate which is to remain in effect beyond the date of the commission's final action upon the pending application for a permanent certificate. Consequently, the act should be interpreted to mean the temporary authorization automatically expires on the date the commission finally acts on the application for a permanent certificate and that section 7(b) is not applicable to the sale in the event the application is denied or the producer refuses to accept the permanent certificate due to the imposition of unacceptable conditions. The courts may issue another "necessity" opinion and reach the opposite result, but this would be illogical in a case where the commission finds that the proposed sale is not required by the public convenience and necessity and refuses to issue a permanent certificate.¹²⁹

¹²⁸ See *Atlantic Ref. Co. v. Public Service Comm'n*, supra note 126; *In the Matter of Sunray Mid-Continent Oil Co.*, 20 F.P.C. 730 (1958).

¹²⁹ Since the date of this writing, this issue was presented to the Tenth Circuit in *Sunray Mid-Continent Oil Co. v. FPC*, ___ F.2d ___ (10th Cir. 1959) but the court did not decide the question because the petition was dismissed as being premature. See note 267 infra.

Before the commission may authorize an abandonment, it must conduct a hearing and enter an express finding that "the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted" or that "the present or future public convenience and necessity permit such abandonment." Independent producers have been unsuccessful in most abandonment proceedings thus far, as it is not in the public interest to allow the abandonment of a sale thereby permitting the producer to enter into a new sale which provides a substantially higher price. However, the price paid for natural gas is not the sole concern of the commission in an abandonment proceeding. The "public interest" or "public convenience and necessity" determination encompasses all factors which have a bearing upon the quality and quantity of the service rendered by the natural gas company. For example, an abandonment was authorized in the case of *In the Matter of Atlantic Ref. Co.*¹³⁰ which permitted an increase in price from 5¢ per Mcf. to 14.6¢ per Mcf. under the terms of a contract offered by a competing pipeline. The revenue provided by the new sale justified the construction of new facilities which would result in the production of approximately seven times the volume delivered under the abandoned sale and the conservation of an amount of gas equal to the volume delivered under the previous sale.

Recently the commission modified its previous policy regarding abandonments in certain situations. The commission has required pipelines to file abandonment applications in those cases where another pipeline was purchasing a portion of its system and the purchaser was to continue the identical services performed by its predecessor. When producing leases are dedicated to the performance of a gas sales contract, the sale of such leases by the producer may be made subject to the pipeline's rights under the gas sales contract or language may be inserted requiring the assignee to assume the contractual obligations of the assignor. In such cases the sale is continued by the assignee under the terms of the existing contract. The commission has issued orders that denied the assignor's application requesting permission to abandon the existing sale.¹³¹ These orders state

¹³⁰ 16 F.P.C. 1010, 6 Oil & Gas Rep. 733 (1956). See also Order issued February 3, 1959, *In the Matter of Hope Producing Co.*, Docket No. G-15537, where the commission authorized the abandonment of a sale at 9.8¢ per Mcf. thereby permitting the producers to make non-jurisdictional sale at 17¢ per Mcf.

¹³¹ Orders issued March 18, 1958, *In the Matters of Llano Grande Corp.*, Docket Nos. G-13367, G-13450, and *In the Matter of R. Olsen*, Docket Nos. G-12310, G-12629, G-13112, G-13113; Order issued March 7, 1958, *In the Matter of Kenneth McCullogh*, Docket Nos. G-11701, G-11702. See order issued January 2, 1959, *In the Matter of Great Sweet Grass Oils Co.*, Docket No. G-15092.

that the act does not require compliance with the provisions of section 7(b) since the identical service will be rendered by the assignee; thus, the commission may simply rescind the former owner's certificate and issue a certificate to the new owner authorizing the existing sale. To be distinguished is the situation where the agreement between the parties changes the price of gas produced from the assigned acreage; here compliance with section 7(b) is required.¹³²

The provisions of section 7(b) may be necessary for the proper administration of the act, but the stringent burden of proof imposed upon producers should be relaxed to allow producers to terminate certain sales. If a producer has the contractual right to terminate a sale at a depressed price and another market is available at a price which will permit the producer to avoid the abandonment of marginal wells, avoid flaring or venting, construct necessary facilities, work-over wells, or develop fully the property, the commission should permit the abandonment of the sale at a depressed price and authorize the new sale, for the public interest demands the increased reserves and the conservation of natural gas. Also, corrective measures are badly needed in another area. Frequently a producer must execute a short term contract to prevent flaring, drainage or the loss of leases. The producer does not intend to dedicate his reserves to a specific purchaser or such purchaser's market outlet, but the producer merely needs a temporary market. Prices provided by these short term contracts may be one-half the going field price available under a long term contract. Federal regulation has forced these low price spot sales off the interstate market; obviously this has destroyed a frequent source of low cost gas to the detriment of all parties concerned, including the consumer.

III. RATE REGULATION

A. *General Considerations*

Since millions of dollars are required to construct the average interstate pipeline, the amortization on the large initial investment must be spread over a considerable length of time; twenty years is considered to be the average amortization period for interstate pipelines. Tremendous quantities of gas reserves must be committed to a proposed pipeline before the project may be commenced since sufficient reserves must be available initially to insure the operation of the line during the amortization or pay-out period. It follows that large

¹³² See Order issued December 16, 1957, In the Matter of Superior Oil Co., Docket No. G-6180.

reserves are necessary to attract bond purchasers, who supply the major portion of the initial investment, and stockholders. Consequently, gas purchase agreements are usually long term contracts which may be made covenants running with the land or leasehold.

Since it is impossible to forecast the commodity value of natural gas over a twenty year period, gas purchase contracts contain provisions that allow the price to increase with the commodity value of the product. Numerous clauses have been adopted which provide specific price increases at certain fixed intervals or increases of an undetermined amount that are contingent upon the occurrence of future events. Favored-nation and renegotiation clauses are the most common of the latter type. Favored-nation clauses provide that the producer will automatically receive an increased price if the buyer or another pipeline pays a higher price to any producer that falls within a specific classification or sells gas within a designated area. Renegotiation clauses provide that the parties will redetermine the contract price at a specified date in accordance with the method prescribed by the agreement. Spiral escalation clauses provide that the producer will receive an increase in the field price when the transmission company receives a rate increase. Further, most gas purchase contracts require the purchaser to reimburse a designated portion of increases in severance, gathering, and other similar taxes imposed upon the producer.

Provisions of this nature are necessary to maintain some relationship between the contract price and the commodity value of natural gas. A fifteen to twenty-year-old price bears no relationship to the commodity value of natural gas today or current production and exploration costs. Unduly depressed prices will not support the type of exploratory program which is required to maintain a healthy gas industry or provide sufficient revenue to develop reserves needed to replace present consumption. Furthermore, depressed prices result in waste during a period in which conservation should be stressed. A gas well may not be capable of production in "paying quantities" when the production is sold at a price of 2¢ or 5¢ per Mcf., but a price of 10¢ per Mcf. may prevent the loss of leases and permit the production of a considerable volume of gas which would otherwise be wasted. Similarly, a work-over may not be economically feasible or further development of a field may not be advisable when the acreage is dedicated to the performance of a contract which provides an unduly depressed price. Clearly, the public interest requires the consideration of numerous factors in addition to the price which will be paid by the ultimate consumer of natural gas. Under the present sys-

tem of regulation, escalation provisions that bring the contractual price up to commodity value are necessary to give the producers an opportunity to come before the commission and justify that portion of the contractual price which may be found to be just and reasonable.

Nevertheless, the commission is presently conducting a proceeding styled *In the Matter of The Pure Oil Co.*,¹³³ in which one of the principal issues is whether the "two-party favored nation" clauses in Pure's contracts with El Paso Natural Gas Company are void or voidable as contrary to the public interest. Moreover, El Paso Natural Gas Company, an intervenor in the *Pure* case and the principal purchaser in the Permian Basin, has recently filed a formal complaint against all producers selling gas to El Paso in the Permian Basin. El Paso's complaint is interrelated with the *Pure* case and requests, among numerous other things, that the commission declare spiral escalation clauses void as a matter of law.

B. Statutory Provisions

The rate provisions of the act are contained in sections 4 and 5. Section 4(a) of the act provides that all rates and charges made, demanded, or received by a natural gas company shall be "just and reasonable" and declares rates which are not just and reasonable to be unlawful.¹³⁴ Section 4(b) states that no natural gas company shall grant any undue preference or advantage to any person, subject any person to any undue prejudice or disadvantage, or maintain any unreasonable differences in rates either as between localities or classes of service.¹³⁵ Section 4(c) requires every natural gas company to file with the commission schedules showing all rates and charges for every jurisdictional sale or transportation and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications and services.¹³⁶

Section 4(d) of the act denies natural gas companies the right to change any rate, charge, classification, service, or contract relating thereto, except after thirty days' notice to the commission and the public.¹³⁷ This notice is given by filing with the commission a new schedule stating the change or changes to be made in the existing schedule and the effective date of the change. For good cause the com-

¹³³ Docket No. G-17930.

¹³⁴ 15 U.S.C.A. § 717c.(a) (1948).

¹³⁵ 15 U.S.C.A. § 717c.(b) (1948).

¹³⁶ 15 U.S.C.A. § 717c.(c) (1948).

¹³⁷ 15 U.S.C.A. § 717c.(d) (1948).

mission may waive the thirty-day notice requirement. When a new schedule is filed by a natural gas company, the commission is authorized by section 4(e) to enter upon a hearing to determine the lawfulness of the new rate or charge and, pending such hearing and decision, to suspend the operation and effectiveness of the new schedule by giving notice to the natural gas company with a statement in writing of the reasons for such suspension. The commission may not suspend the new schedule for a longer period than five months beyond the time when the schedule would otherwise go into effect and does not have the authority to suspend a rate applicable to the sale of gas for resale for industrial use only. If the proceeding has not been concluded and the final order issued at the expiration of the suspension period, the natural gas company may move to have the new rate, charge, classification, or service become effective pending a final determination of the matter. When the increased rate or charge is made effective, the commission may require the natural gas company to furnish bond to assure the refund with interest of any amount which the commission, by its final decision, may find unjustified. In a section 4 proceeding, the statute imposes the burden of proof upon the natural gas company to show that the increased rate or charge is just and reasonable.¹³⁸

Section 5(a) of the act provides that whenever the commission, after a hearing instituted upon its own motion or upon complaint, finds that any rate, charge or classification, or any rule, regulation, practice or contract affecting such rate, charge or classification, is unjust, unreasonable, unduly discriminatory or preferential, the commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and shall fix the same by order. The commission may order a decrease in rate where existing rates are unjust, unduly discriminatory, preferential or otherwise unlawful or when the existing rates are not the lowest reasonable rates. The commission does not have the power, however, to increase any rate contained in an effective rate schedule unless such increase is in accordance with a new schedule on file with the commission.¹³⁹

The act therefore establishes two procedures to test the lawfulness of a natural gas company's rates. The provisions of section 5(a) apply to all existing rates of the company under investigation and a proceeding under this section may be initiated upon the commission's

¹³⁸ 15 U.S.C.A. § 717c.(e) (1948).

¹³⁹ 15 U.S.C.A. § 717d.(a) (1948).

own motion or upon complaint. The provisions of section 4(d) and (e) are only applicable to new rates and a section 4 proceeding may only be instituted by the commission after a natural gas company files a new schedule to change an existing rate. The act does not define "just and reasonable" or prescribe any method for determining a just and reasonable rate. It is the commission's duty to determine a just and reasonable rate in both section 4 and section 5 proceedings, but the proceedings arise and are conducted in a different manner.

Other provisions of the act grant broad powers to the commission to enable it to enforce the rate provisions of the act. The commission may, when necessary, initiate investigations to ascertain the actual legitimate cost and depreciation of the property of every natural gas company and to discover other facts which influence the determination of such cost or depreciation.¹⁴⁰ The commission may investigate the cost of production and transportation of natural gas, even where it has no authority to establish a rate governing the transportation or sale of the particular gas involved.¹⁴¹ The commission may also investigate any facts, conditions, practices, or matters which it may find necessary or proper to (a) determine whether any person has violated, or is about to violate, any provision of the act or any rule, regulation, or order issued under the act; (b) prescribe rules and regulation; or (c) obtain information to serve as a basis for recommending further legislation to Congress.¹⁴² The commission may ascertain and by order fix proper and adequate rates of depreciation and amortization on the several classes of property of each natural gas company.¹⁴³ Further, the commission may prescribe a system of accounts or a uniform accounting procedure to be maintained by every natural gas company.¹⁴⁴

C. Changes In Rate

An initial rate becomes operative when the natural gas company's rate schedule is accepted by the commission.¹⁴⁵ The initial rate is the lawfully effective rate and the only rate the company is entitled to collect until it is changed in the manner provided by the act. The act provides two procedures for changing an effective rate and determining the lawfulness of a natural gas company's rates.

Section 5(a) prescribes a procedure which the commission may initiate, upon complaint or its own motion, to determine the reason-

¹⁴⁰ 15 U.S.C.A. § 717e.(a) (1948).

¹⁴¹ 15 U.S.C.A. § 717d.(b) (1948).

¹⁴² 15 U.S.C.A. § 717m.(a) (1948).

¹⁴³ 15 U.S.C.A. § 717h.(a) (1948).

¹⁴⁴ 15 U.S.C.A. § 717g.(a) (1948).

¹⁴⁵ Cf. *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956).

ableness of all rates of the party under investigation. A section 5(a) proceeding begins with a field investigation of the natural gas company by the commission's staff. During the investigation, the staff compiles a record upon which the commission may make its ultimate findings and conclusions and which the commission may use as the basis for establishing reasonable rates. The burden of going forward with the evidence and proving the unlawfulness of existing rates and the reasonableness of the substituted rates is upon staff counsel.

The commission's investigation is not limited to a single sale or several sales in a given area, but the commission may question the reasonableness of all rates of the party under investigation applicable to jurisdictional transactions. The commission is authorized to determine just and reasonable rates and to fix such rates by order as the lawfully effective rates; the commission's power is prospective only as section 5(a) provides that such rates are "to be thereafter observed." In the absence of a change proposed by the natural gas company, an existing or effective rate may only be modified after notice and hearing in a section 5(a) proceeding and after the commission enters findings that the rate is unlawful.¹⁴⁶ A finding that a rate is not just and reasonable has been said to be tantamount to a finding that the rate is unlawful.

A proceeding may only be instituted under section 4(e) of the act when a natural gas company files a new schedule or a "notice of change" pursuant to section 4(d). Independent producers maintain a rate schedule applicable to each jurisdictional sale; therefore, the change in rates relates only to the sale or sales covered by the rate schedule or schedules being changed under section 4(d). Section 4(d) requires thirty days' notice to the commission and to the public. If the parties attempt to change a rate without complying with the notice provision of section 4(d), there is no valid change in rate.¹⁴⁷ Thus, in order to receive the increases on the date provided by the gas sales contract, a producer must give notice or file a notice of change a minimum of thirty days prior to the date the increase in price is to become contractually effective.

Notice is given by filing a new schedule or a notice of change with the commission setting forth the change or changes to be made in the existing or effective schedule and the effective date of the change. If the commission does not question the reasonableness of an increased rate and does not suspend the effectiveness of the filing, the increased

¹⁴⁶ See *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, *supra* note 145; and the authorities cited in footnote 173 *infra*.

¹⁴⁷ *Cities Service Gas Producing Co. v. FPC*, 233 F.2d 726 (10th Cir. 1956).

rate automatically becomes effective at the end of the thirty-day notice period or the date the increase is contractually due if the notice of change is filed more than thirty days prior to the date provided by the contract. Should the commission question the reasonableness of the increased rate, the effectiveness of the change will be suspended and the use of the increased rate may be deferred for a period not exceeding five months beyond the effective date of the change. When a notice of change is filed with the commission more than thirty days prior to the proposed effective date, the decisions have held that the commission may validly suspend the increased rate after the expiration of thirty days so long as the suspension order is issued prior to the proposed effective date. However, the commission may not suspend a new schedule or notice of change after its effective date.¹⁴⁸ The pipeline regulations provide that a rate cannot be changed during the suspension period;¹⁴⁹ although this rule has not been brought forward in the producer regulations, the commission inserts a clause forbidding such action in suspension orders directed to independent producers.

If the section 4(e) proceeding has not been concluded and the final order issued at the expiration of the suspension period, the natural gas company may move to have the new rate become effective, subject to refund, pending the issuance of a final order by the commission. If this procedure is followed, the commission may require a bond or a corporate undertaking to insure the refund of any portion of the increase which the commission may find unreasonable. Thus, the commission may defer the use of an increased rate for a period of five months, and, at the conclusion of the proceeding, it may assert its rate-making powers retroactively by employing the refund procedure.

As a matter of practice, the commission has established a rate level for each of the producing areas which it tentatively considers to be the maximum reasonable rate. If a producer files a notice of change to effectuate a rate lower than the area level, the commission will not issue a suspension order and the increased rate will become effective at the end of the thirty-day notice period. If the increased rate is higher than the arbitrary area level, the commission issues an order stating that the commission has found that the increased rate may

¹⁴⁸ See sections 2.4 and 2.52 of Commission's General Policy and Interpretations, Rules of Practice and Procedure, Part II (1958); *Atlantic Seaboard Corp. v. FPC*, 201 F.2d 568 (4th Cir. 1953); Order issued May 6, 1959, In the Matter of Hassie Hunt Trust, Docket No. G-17431, wherein the commission recognized that the statutory notice period commences on the date of initial tender when the secretary unlawfully and erroneously rejects a notice of change.

¹⁴⁹ 18 C.F.R. § 154.66(b) (1958 Supp.).

not be just and reasonable and that the effectiveness of the increased rate is suspended for five months.

It is highly improbable that the commission will conclude a section 4(e) case within five months; therefore, it is necessary for the producer to file a motion pursuant to section 4(e) to have the increased rate become effective subject to refund. If the producer fails to file a motion prior to the expiration of the suspension period, the increased rate will become effective, under the commission's present policy on the date the motion is received by the commission; however, the validity of this policy has not been litigated.

After notice from the secretary of the commission, a hearing is convened to determine the lawfulness of the increased rate; the commission's sole concern in such proceeding is the reasonableness of the increased rate. The burden of proof is upon the producer to prove the reasonableness of the increased rate. If the increased rate is found to be just and reasonable, the producer is entitled to retain all funds collected at the increased rate, and the producer receives the increased rate in the future. If the increased rate is found to be unlawful, the producer must continue the sale at the previous rate or the rate established by the commission's order and make refunds to the purchaser, together with six per cent interest.

D. Rules And Regulations

Order 174, the first general order directed to independent producers and gatherers subsequent to the *Phillips* decision, compelled independent producers who were engaged in a jurisdictional transportation or sale on June 7, 1954 to file rate schedules with the commission setting forth the terms and conditions of each sale and service. Order 174 froze all producer rates at the June 7, 1954 level; the courts have upheld the validity of the commission's policy to consider the producer's June 7, 1954 rate as an initial rate.¹⁵⁰ Hence, the June 7, 1954 rate became the lawfully effective rate, and this was true even in those cases where the producer failed or refused to comply with the order.¹⁵¹ Increased rates which became effective on or

¹⁵⁰ *Amerada Petroleum Corp. v. FPC*, 231 F.2d 461 (10th Cir. 1956); *Phillips Petroleum Co. v. FPC*, 227 F.2d 470 (10th Cir. 1955).

¹⁵¹ *Natural Gas Pipeline Co. of America v. Harrington*, 246 F.2d 915 (5th Cir. 1957): The failure to file it (rate schedule) earlier, however, did not prevent the jurisdiction of the Commission from attaching. . . . There is nothing in the Natural Gas Act or in the orders of the Federal Power Commission to indicate that, under such circumstances, until the rates were filed there was no effective or lawful rate. To the contrary, the Act expressly provided for delay in such filings, and under the rationale of *United Gas Pipe Line Co. v. Mobile Gas Corporation*, supra, the contract rate, even though unfiled, became and remained the only lawful rate until changed by order of the Federal Power Commission. 246 F.2d at 919.

before June 7, 1954 pursuant to the terms of an escalation provision were effective rates, and such increased rates were not subject to the commission's suspension power.¹⁵²

The commission attempted to establish the rule that the June 7, 1954 rate is the price actually received by the producer on such date, but, in at least one instance, the commission considered the intention of the parties to determine the June 7, 1954 rate.¹⁵³ Several decisions have held that the commission has exclusive jurisdiction over rate matters, and it, therefore, possesses the authority to construe gas sales contracts to determine the June 7, 1954 rate.¹⁵⁴ The revised opinion rendered in *Phillips Petroleum Co. v. FPC*¹⁵⁵ follows this line of cases, holding that the producer's June 7, 1954 rate, or initial rate for regulatory purposes, was the correct and effective price on June 7, 1954, under the terms of the gas sales contract. Thus, the provisions of the contract were controlling, not the price actually received on this date or set forth in the billing determinant.¹⁵⁶

Prior to the *Phillips* decision the courts upheld state statutes which established a minimum price for natural gas as a conservation measure,¹⁵⁷ but, as a result of the *Phillips* case, these minimum price statutes have been declared invalid.¹⁵⁸ Consequently, a June 7, 1954 rate which was established by an unlawful order of a state agency is not the lawfully effective rate on such date, but the producer's initial rate is the contractual rate which was to be in effect on such date.¹⁵⁹ However, several producers involved in pending litigation are contending

¹⁵² *Phillips Petroleum Co. v. FPC*, supra note 150.

¹⁵³ See *Shell Oil Co. v. FPC*, 263 F.2d 223 (3rd Cir. 1959).

¹⁵⁴ See *Natural Gas Pipeline Co. v. Panoma Corp.*, 349 U.S. 44 (1955); *Trunkline Gas Co. v. FPC*, 247 F.2d 159 (5th Cir. 1957); *State Corp. Comm'n v. FPC*, 206 F.2d 690 (8th Cir. 1953); *United Gas Pipe Line Co. v. Willmut Gas & Oil Co.*, 231 Miss. 700, 97 So. 2d 530, 8 Oil & Gas Rep. 109 (1957).

¹⁵⁵ 258 F.2d 906 (10th Cir. 1958). See also *Kerr-McGee Oil Industries, Inc. v. FPC* 260 F.2d 602 (10th Cir. 1958).

¹⁵⁶ The Court held that it was within the jurisdiction of the commission to determine whether a revised and corrected billing statement filed by the producer should be accepted, and, as an incident of such jurisdiction, to determine the correct rate in effect on June 7, 1954. The Court rejected the commission's contention that the rate actually being paid on June 7, 1954, is controlling for regulatory purposes, and the Court concluded that the contractual rate was the lawfully effective rate. Thus, the rate reflected by the billing determinant filed with the producer's rate schedule or the rate actually received by the producer on June 7, 1954, may not be the producer's initial rate, but such rate is the "correct and effective price" on June 7, 1954, under the terms of the gas sales contract.

¹⁵⁷ *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179 (1950); *Phillips Petroleum Co. v. Oklahoma*, 340 U.S. 190 (1950); *Kansas-Nebraska Natural Gas Co. v. State Corp. Comm'n*, 169 Kan. 722, 222 P.2d 704 (1950).

¹⁵⁸ *Cities Service Gas Co. v. State Corporation Comm'n*, 355 U.S. 391 (1958); *Michigan Wisconsin Pipe Line Co. v. Corporation Comm'n*, 355 U.S. 425 (1958); *Natural Gas Pipeline Co. of America v. Panoma Corp.*, 349 U.S. 44 (1955); *Natural Gas Pipeline Co. of America v. FPC*, 253 F.2d 3 (3rd Cir. 1958).

¹⁵⁹ *Natural Gas Pipeline Co. of America v. FPC*, supra note 158.

that the minimum price orders have become a part of the gas sales contracts and that they are not void *ab initio*, but merely voidable.

When a producer intends to enter into a new sale or service, he is required to file a rate schedule not less than thirty days nor more than ninety days prior to the proposed date of initial deliveries or services, provided that the regulations require him to make certificate and rate filings.¹⁶⁰ The producer's rate filing should state the date upon which the proposed sale or service is to be commenced, and a sample billing must be attached to show the estimated volume deliverable during the first month of service, the method of billing, and the prices charged. If an independent producer transports or sells less than 100,000 Mcf. of natural gas annually in jurisdictional transactions, he may file a statement in lieu of a rate schedule.¹⁶¹

The commission does not require independent producers to compile and file tariffs, as in the case of transmission companies, but the rules and regulations define a producer's rate schedule as ". . . the basic contract and all supplements or agreements amendatory thereof, effective and applicable on and after June 7, 1954 showing the service to be provided and the rates and charges, terms, conditions, classifications, practices, rules, and regulations affecting or relating to such rates or changes, applicable to the transportation . . . or the sale of natural gas"¹⁶² In the event a producer is making a jurisdictional sale or transportation under an oral agreement, the agreement must be reduced to writing and filed with the commission. If the parties are not able to agree on the terms of the oral agreement, the producer files a statement of his understanding of the agreement and serves a copy on the purchaser, and the purchaser may subsequently file his version of the agreement.¹⁶³

Independent producers are denied the right to collect any rate in excess of the June 7, 1954 rate, or, if the rate schedule became effective after such date, the initial rate, unless the producer has complied with the provisions of section 4 of the act. The regulations provide that no change in rates or charges for any jurisdictional sale or service shall be made by an independent producer subsequent to June 7, 1954 without filing a "notice of change" pursuant to section 4(d) of the act not less than thirty days nor more than ninety days prior to the proposed effective date.¹⁶⁴ The regulations define a "change in rate

¹⁶⁰ As previously discussed, the regulations require certain producers to make filings, deny certain producers the right to maintain rate schedules, and grant certain producers an election to comply or to refrain from complying with the regulations.

¹⁶¹ 18 C.F.R. § 154.92 (1958 Supp.).

¹⁶² 18 C.F.R. § 154.93 (1958 Supp.).

¹⁶³ 18 C.F.R. § 154.95 (1958 Supp.).

¹⁶⁴ 18 C.F.R. § 154.94(a)(b) (1958 Supp.).

schedule" as the "operation of any provision of the rate schedule providing for future or periodic changes in rate, charge, classification or service after June 7, 1954 or the operation of any like provision in any initial rate schedule filed after June 7, 1954" ¹⁶⁵ Thus, a price increase, which becomes effective subsequent to June 7, 1954 under the provisions of a contract executed prior to June 7, 1954, is a "change" within the purview of section 4 of the act.

The producer's notice of change must contain the reasons, nature, and basis for the change in rate, the date the change is to become effective, and a comparative statement which shows the financial impact of the new rate upon the purchaser. ¹⁶⁶ Also, the producer must submit a full statement in support of his filing if the change results in an increased rate or charge. ¹⁶⁷ If the producer transports or sells less than 100,000 Mcf. of natural gas annually, subject to the commission's jurisdiction, the producer may file a statement in lieu of the usual notice of change. ¹⁶⁸

When a producer intends to cancel or terminate a rate schedule, in whole or in part, and no new rate schedule is to be filed in its place, the producer must notify the commission of the proposed cancellation or termination at least thirty days prior to the date such action is contemplated. A statement indicating the reasons for the cancellation or termination must be submitted with the notice. ¹⁶⁹

E. Relationship Between The Act And Contractual Rights

Rates and contracts which conflict with the act must yield. ¹⁷⁰ This does not mean the Natural Gas Act sets aside contractual relationships established by the parties; to the contrary, the act contemplates the initial relationship between the parties to be set by contract, with review of the agreement by the commission to protect the public interest. On review the commission may determine the "just and reasonable" rate and establish it as the lawfully effective rate. Similarly, there is authority which states that the commission may modify other contractual provisions which are found to be contrary to the public interest. ¹⁷¹ The commission's rate powers are prospective only;

¹⁶⁵ 18 C.F.R. § 154.94(c) (1958 Supp.).

¹⁶⁶ 18 C.F.R. § 154.94(e) (1958 Supp.).

¹⁶⁷ 18 C.F.R. § 154.94(f) (1958 Supp.).

¹⁶⁸ 18 C.F.R. § 154.94(g) (1958 Supp.).

¹⁶⁹ 18 C.F.R. § 154.97 (1958 Supp.).

¹⁷⁰ *Michigan Consol. Gas Co. v. Panhandle Eastern Pipe Line Co.*, 226 F.2d 60 (6th Cir. 1955); *Mississippi Power & Light Co. v. Memphis Natural Gas Co.*, 162 F.2d 388 (5th Cir. 1947); *Colorado Interstate Gas Co. v. FPC*, 142 F.2d 943 (10th Cir. 1944); *Mississippi River Fuel Corp. v. FPC*, 121 F.2d 159 (8th Cir. 1941).

¹⁷¹ See *Mississippi River Fuel Corp. v. FPC*, 252 F.2d 619 (D.C. Cir. 1957); *Michigan Consol. Gas Co. v. Panhandle Eastern Pipeline Co.*, *supra* note 170.

newly determined rates can only apply in the future.¹⁷² Previously accepted rates may be modified by the commission only after notice, hearing, and the issuance of an order based upon findings of fact and conclusions of law supported by substantial evidence.¹⁷³

*United Gas Pipe Line Co. v. Mobile Gas Service Corp.*¹⁷⁴ is the leading case in this area. The *Mobile* case presented to the court a factual situation in which the transmission company sold gas to a distributing company for resale to an industrial consumer under a contract which provided a specific price.¹⁷⁵ By a section 4(d) filing United attempted to increase the rate charged Mobile to an amount which exceeded the contractual price. Mobile petitioned the commission to reject United's filing, but the commission refused to do so, holding it did not have the authority to suspend an industrial rate. Therefore, the increased rate became effective at the expiration of the thirty-day notice period. Suit was then brought by Mobile for restitution of the excess charges resulting from the rate increase.

When the case reached the Supreme Court, United contended that the act set forth two distinct procedures to effect a rate change, arguing that the commission may find that existing rates are unreasonable and order rate changes after notice and hearing in a section 5 proceeding, or that the natural gas company may effect a unilateral change in rates under the provisions of section 4. If the latter procedure is followed, United contended that the commission's sole concern is the reasonableness of the increased rate. The Supreme Court, however, rejected the pipeline's arguments by holding that section 4(d) of the act does not prescribe circumstances under which a change may be made but merely prohibits a change without proper notice to the commission. Since the act contained references to contracts and did not expressly authorize a unilateral change by either party, the Court

¹⁷² *Cities Service Gas Producing Co. v. FPC*, 233 F.2d 726 (10th Cir. 1956); *State Corp. Comm'n v. FPC*, 215 F.2d 176 (8th Cir. 1954).

¹⁷³ See 15 U.S.C.A. §§ 717c.(e), 717d.(a), 717r.(b) (1948); *Colorado-Wyoming Gas Co. v. FPC*, 324 U.S. 626 (1945); *Michigan Consol. Gas Co. v. Panhandle Eastern Pipeline Co.*, supra note 170; *Mississippi River Fuel Corp. v. FPC*, 202 F.2d 899 (3rd Cir. 1953); *State Corp. Comm'n v. FPC*, 206 F.2d 690 (8th Cir. 1953); *Mississippi River Fuel Corp. v. FPC*, 163 F.2d 433 (D.C. Cir. 1947); *Colorado Interstate Gas Co. v. FPC*, supra note 170.

¹⁷⁴ 350 U.S. 332 (1956). See *Natural Gas Pipeline Co. of America v. FPC*, supra note 158; *Tyler Gas Service Co. v. FPC*, 247 F.2d 590 (D.C. Cir. 1957).

¹⁷⁵ Transmission companies sell natural gas under contracts which prescribe a specific price and standard tariff agreements which set the contractual price at the rate allowed the transmission company by the Federal Power Commission or a state regulatory agency. Transmission companies file for increases in rates under section 4 (d) when existing rates do not provide sufficient revenue to meet increasing expenses. Prior to the *Mobile* case, some transmission companies increased the rates of all customers by such procedure whether the agreement between the parties was a standard tariff agreement or a contract prescribing a specific price.

concluded that the act definitely contemplated certain rates set by private contract. "To find in the section a further purpose to empower natural gas companies to change their contracts unilaterally," the Court said, "requires reading into it language that is neither there nor reasonably to be implied."¹⁷⁶ Thus, the basic scheme of the Natural Gas Act is to permit rates to be determined in the first instance by natural gas companies by contract or otherwise,¹⁷⁷ and a natural gas company must be contractually entitled to the increased rate or its unilateral rate filing must be rejected by the commission. In accord with the *Mobile* case is *Cities Service Gas Co. v. FPC*,¹⁷⁸ in which it is stated that the act "recognizes the right of the parties to set rates by individual contract and abrogates none of the usual contract rights except for the reviewing powers granted the commission upon hearing."¹⁷⁹

Although the Court refused to allow a unilateral change under section 4(d) in the *Mobile* case, it suggested that a party contractually bound at an unreasonably low rate apply to the commission under section 14(a) of the act¹⁸⁰ and request that the commission initiate a section 5(a) investigation. In the event the commission investigates

¹⁷⁶ 350 U.S. at 341. The Court clarified the powers of the commission under sections 4 and 5 as follows:

The powers of the Commission are defined by §§ 4 (e) and 5 (a). The basic power of the Commission is that given it by § 5 (a) to set aside and to modify any rate or contract which it determines, after hearing, to be 'unjust, unreasonable, unduly discriminatory, or preferential.' This is neither a 'rate-making' nor a 'rate changing' procedure. It is simply the power to review rates and contracts made in the first instance by natural gas companies and, if they are determined to be unlawful, to remedy them. Section 5 (a) would of its own force apply to *all* the rates of a natural gas company, whether long established or newly changed, but in the latter case the power is further implemented by § 4 (e). All that § 4 (e) does, however, is to add to this basic power, in the case of a newly changed rate or contract (except 'industrial' rates), the further powers (1) to preserve the status quo pending review of the new rate by suspending its operation for a limited period, and (2) thereafter to make its order retroactive, by means of the refund procedure, to the date the change became effective. The *Mobile* opinion contains strong language regarding the contractual relationship of the parties:

We should bear in mind that it (the Act) evidences no purpose to abrogate private rate contracts as such. To the contrary, by requiring contracts to be filed with the Commission, the Act expressly recognizes that rates to particular customers may be set by individual contracts. . . . The Natural Gas Act permits the relations between the parties to be established by contract, the protection of the public interest being afforded by supervision of the individual contracts, which to that end must be filed with the Commission and made public.

¹⁷⁷ *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, supra note 145; *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956); *Cities Service Gas Co. v. FPC*, 255 F.2d 860 (10th Cir. 1958); *Colorado Interstate Gas Co. v. FPC*, supra note 170.

¹⁷⁸ Supra note 177.

¹⁷⁹ 255 F.2d at 864. See the *Mobile* opinion, 350 U.S. at 343, where the Court states that the "obvious implication is that, except as specifically limited by the Act, the rate making powers of natural gas companies were to be no different from those they would possess in the absence of the Act. . . ."

¹⁸⁰ 15 U.S.C.A. § 717m.(a) (1948).

the natural gas company and finds the depressed price is unjust and unreasonable, the Court held that the commission could permit the company to file a schedule increasing the depressed rate; thus, the commission may allow an increase in rate when such action is required by the public interest. The standard which must be met before a rate increase is authorized under this procedure was stated in *FPC v. Sierra Pacific Power Co.*¹⁸¹ The *Sierra* case, a companion to the *Mobile* case, arose under the Federal Power Act, which contains procedural provisions very similar to those in the Natural Gas Act. The language employed by the Supreme Court in the *Sierra* opinion establishing the standard is as follows:

While it may be that the Commission may not normally *impose* upon a public utility a rate which would produce less than a fair return, it does not follow that the public utility may not itself agree by contract to a rate affording less than a fair return or that, if it does so, it is entitled to be relieved of its improvident bargain. . . . In such circumstances the sole concern of the Commission would seem to be whether the rate is so low as to adversely affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory.¹⁸²

When an increase is provided for by contract (*i.e.*, is bilateral rather than unilateral) the natural gas company must give notice to the commission and the public, and the commission may institute a section 4(e) proceeding against the company to determine the reasonableness of the increased rate. It is generally conceded that the order issued at the conclusion of a section 4(e) proceeding may establish, as the lawfully effective rate, any amount between the previous rate and the new rate but that the commission may not impose upon the natural gas company a rate that is less than the previous rate. However, two commissioners have construed certain language in the *Mobile* case to mean that the commission *could* find that a rate lower than the previous or existing rate is the just and reasonable rate and establish the lesser rate as the lawfully effective rate.¹⁸³

¹⁸¹ 350 U.S. 348 (1956). See *Pacific Gas & Electric Co. v. FPC*, 267 F.2d 165 (D.C. Cir. 1959).

¹⁸² 350 U.S. at 355.

¹⁸³ Commissioners Digby and Steuke dissenting, In the Matter of Union Oil Company of California, 16 F.P.C. 100, 115 (1956):

We believe that the Commission's responsibility under Section 4 of the Natural Gas Act in a rate proceeding such as this is to find and determine a lawful rate and that this lawful rate might be anything not greater than the rate requested in the applicant's filing. The only control over the Commission's authority in determining the lawful rate is the injunction that the rate shall not be greater than that requested by the applicants. We take the position that even the starting price under the contract is

Several producers have contended that the *Mobile* and *Sierra* opinions held that gas sales contracts are indivisible. Under this interpretation, an increase in price provided by a price escalation provision in the initial contract would not constitute a "change" in rates, and the natural gas company would automatically be entitled to the increased rate without complying with the provisions of section 4(d). Commissioners have, at times, supported this interpretation; however, the majority has uniformly held that periodic escalations and other increases constitute a "change" in rate within the purview of section 4(d) and are subject to suspension under section 4(e) although such increases are provided by the basic contract of sale.¹⁸⁴ This question was presented in *Episcopal Theological Seminary of the Southwest v. FPC*.¹⁸⁵ The court held that the contractual provisions cannot modify the regulatory provisions of the Act and an increase in price under an escalation clause is a change in rate within the purview of section 4(d). The opinion states:

To approve escalation clauses in long term contracts when the contracts were originally filed, would determine rates for indefinite future periods. Fair adjustments of escalation-clause rates to future costs and earnings would be impossible at that time. Public utility rates cannot be fixed solely by bargaining between producers and distributors. The governmental agency also has the duty to protect the consumer.¹⁸⁶

The courts have held that periodic escalations, favored nation increases, and increases resulting from amendatory agreements are rate "changes" which require notice to the commission before they may become effective.¹⁸⁷ Furthermore, when a producer enters into a completely new gas sales contract upon the expiration of the initial con-

not controlling as a minimum lawful rate.

This dissenting opinion should be considered with the following language in the *Mobile* case:

It [a rate proposed by a natural gas company] is thus no more a "proposed" rate than any other rate, all of which are equally subject to Commission review. Likewise, no "proceeding" is initiated by a § 4 (d) filing. A proceeding to review the new rate may be initiated under § 4 (e), but, if so, it is initiated by the Commission in the same manner as a proceeding under § 5 (a) to review any other rate, that is, upon complaint or its own motion. The only difference is the interim suspension power given by § 4 (e), but that in no way affects the character of the proceeding, which remains, like a § 5 (a) proceeding, simply a review by the Commission of a rate established by the natural gas company. [350 U.S. at 342-43.]

¹⁸⁴ *In the Matter of Forest Oil Corp.*, 17 F.P.C. 586 (1957); *In the Matter of Humble Oil & Ref. Co.*, 17 F.P.C. 39 (1957); *In the Matter of Crow Drilling Co.*, 17 F.P.C. 226 (1956); *In the Matter of Sun Oil Co.*, 17 F.P.C. 174 (1956); *In the Matter of Union Oil Co.* 16 F.P.C. 100 (1956).

¹⁸⁵ 269 F.2d 228 (D.C. Cir. 1959).

¹⁸⁶ *Id.* at 233-34.

¹⁸⁷ *Bel Oil Corp. v. FPC*, 255 F.2d 548 (5th Cir. 1958); *Gulf Oil Corp. v. FPC*, 255 F.2d 556 (5th Cir. 1958); *Cities Service Gas Producing Co. v. FPC*, supra note 172; *Mississippi Power & Light Co. v. Memphis Natural Gas Co.*, supra note 170; *Mississippi River*

tract, the second contract is a "change in rate schedule," and it does not prescribe a separate and distinct "sale" of natural gas. Consequently, the price provided by the new contract is not an initial rate, and the increase in rate is subject to suspension.¹⁸⁸

After the *Mobile* decision the commission concluded that increases invoked under a standard tariff agreement are not unilateral increases and that *ex parte* filings pursuant to section 4(d) of the act are not subject to attack as being contrary to the *Mobile* doctrine.¹⁸⁹ The validity of the commission's ruling was questioned in *Memphis Light, Gas & Water Div. v. FPC*,¹⁹⁰ and the United States Court of Appeals for the District of Columbia Circuit set aside an order of the commission which, in effect, held that such changes are bilateral.¹⁹¹

The Supreme Court reversed the court of appeals in *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*¹⁹² The Court reviewed the provisions of section 4 and concluded that it contains nothing which implies that the parties must agree to a specific price before a filing may be made under section 4(d). The Court reviewed the *Mobile* case and distinguished it, deciding that United was free, under the tariff agreement, to change its rates from time to time, subject to the procedures and limitations of the act. Further, the opinion states:

Mobile makes it plain that § 4 (d) on its face indicates no more than that *otherwise valid* changes cannot be put into effect without giving the required notice to the Commission The necessary corollary of this proposition is that changes which in fact are 'otherwise valid' in the light of the relationship between the parties can be put into effect under § 4 (d) by a seller through giving the required notice to the Commission. *Mobile* expressly notes that in the absence of any contractual relationship rates determined *ex parte* by the seller may be filed under § 4 (d). 350 U.S., at 343. We perceive no tenable basis of distinction between the filing of such a rate in the absence of contract and a similar filing under an agreement which explicitly permits it.¹⁹³

Fuel Corp. v. FPC, supra note 170.

¹⁸⁸ Sun Oil Co. v. FPC, 266 F.2d 222 (5th Cir. 1959).

¹⁸⁹ In the Matter of United Gas Pipeline Co., 16 F.P.C. 10, 6 Oil & Gas Rep. 758 (1956); In the Matter of United Gas Pipeline Co., 16 F.P.C. 19 (1956).

¹⁹⁰ 250 F.2d 402 (D.C. Cir. 1957).

¹⁹¹ The basic question presented to the court was whether a tariff agreement provides the consent required by the *Mobile* case. The court distinguished between a consent to a rate filing and consent to a specific rate and held that the tariff agreement constituted the purchaser's consent to the filing but not that particular rate. The *Mobile* case was construed to mean that the parties to the contract must agree to a specific price; therefore, this decision required the commission to reject any rate filing which is not in accordance with the agreement of the parties or which sets forth a rate that is not specifically provided by the agreement.

¹⁹² 358 U.S. 103 (1958). See Nevada Natural Gas Pipe Line Co. v. FPC, 267 F.2d 405 (5th Cir. 1959).

¹⁹³ 358 U.S. at 112-13.

Dicta in the Supreme Court's *CATCO* decision¹⁹⁴ follows the above quoted language. The *CATCO* case involved independent producers, not pipelines. The opinion states that the producer ". . . although to this extent a captive subject to the jurisdiction of the Commission, is not without remedy to protect himself. He may, unless otherwise bound by contract . . . file new rate schedules with the Commission."¹⁹⁵ Therefore, it may be assumed that the court has endorsed *ex parte* filings by independent producers. A producer may apparently file *ex parte* under section 4(d) to increase a rate to any level within the realm of reason when the producer is not contractually obligated to accept a lower rate and the filing does not abrogate an enforceable agreement.

F. Method Of Rate Regulation

1. The Rate Base Method

Although several successful methods have been developed to establish and evaluate public utility rates, the "rate base method" is the traditional method and judicial means used to determine and test a "just and reasonable" rate as required by the Natural Gas Act. The rate base method was first applied to the natural gas industry in *Newark Natural Gas & Fuel Co. v. City of Newark*.¹⁹⁶

Basically the rate base method seeks to permit the natural gas company to receive from its customers sufficient funds to meet its expenses and to allow a moderate return upon the investment employed to serve the public. The rate base is a figure representing the money invested in equipment and properties necessary or useful for fulfillment of the service requirements of the utility plus an allowance for working capital. To determine the return allowed the natural gas company, the rate of return (a percentage) is multiplied by the rate base. All expenditures that are necessary and proper to supply the required services or goods, including taxes and depreciation, are allowable expenses. The amount of revenue which the natural gas company is entitled to receive is determined by adding the return and all allowable expenses. The goods furnished or services rendered are then charged proportionately to realize the necessary revenue.

When a natural gas company is engaged in several types of business, only a part of which is subject to the jurisdiction of the commission, some separation of property, capital, expenses, and revenue is essential to confine the federal regulation to the jurisdictional func-

¹⁹⁴ *Atlantic Ref. Co. v. Public Service Comm'n*, 360 U.S. 378 (1959).

¹⁹⁵ *Id.* at 385.

¹⁹⁶ 242 U.S. 405 (1917). Several cases, none of which pertained to natural gas or a similar irreplaceable commodity, were cited to support this decision.

tions of the company. The commission must segregate the jurisdictional from the non-jurisdictional business or employ a suitable allocation formula adapted to the particular circumstances. The commission is given much discretion in the selection of the allocation formula since it is exercising a legislative function. When the commission uses a particular allocation formula, the courts are not warranted in rejecting the formula which the commission employs unless it plainly contravenes the statutory scheme of regulation.¹⁹⁷

Some authorities advocate the fluctuation of the rate of return with the demand for capital.¹⁹⁸ The use of this "cost of capital" approach may be appropriate when considering a business which is financed by the sale of stock and long term bonds; but the average independent producer primarily depends upon the reinvestment of its earnings, the sale of oil payments, and occasionally the sale of producing properties to finance expenses which would normally be considered capital expenditures, e.g., the acquisition of property and the maintenance of an active exploratory program. Therefore, it is submitted that the cost of capital approach should not be employed to establish the producers' rate of return due to the lack of debt or equity financing. The criterion announced in *Bluefield Waterworks & Improvement Co. v. Public Service Commission*¹⁹⁹ and set forth below is believed by the writer to be the correct one.

What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable

¹⁹⁷ See *Colorado-Wyoming Gas. Co. v. FPC*, supra note 173; *Panhandle Eastern Pipe Line Co. v. FPC*, 324 U.S. 635 (1945); *State Corp. Comm'n v. FPC*, supra note 173; *Alabama-Tennessee Natural Gas Co. v. FPC*, 203 F.2d 494 (3rd Cir. 1953); *Mississippi River Fuel Corp. v. FPC*, 163 F.2d 433 (D.C. Cir. 1947); *Cities Service Gas Co. v. FPC*, 155 F.2d 694 (10th Cir. 1946); *Colorado Interstate Gas Co. v. FPC*, supra note 170.

¹⁹⁸ See, e.g., Morton, *Rate of Return and the Value of Money in Public Utilities*, 28 *Land Econ.* 91 (1952).

¹⁹⁹ 262 U.S. 679 (1923). See *Willcox v. Consolidated Gas Co.*, 212 U.S. 19 (1909); *Knoxville v. Knoxville Water Co.*, 212 U.S. 1 (1908); *In the Matter of Natural Gas Pipe Line Co.*, 2 F.P.C. 218 (1940).

it to raise the money necessary for the proper discharge of its public duties.²⁰⁰

The *Bluefield* approach presupposes that the risks are not highly speculative and the business is non-competitive. The gas producing business is both speculative and competitive. The *Bluefield* rationale, however, would permit the regulated independent producer to receive a return comparable to the profit received by a similar, successful, non-regulated producing company, thus taking into account the risks inherent in the producing industry. Should the commission fail to make appropriate allowances for such risks, sufficient revenue will not be generated to maintain active and effective exploratory programs, and the inevitable result will be the discovery and development of insufficient reserves to supply the growing domestic, commercial, and industrial markets of this country.

2. *Transportation Rate Cases*

Nineteen years prior to the *Newark Natural Gas & Fuel Co. v. City of Newark* decision²⁰¹ the doctrine of *Smyth v. Ames*²⁰² had been stated. *Smyth v. Ames* held that a utility is entitled to a return upon the "fair value" of that which it employs for the public convenience. Thus, the rate base would constitute a figure representing the present value of the property necessary and useful to perform the required service to the public.

The first decision to upset the "fair value" determination of *Smyth v. Ames* substantially arose under the Natural Gas Act. In *FPC v. Natural Gas Pipe Line Co.*,²⁰³ the commission's staff computed the rate base on the basis of reproduction cost, but the depreciation base was computed at actual cost plus estimated future capital additions. The staff's evidence resulted in a finding that the existing rates of the company were unjust, unreasonable, and excessive. The United States Court of Appeals vacated the commission's order, but the Supreme Court reversed the court of appeals and upheld the commission. The Supreme Court's majority opinion held that there is a "zone of reasonableness" within which the commission is free to act and that the commission was authorized by section 5 (a) of the act to decrease any rate which was not the lowest reasonable rate. The majority further stated that the courts are without authority to set aside as too low any reasonable rate adopted by the commission which is consistent with constitutional requirements. The constitutional requirements

²⁰⁰ 262 U.S. at 692.

²⁰¹ *Supra* note 196.

²⁰² 169 U.S. 466 (1898).

²⁰³ 315 U.S. 575 (1942).

were said to coincide with the statutory requirements. The majority opinion concluded: "The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances."²⁰⁴ Although the majority opinion did not expressly overrule *Smyth v. Ames*, the previous doctrine of rate-making was effectively repudiated. The minority opinion of Justices Black, Douglas, and Murphy²⁰⁵ went further and advocated the abolition of the "fair value" determination of *Smyth v. Ames*.

Confident of its position because of the language used by the Court in the *Natural Gas Pipeline Co.* opinions, the commission subsequently ascertained the rate base upon the basis of actual cost. The validity of this policy was tested in *FPC v. Hope Natural Gas Co.*²⁰⁶ Hope Natural Gas Company, a West Virginia corporation, produced and purchased natural gas in West Virginia and sold gas to West Virginia customers, but the bulk of Hope's sales were to three affiliate and two non-affiliate distributing companies in Ohio and Pennsylvania. Several cases involving the reasonableness of Hope's rates were consolidated for hearing. In the preparation of its case the commission's staff computed the rate base, depletion, and depreciation upon the basis of actual legitimate cost; Hope advocated the use of reproduction cost or trended original cost. The commission approved the staff's method. The eight per cent rate of return proposed by the company was found to be unreasonable, and six and one-half per cent was declared to be a fair rate of return. The six and one-half per cent rate of return applied to the rate base, computed upon actual legitimate cost, produced a return of \$2,191,314 annually, which was less than one-half of the company's annual earnings of approximately \$5,801,171. The commission ordered a reduction in rates consistent with its findings, and the company appealed.

The United States Court of Appeals set aside the commission's order primarily upon the theory that the rate base should have been computed on the basis of present fair value rather than actual

²⁰⁴ *Id.* at 586. The Court also upheld the commission's computation of the amortization base on the basis of actual cost, stating that it was an expense item and that any allowance in excess of cost would constitute an additional profit over and above a fair return.

²⁰⁵ The minority interpreted the decision of the majority to mean that the "Commission may now adopt, if it chooses, prudent investment [determining reasonable rates in comparison with the cost of rendering the required service under prudent management] as a rate base" and "there could be no constitutional objection if the Commission adhered to that formula and rejected all others." 315 U.S. at 606.

²⁰⁶ 320 U.S. 591 (1944).

legitimate cost. The Supreme Court, however, reversed the court of appeals and sustained the commission's order. The Supreme Court's opinion states:

The Commission was not bound to the use of any single formula or combination of formulas in determining rates. Its rate-making function, moreover, involves the making of '*pragmatic adjustments*'. . . . When the Commission's order is challenged in the courts, the question is whether the order 'viewed in its entirety' meets the requirements of the Act. . . . Under the statutory standard of 'just and reasonable' it is the *result* reached not the method employed which is controlling. . . . If the *total effect* of the rate order can not be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. . . . It [the order] is the product of expert judgment which carries a presumption of validity. And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid. . . .²⁰⁷ (Emphasis added.)

Further, the Court held that the function of the rate-making process is to balance the investor and consumer interests. Thus, there must be sufficient revenue for capital costs as well as operating expenses. These capital costs include interest on the debt and dividends to stockholders commensurate with those paid shareholders in enterprises having corresponding risks. The return should be sufficient to assure confidence in the financial integrity of the enterprise, thereby permitting the company to maintain its credit and attract capital. Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks may be just and reasonable even though such rates produce only a meager return on the fair value of the property dedicated to the public service.

Since the *Hope* case fair value is no longer deemed an essential ingredient of an economic rate base; fair value is the end product and not the means of the rate-making process.²⁰⁸ The commission is given much discretion in the selection of the method used to test and fix rates so long as the overall end result is fair, just, and equitable to all parties. Thus rate-making was transformed into price-fixing whereby the regulatory agency determines rates by considering all economic factors and makes "pragmatic adjustments" to reach a reasonable result. Therefore, the commission may consider the unique features of each case and make adjustments without complying with any accepted standard to normalize the result, which, of course, could constitute arbitrary action.

²⁰⁷ Id. at 602.

²⁰⁸ *Cities Service Gas Co. v. FPC*, supra note 197, at 701.

The Supreme Court reaffirmed its position in *Colorado Interstate Gas Co. v. FPC*,²⁰⁹ for the Court held that rate-making is essentially a legislative function, and, when Congress fails to provide a formula for the commission to follow, the courts are not warranted in rejecting the formula adopted by the commission unless it plainly contravenes the statutory scheme of regulation. The Court upheld the commission's use of the rate base method and, of more importance, refused to deny the commission the authority to depart from the rate base method.

Since the *Hope* case, the commission has consistently employed the rate base method and computed the rate base at cost.²¹⁰ On the authority of the *Hope*, *Natural Gas Pipeline Co.*, and *Colorado Interstate* cases, however, it is assumed that the commission may use a method other than the rate base method even though the other method would produce a higher rate.

The decisions unanimously reflect that the problems of rate-making are to be decided by the administrative experts, not the courts, and one Supreme Court decision questions the ability of inferior courts to consider the questions involved.²¹¹ The decisions rendered to date permit the commission to use original cost, prudent investment, fair value, reproduction cost, reasonable value, book value, or any combination of methods in establishing the rate base and in making other valuations which must necessarily be made when the rate base method is used.

3. *Natural Gas Rate Cases—Field Sales*

a. *Pipeline Cases.*—In the *Hope* case the company's investment in producing properties was included in the rate base for a reasonable return in accordance with the traditional method. Since *Hope's* argument rested upon the use of reproduction or trended original cost as the method of ascertaining the rate base, there was no objection to the inclusion of this class of property in the rate base. Mr. Justice Jackson's opinion, however, emphasized the fact that *Hope* was engaged in two divergent types of business. According to this opinion, the rate base method would be reasonably satisfactory for the transportation phase of *Hope's* business, but improper for the production phase since the price of gas, when captured, bears little relation to

²⁰⁹ 324 U.S. 581 (1945).

²¹⁰ The commission on one occasion abandoned the rate base method, but was reversed by the circuit court. *City of Detroit v. FPC*, 230 F.2d 810 (D.C. Cir. 1955). Even this decision, however, contains language which indicates that the commission may employ other methods.

²¹¹ *FPC v. Colorado Interstate Gas Co.*, 348 U.S. 492 (1955).

the cost of tools, supplies, and labor required to develop the reserves.²¹²

The question of whether the commission should allow a transmission company the fair field value of gas produced by its wells as an operating expense or whether the pipeline's investment in producing properties should be included in the rate base for the traditional return was first presented to the Supreme Court in *Colorado Interstate Gas Co. v. FPC*.²¹³ The Court upheld the commission's use of the rate base method to establish the pipeline's allowance for gas produced by the pipeline and transported in its own system. The Court concluded that the production and gathering exemption of section 1 (b) of the act did not prevent the commission from including the company's investment in production facilities in the rate base for the traditional return and that the end result was just and reasonable.²¹⁴ Thus transmission companies, which are also in the production business, were denied the right to receive, as an expense item, an amount commensurate to the commodity value of its production or the average price received by independent producers in the field; only a moderate return was allowed despite the risks incident to the production business.

The dissenting opinion of Justices Roberts, Reed, Frankfurter and Chief Justice Stone states that the commission should not be permitted to integrate producing properties in the rate base or apply the standards of valuation applicable to the transportation business. This opinion relies upon the legislative history of the act and the clarity of section 1 (b). Mr. Justice Jackson's opinion reaffirmed his previous position in the *Hope* case. The record disclosed that five leases consisting of approximately 47,000 acres were included in the rate base at \$4,244.24, and three leases were included at zero. Thus, property which had an estimated market value of over three million dollars was allowed an annual return of less than three hundred dollars. This, Mr. Justice Jackson said, was a "fantastic" method of establishing a just and reasonable price for natural gas.²¹⁵

After regulating the price of natural gas produced by pipelines for many years in accordance with the method approved by the *Colorado Interstate* case, the commission reversed its policy in *In the Matter of Panhandle Eastern Pipe Line Co.*²¹⁶ The producing properties of the pipeline were excluded from the rate base, and the transmission com-

²¹² 320 U.S. at 628-60.

²¹³ 324 U.S. 581 (1945).

²¹⁴ See pp. 431-32 *supra*.

²¹⁵ 324 U.S. at 610-11.

²¹⁶ Op. No. 269, Docket No. G-1116, issued April 15, 1954. This case was never officially reported.

pany was allowed the weighted average field price for gas which it produced as an operating expense. In reaching its decision the commission reviewed prior Supreme Court decisions and concluded that it was free to adopt a method other than the rate base method. The commission found that this change was necessary for the following reasons: (1) the use of the rate base method resulted in an arbitrarily depressed price which accelerated consumption and failed to encourage the necessary discovery and development; and (2) it is in the public interest that transmission companies remain in the business of producing natural gas, and during the period the rate base method had been employed production by these companies had declined considerably.

The *Panhandle Eastern* case was styled *City of Detroit v. FPC*²¹⁷ on review. The *City of Detroit* opinion states that section 5(a) does not mean that rates which are not the lowest reasonable rates cannot also be just and reasonable and that section 5(a) "permits but does not compel the Commission to go to the very limit of constitutional power."²¹⁸ The court conceded that the commission had the power to depart from the traditional rate base method, but explained that the principal purpose of the act was to protect consumers against exploitation at the hands of natural gas companies. Admitting the relevance of the two factors emphasized by the commission and recognizing their importance, the court held that the proceedings did not show the resulting increase in rates was no greater than reasonably necessary for the purposes advanced. The opinion further states:

If the Commission contemplates increasing rates . . . it must see to it that the increase is in fact needed, and is no more than is needed. . . . It is essential in such a case as this that it (the rate base method) be used as a basis of comparison. . . . Unless it is continued to be used at least as a point of departure, the whole experience under the Act is discarded. . . .²¹⁹

Even though the commission finds that a natural gas company needs additional revenue as an incentive to explore for and produce natural gas, this case requires the commission to test the increased rate by the rate base method, as well as the other method adopted by the commission, to be sure that the rate allowed is no more than necessary to provide such incentive. As a result of the *City of Detroit* case the commission has taken the position that producers must use the rate base method to prove the reasonableness of their rates unless there is

²¹⁷ *Supra* note 210.

²¹⁸ *Id.* at 815.

²¹⁹ *Id.* at 818-19.

a showing that unusual circumstances prevent the use of such method or serious complications will arise if such method is employed.

Prior to *Interstate Natural Gas Co. v. FPC*,²²⁰ the unregulated field price received by a regulated pipeline company from the sale of its production to another pipeline was not subject to the commission's regulation, and funds received from such sales were non-jurisdictional income provided they were at arm's length. This was true even if the purchaser was a regulated interstate pipeline and the production was transported or sold in interstate commerce for resale by the purchasing pipeline. Independent producers also established their prices by contracts which were not subject to review by the commission prior to the *Phillips* case. However, where a producer or pipeline sold gas to an affiliated company and the purchaser transported or sold such gas in interstate commerce for resale, the commission could pierce the corporate veil and regulate the inter-affiliate sale. The transaction did not necessarily have to be between a parent corporation and a wholly owned subsidiary because the commission could question the contractual price and require a company under investigation to submit evidence to support the contractual price so long as the transaction was not at "arm's length."²²¹ The definition of an "arm's length" transaction for Federal Power Commission purposes is yet to be determined.

The *Interstate* case and the *Phillips* case extended federal regulation to field sales by pipelines and independent producers. This does not mean, however, that the question of arm's length bargaining has become moot. An allowance claimed by a pipeline, gatherer, plant operator, or producer for purchased gas which is resold in interstate commerce is not infrequently questioned. If the sale is between affiliates or not at arm's length, the commission may refuse to allow the natural gas company the cost of purchased gas unless the company presents evidence to support the reasonableness of the price which it in fact paid and the seller received. One case held that a producing company which is wholly owned by a regulated pipeline company stands in the same position as an integrated producing arm or department of the pipeline company, and the court required the pipeline to substantiate prices charged by the affiliate with the type of evidence required by the *Colorado Interstate* and *City of Detroit* cases.²²² Therefore, when the commission finds that the sale is not at

²²⁰ 331 U.S. 682 (1947).

²²¹ See Newcomb, *Effects of Federal Regulation Under the Natural Gas Act Upon the Production and Gathering of Natural Gas*, 14 Geo. Wash. L. Rev. 217, 224 (1956).

²²² *Mississippi River Fuel Corp. v. FPC*, 252 F.2d 619 (D.C. Cir. 1957).

arm's length and the commission has not previously established the seller's rate at a just and reasonable level, the commission may require the purchaser to justify the purchased gas expense by proving the reasonableness of the seller's rates by the rate base method. Since the commission would not have the authority to change the seller's rates, the sole question in such a proceeding would be the determination of the amount the purchaser is entitled to receive as an expense. In the event that the purchaser does not dominate the seller to the extent that he could force him to adjust the price and if there is no common ownership, the question would be whether the disallowance of the full contractual price would constitute confiscation of the purchaser's property.²²³

b. *Independent Producer Cases.*—The commission has disposed of several independent producer cases instituted under sections 4(e) and 5(a). However, a final decision by the commission has not been issued in any case of consequence dealing with the principal problems of producer rate regulation or prescribing the evidence required to prove the justness and reasonableness of field prices. The Phillips investigation was dismissed in 1951, but it was reconvened in 1954 after the issuance of the Supreme Court's *Phillips* decision; the examiner has rendered his decision and this matter is presently before the commission.

The opinions rendered by the commission in producer cases have shed little light upon what is expected of a producer who must prove that existing or increased rates are just and reasonable. However, the commission has stated that producer rate cases will proceed on an *ad hoc* basis, and the decisions indicate that producers will be required, except in certain undefined situations, to use the rate base method to prove the reasonableness of existing and increased rates. This position has been forced upon the commission by the judicial decisions as a result of the Supreme Court's failure to make any distinction between an independent producer and an integrated interstate transmission company. On several occasions the commission has protested the use of the traditional rate base method to fix the field price of natural gas produced by independent producers and transmission companies, but the decisions have required the commission to control field prices by the rate base method.

The burden rests upon the producer in a section 4(e) proceeding to prove the reasonableness of an increased rate. When the producer's evidence does not support the reasonableness of the increased rate

²²³ For a recent decision presenting this problem, see *In the Matter of H. L. Hunt*, 19 F.P.C. 748 (1958).

and the commission is unable to determine the reasonable rate from the evidence presented, the producer has not presented a prima facie case, and the rate increase must be disallowed.²²⁴ The commission has construed the Act to mean that the producer's evidence must be "clear and convincing" or "affirmative, concrete and persuasive."²²⁵

The usual procedure followed in early section 4(e) cases was for the staff or an intervenor to make a motion to dismiss after the presentation of the producer's evidence and cross examination by the staff. Most producer cases which have been concluded were dismissed at this stage of the proceeding after a ruling by the examiner to the effect that the producer did not present a prima facie case.²²⁶ When ruling upon a motion to dismiss, the commission has held that the examiner must determine every presumption and inference reasonably to be drawn from the evidence in favor of the producer.²²⁷ If the producer presents a prima facie case, one case indicates that the commission's staff should present a rebuttal case; however, it does not hold that the producer is entitled to the increased rate if the staff fails to make out its case.²²⁸

*In the Matter of Union Oil Co.*²²⁹ illustrates the type of evidence presented by independent producers in early section 4(e) cases. The second opinion rendered in the *Union Oil* case contains the basic policy of the commission governing independent producer cases. At the initial hearing Union Oil presented evidence showing that the increased rates were the result of arm's length bargaining and such rates were comparable to field prices existing in the area. Evidence was introduced to prove the increased price of 17¢ per Mcf. reflected the commodity value of Union Oil's production. Other evidence showed that the purchasing pipeline company could sell such gas to its customers at a price which would compete favorably with coal and fuel oil purchased for space heating and similar uses. Further, Union Oil presented evidence to prove that it granted additional consideration to the purchaser, as the dedication of additional reserves, to obtain the increased price. Although the commission held that Union Oil's evidence did not establish the reasonableness of the increased

²²⁴ See *Mississippi Power & Light Co. v. Memphis Natural Gas Co.*, 162 F.2d 388 (5th Cir. 1947); *Mississippi River Fuel Corp. v. FPC*, 121 F.2d 159 (8th Cir. 1941); *In the Matter of H. F. Sears*, 18 F.P.C. 244 (1957); *In the Matter of Crow Drilling Co.*, 17 F.P.C. 226 (1956); *In the Matter of Union Oil Co.*, 16 F.P.C. 100 (1956).

²²⁵ See *In the Matter of Union Oil Co.*, supra note 224; *In the Matter of Transcontinental Gas Pipe Line Corp.*, 11 F.P.C. 94 (1952).

²²⁶ See authorities cited note 231 infra.

²²⁷ *In the Matter of United Carbon Co.*, 19 F.P.C. 242 (1958); *In the Matter of Union Oil Co.*, supra note 224.

²²⁸ *In the Matter of United Carbon Co.*, supra note 227.

²²⁹ 16 F.P.C. 100, 17 F.P.C. 89, 17 F.P.C. 256 (1956).

rates, the proceeding was not terminated, and the producer was given another opportunity to present additional evidence.²³⁰ At the second hearing Union Oil continued its policy argument, contending that the evidence presented at the first hearing was sufficient to prove the reasonableness of the increased rates and that the public interest required the acceptance of field price evidence rather than cost of service evidence.

The decision issued at the conclusion of the second hearing established the pattern which was followed in succeeding producer cases. Briefly stated, the *Union Oil* case ruled that the Natural Gas Act does not permit the commission to approve increased rates when only evidence of arm's length bargaining, field prices, and commodity or market value is introduced and there is no cost evidence presented which shows the increased rates are no higher than necessary to maintain the financial integrity of the producer and encourage exploration.

The decisions rendered to date indicate quite clearly that proof of arm's length bargaining and evidence showing that the increased rate is in line with prevailing field prices is insufficient to sustain the burden of proof in the usual producer rate case.²³¹ Moreover, additional proof of workable competition in the field will not remove a case from the above rule.²³²

*In the Matter of United Carbon Co. & Columbian Fuel Corp.*²³³ involved an increase from 22.5¢ to 26¢ per Mcf. for gas produced from various fields in Kentucky. The increase, which resulted from price redeterminations, amounted to approximately \$200,000 annually for each of the two producers. The producers' direct case did not include traditional rate base evidence, but cost studies were introduced which reflected the estimated total cash expenditures necessary to maintain deliveries and gas reserves during a period of five years following the effective date of the price redetermination. United Carbon's cost of service ranged from 24.53¢ per Mcf. in 1956 to an estimated cost of service in 1960 of 26.58¢ per Mcf. Columbian Fuel's studies estimated the cost of service at 23.91¢ per Mcf. to 26.03¢ per Mcf. during the same period. The examiner held that the producers' evidence fell short of the standard required by the *City of Detroit* decision and recommended dismissal pursuant to the staff's motion.

²³⁰ The case was not dismissed because it was one of the first producer rate cases.

²³¹ *In the Matter of Sun Oil Co.*, 19 F.P.C. 973 (1958); *In the Matter of H. L. Hunt*, supra note 223; *In the Matter of Delhi-Taylor Oil Co.*, 18 F.P.C. 375 (1957); *In the Matter of Forest Oil Corp.*, 17 F.P.C. 586 (1957); *In the Matter of H. F. Sears*, supra note 224; *In the Matter of Crow Drilling Co.*, supra note 224; *In the Matter of Crow Drilling Co.*, supra note 224; *In the Matter of Sun Oil Co.*, 17 F.P.C. 174 (1956).

²³² *In the Matter of Associated Oil & Gas Co.*, 17 F.P.C. 199 (1956).

²³³ 19 F.P.C. 242 (1958).

On review, the commission reversed the examiner's decision and remanded the proceeding to the examiner for the submission of additional evidence. With respect to that part of the examiner's decision which held the producers' cost evidence was inadequate to discharge the burden of proof required by the *City of Detroit* case, the commission stated:

We believe that, under the present uncertain and peculiar situation created by applicable court decisions, together with the obvious difficulty of fixing just and reasonable rates for producers by allowing a rate of return on a rate base, the applicants here have introduced sufficient evidence of a persuasive nature to warrant our permitting this case to proceed. The evidence above mentioned in this case distinguishes it from the other producers' rate cases which we have dismissed.²³⁴

The commission ordered the case remanded to the examiner to give the parties an opportunity to present additional evidence or to demonstrate why the rate base approach was not necessary, practical, or appropriate in that particular case.

An exception to the *Union Oil* case was formulated and presented in the *West Edmond* case.²³⁵ Within the West Edmond Field there is a unitized area consisting of 133 leases which are owned by eleven producers. The 133 leases cover 754 tracts of land, and each tract has a different percentage of participation in unitized substances. The commission recognized that the rate base method would result in 133 widely varying prices for gas produced from the same field and would require a study of the entire operations of each company, although all of the companies' rates were not under review. The commission concluded, therefore, that such an undertaking was not feasible.

The commission stated that it was not disapproving the use of the rate base method, which it said "must under the *City of Detroit* decision continue in a proper case to attempt to apply."²³⁶ But the commission allowed the producers the increased rates on the basis of evidence similar to that presented in the *Union Oil* case and a token showing of costs, without requiring the presentation of traditional rate base evidence. The commission concluded that:

It [the facts of the instant case] demonstrates clearly the inappropriateness of utilizing the rate base formula in fixing producer rates and that use of such a formula produces incongruous results and in the long run

²³⁴ Id. at 244.

²³⁵ In the Matter of Pan Am. Petroleum Corp., 19 F.P.C. 463 (1958).

²³⁶ Id. at 469.

is detrimental to the interest of the consumers who need supplies of natural gas on a long term basis.²³⁷

It is not clear at this date what factual situations will come within the *West Edmond* exception to the *Union Oil* rule. In the *Matter of Continental Oil Co.*²³⁸ arose as a result of a rate increase in the Woodlawn Field, Harrison County, Texas. The Woodlawn Field is not operated under a field-wide unitization agreement, but there are numerous jointly owned production units comprising approximately 640 acres each. The producers entered into agreements with a third party for the gathering and processing of their production and the delivery of residue gas to two interstate transmission companies at the tail gate of the plant. The producers entered into gas purchase contracts with the transmission companies, and all of the contracts, including the processing agreements, were apparently the result of arm's length bargaining.

In the *Continental* case the commission refused to apply the principles announced in the *West Edmond* opinion on several grounds; viz., (1) that the record disclosed facts and circumstances differing from those of the *West Edmond* case; (2) that general cost evidence was presented in the *West Edmond* case and such evidence was completely lacking in the *Continental* case; and (3) that the commission had not allowed other producers in the general area of the Woodlawn Field rates higher than the increased rate.²³⁹ Thus the commission followed the *Union Oil* case and required the producers to introduce cost evidence to support the increased rate. Commissioners Digby and Kline dissented, stating that they were unable to distinguish between the two cases. The District of Columbia Circuit Court affirmed the commission's order dismissing the proceeding for failure to present cost evidence.²⁴⁰ The court did not discuss the relevance of the *West Edmond* case, however.

The *Union Oil* case, styled *Bel Oil Corp. v. FPC*²⁴¹ upon review, was reviewed by the United States Court of Appeals for the Fifth Circuit shortly after the release of the *West Edmond* opinion. The *Bel Oil* case affirmed the commission's *Union Oil* decision and held that field price or commodity value evidence was relevant to a pro-

²³⁷ Id. at 466.

²³⁸ 19 F.P.C. 519, 19 F.P.C. 917 (1958). See also *In the Matter of Sun Oil Co.*, supra note 231.

²³⁹ The commission had allowed other producers in the area of the *West Edmond* field rates higher than the increased rate.

²⁴⁰ *Episcopal Theological Seminary of the Southwest v. FPC*, 269 F.2d 228 (D.C. Cir. 1959).

²⁴¹ 255 F.2d 548 (5th Cir. 1958). See *Associated Oil & Gas Co. v. FPC*, 255 F.2d 555 (5th Cir. 1958).

ducer rate proceeding, but such evidence alone is "not sufficient to warrant a finding by the commission that a price comparable to them is just and reasonable within the intentment of the Natural Gas Act."²⁴² The court further held that additional testimony by expert witnesses, which is introduced to prove the increased price is needed to provide incentive for exploration and development, would not suffice. The *Bel Oil* opinion did not define the facts which bring a case within the exception created by *West Edmond*.²⁴³

Gulf Oil Corp. v. FPC,²⁴⁴ a companion to the *Bel Oil* case, considered the producers' contention that the use of the rate base method was too difficult and hence was not feasible. The *West Edmond* case was cited by the producers to support the use of field price evidence. The court stated that the commission has "much latitude" in its selection of the applicable criteria and that the commission must initially decide what factors are necessary for a case to come within the *West Edmond* rule; it was unwilling to extend the application of the *West Edmond* decision. Subsequently, in *Forest Oil Corp. v. FPC*,²⁴⁵ the Fifth Circuit clarified its holding in the *Gulf* case in the following language:

What we intended there [*Gulf* case] to make clear, and what we now say, is: If the Commission finds that a rate is reasonable to the consuming public it need not reject such rate as not being just and reasonable merely because it will yield to a particular producer more than the very minimum required by constitutional standards or more by way of net yield than is returned to another producer in the same well or field, especially if such result follows from a considered decision by the Commission that a uniform price for all the producers of a single well or a single field is not only reasonable but is also highly desirable for convenience of administration. This is what the Commission did in order No. 310, [*West Edmond*] *supra*.²⁴⁶

However, it is submitted that the commission will confine the application of the *West Edmond* rule to cases which involve field-wide unitization programs and similar factual situations, *e.g.*, plant sales where the use of the rate base method would be impractical due to the number of parties, allocations, rate bases, and costs of service involved. Since the courts have not as yet sustained the validity of the *West Edmond* rule, it is apparent that the commission is hesitant to extend it.

²⁴² 255 F.2d at 553.

²⁴³ The court questioned the validity of some of the distinctions drawn by the commission in the *West Edmond* case, but indirectly approved the commission's decision.

²⁴⁴ 255 F.2d 556 (5th Cir. 1958).

²⁴⁵ 263 F.2d 622 (5th Cir. 1959). See *Sears v. FPC*, 263 F.2d 626 (5th Cir. 1959).

²⁴⁶ 263 F.2d at 625-26.

The proceedings before the commission indicate that the rate base approach may be feasible when the commission is considering a large producing company and the record covers the entire operations of the company. But the producer's operations must be broad enough to give sufficient economic data to reflect a meaningful result or average. At least one commissioner has publicly recognized that, with respect to small producers, the type of cost evidence introduced in current cases does little to aid the commission in determining just and reasonable rates since the use of economic data pertaining to a few isolated sales may reflect a rate which is either exorbitantly high or ridiculously low. Consequently, it is apparent that the commission may be forced to depart from the traditional method to reach a reasonable result. The Fifth Circuit, in its *Forest Oil*²⁴⁷ decision, apparently attempted to pave the way for this departure.

We do not think that either the Commission or the petitioner should be baffled or handicapped in this new field of regulation by any formulas by whatever name they are known. Specifically, if there is an accounting or rate-making formula known to the public utilities industry as a "conventional rate-base method of rate-making" which the Commission in its order of dismissal in this case said must be used at least as a basis of comparison or point of departure, we say the Commission need not require it unless such method is the only way by which the Commission can make its required determination. This is what we undertook to say in the *Bel Oil* opinion, and it is clear that the Commission recognizes that it is free to act thus by such of its opinions as 310, [*West Edmond*] *supra*.²⁴⁸

Nevertheless, the commission has not formulated or announced the adoption of any method of general application in lieu of the traditional method.

The decisions rendered by the commission and the courts thus indicate that independent producers will be generally required to prove that the increased rates which they seek are "just and reasonable" by the traditional method; producers may substantiate increased rates by means other than the traditional method when such method is not feasible or its use casts an undue burden on the parties and the commission. The traditional rate base method must be adapted to the producing industry in the usual case; however, authoritative statements have not been issued by the commission regarding the manner in which the method will be used, and there has been little indication as to the accounting principles and theories which will be controlling.

²⁴⁷ *Supra* note 245.

²⁴⁸ 263 F.2d at 626.

The commission allowed increased rates in *In the Matter of Wunderlick Dev. Co.*,²⁴⁹ *In the Matter of Christie, Mitchell & Mitchell*,²⁵⁰ *In the Matter of Davidor & Davidor*,²⁵¹ *In the Matter of Harper Oil Co.*,²⁵² and *In the Matter of Negley d/b/a Paisano Trading Co.*,²⁵³ but it did not state the factors which it regarded as justifying the increases. These cases are probably useless as authority (except possibly for the *Davidor & Davidor* case) but they may have some comparative value.

In the *Davidor & Davidor* case evidence was introduced which indicated that revenue received from the sale of exhausted gas reserves, revenue to be realized from the sale of the remaining gas reserves at the increased price, and an additional sum for distillate sold and to be sold would amount to \$161,450 during the life of the wells. Operating expense, computed during a twelve month test period, and the total investment, less salvage, was calculated at \$128,998. This figure did not include the cost of a dry hole, preliminary exploration expenses, income taxes, and lease acquisition costs. The producer's evidence showed that the working interest would net \$32,452 over the life of the wells. The commission stated that it did not place great reliance upon the producer's cost study or upon the fact that a rate of return of nine per cent would produce a price close to the increased rate, but the commission allowed the increase on the basis of this "dollar-in-dollar-out" and "net cash realization" presentation.

When the commission's *Union Oil* decision was affirmed, numerous producer rate cases were set for hearing, and in the summer of 1958, producers began to introduce comprehensive cost studies. Since that time, the commission has disposed of several producer rate cases. *In the Matter of Hassie Hunt Trust*²⁵⁴ and *In the Matter of Rebstock & Reeves Drilling Co.*²⁵⁵ are section 4(e) cases which were settled without full hearings and which allowed the producers the increased rates. In the *Hassie Hunt Trust* case the commission's staff introduced a cost of service study solely for the purpose of settlement and moved to terminate the proceeding on the ground that the increased rates were within the zone of reasonableness and had not been shown to be unjust or unreasonable. The commission terminated the proceedings and allowed the increased rates. In the *Rebstock & Reeves*

²⁴⁹ 15 F.P.C. 690, 6 Oil & Gas Rep. 1090 (1956).

²⁵⁰ 15 F.P.C. 751, 6 Oil & Gas Rep. 385 (1956).

²⁵¹ 15 F.P.C. 1236, 5 Oil & Gas Rep. 1081 (1956).

²⁵² 17 F.P.C. 803 (1957).

²⁵³ 17 F.P.C. 550, 7 Oil & Gas Rep. 521 (1957).

²⁵⁴ 21 F.P.C. 27 (1959).

²⁵⁵ ___F.P.C.__(1959), issued April 20, 1959, Docket No. G-9721.

case the staff verified the accuracy of the producer's cost exhibit and moved to place the study in evidence as justification for terminating the proceeding. *In the Matter of Bayview Oil Corp.*²⁵⁶ is a section 4(e) case that was terminated upon motion by staff counsel. Both the producer and the staff introduced cost evidence. One exhibit was introduced for the limited purpose of supporting the staff's motion; it showed that the total cost of service exceeded the producer's revenues.

In the Matter of the Altex Corp.,²⁵⁷ *In the Matter of Gillring Oil Co.*,²⁵⁸ and *In the Matter of Ralph E. Fair & Ralph E. Fair, Inc.*²⁵⁹ are section 5(a) investigations which have been dismissed. In each of these cases, the rates of the party under investigation were either lower than, or in line with, the rates determined by the staff's cost of service studies; thus, the motions to dismiss were granted solely on the basis of the staff's studies. The orders of the commission do not comment on the merits of the cases, but the examiners' decisions may have some comparative value.

Few producers have succeeded before the commission in obtaining increases, but several producers have been successful in having suspension orders rescinded before hearings were convened.²⁶⁰ These producers submitted cost of service studies in support of the increased rates, and the commission set aside the orders suspending these rates and terminated the section 4(e) proceedings. Percentage-wise, producers who have used this procedure have been more successful than producers who have presented evidence at the usual hearing. Several producers, whose filings for favored-nation increases had been suspended, requested the commission to rescind the favored-nation filing and suspension order and to accept a superseding periodic escalation filing (for a lesser rate) without suspension. Recently, the commission allowed filings of this type for lesser rates where they were supported by field price evidence and where the producer agreed to forego certain contractual rights to obtain the rate free from any obligation to refund. These latter orders were issued without requiring cost data to support the rate which was allowed.

²⁵⁶ ___ F.P.C. ___ (1959), issued March 27, 1959, Docket No. G-9417.

²⁵⁷ 20 F.P.C. 716 (1958).

²⁵⁸ 20 F.P.C. 770 (1958).

²⁵⁹ 20 F.P.C. 810 (1958).

²⁶⁰ See, e.g., the order issued *In the Matter of The Texas Co.*, Docket No. G-13924, June 12, 1958.

IV. CONDITIONAL CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY

Section 7(e) of the act provides that the commission "shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require."²⁶¹ There are no decisions defining the sort of conditions which the commission may insert in an independent producer's certificate, and it may be decided that the commission may impose any reasonable condition found to be necessary to protect the public interest. However, section 7(e) is most frequently used in producer certificate cases in an attempt to reduce the initial rate; the commission authorizes the sale subject to the condition that the initial rate be reduced to a certain level. This area of federal regulation is in a state of flux as a result of the Supreme Court's *CATCO* decision,²⁶² which was issued June 22, 1959. The commission has not yet issued an opinion interpreting the *CATCO* decision or resolving the conflicts between the *CATCO* case and its previous decisions; therefore, these decisions must be reviewed before the impact of the *CATCO* case may be understood or any conclusions may be drawn.²⁶³

Several factors have caused purchasers and consumer interests to urge the commission to insert rate conditions in producer certificates. Section 4(e) of the act does not authorize the suspension of initial rates; therefore, a time consuming company-wide investigation under section 5(a) must be instituted and concluded before an initial rate may be modified. Further, the going price for new gas reserves has been steadily rising in most areas since the *Phillips* case. Federal regulation has caused producers to seek intrastate markets; for this reason, and since section 4 of the act has partially defeated the effectiveness of escalation clauses, interstate transmission companies have been forced to pay a premium price to obtain gas to be introduced into interstate commerce.²⁶⁴ To prevent producers from taking advantage of the present sellers' market, consumer interests have frequently advocated the issuance of producer certificates conditioned under section 7(e) on a "just and reasonable" rate.

Prior to the *Phillips* case administrative precedent and judicial sanction existed which permitted the commission to consider the im-

²⁶¹ 15 U.S.C.A. § 717f.(e) (1948).

²⁶² *Atlantic Ref. Co. v. Public Service Comm'n*, 360 U.S. 378 (1959).

²⁶³ Since the date of this writing, the commission issued its Transwestern decision, Opinion No. 328, issued August 10, 1959, as modified on September 23, 1959.

²⁶⁴ Federal regulation has mitigated the pipelines' fear of triggering favored nations clauses by paying higher prices.

pact of pipeline rates upon consumers and, when such action was found necessary to protect the ultimate consumer, to impose rate conditions in pipeline certificates. *In the Matter of Cities Services Gas Co. & Signal Oil & Gas Co.*²⁶⁵ was the first producer case in which the commission invoked its power under section 7 (e) and conditioned a permanent producer certificate. In the *Signal* case the commission's staff introduced considerable evidence indicating that 10¢ per Mcf. was the prevailing price in the area and that the initial price of 12¢ per Mcf. provided by the gas sales contract would trigger numerous favored-nation clauses if it were allowed. The commission conditioned the producer's certificate to the 10¢ rate; this action was based on findings that the rate proposed by the producer would cause economic disruption in a large area and that the producer's sale at the proposed rate was not in the public interest. The commission's order was affirmed by the United States Court of Appeals for The Third Circuit.²⁶⁶

The commission has conditioned a number of temporary authorizations, but the validity of this policy has not been litigated. Section 7(e) authorizes the commission to condition "the certificate and . . . the exercise of the rights granted thereunder" and does not expressly grant the commission authority to condition a "temporary certificate." Moreover, the commission is only authorized to attach to the issuance of certificates "such reasonable terms and conditions as the public convenience and necessity may require." The determination of reasonable terms and conditions required by the public convenience and necessity clearly contemplates a hearing and findings based on substantial evidence, but section 7(c) authorizes the issuance of temporary certificates "without notice or hearing." Consequently, the courts may find that the commission was not granted the power to condition temporary authorizations.²⁶⁷

With two exceptions, the commission has consistently held that it is not in the public interest to determine the reasonableness of independent producers' rates in certificate proceedings, and it has relied upon its authority to test the producers' rates subsequently in proceedings instituted under sections 4 and 5 of the act.²⁶⁸ The majority of

²⁶⁵ 15 F.P.C. 147, 5 Oil & Gas Rep. 625 (1956).

²⁶⁶ *Signal Oil & Gas Co. v. FPC*, 238 F.2d 771 (3rd Cir. 1956).

²⁶⁷ Since the date of this writing, the Tenth Circuit issued its decision in *Sunray Mid-Continent Oil Co. v. FPC*, 270 F.2d 404 (10th Cir. 1959), which held that the commission has the authority to condition a temporary authorization.

²⁶⁸ In the *Matter of Columbian Fuel Corp.*, 19 F.P.C. 479 (1958); In the *Matter of Hope Natural Gas Co.*, 19 F.P.C. 405 (1958); In the *Matter of Seaboard Oil Co.*, 19 F.P.C. 416 (1958); In the *Matter of Sunray Mid-Continent Oil Co.*, 19 F.P.C. 618 (1958); In the *Matter of Superior Oil Co.*, 19 F.P.C. 637 (1958); In the *Matter of Lexia Buchanan*,

the commission has recognized that the adoption of a contrary policy would cast an undue burden on independent producers and an administrative burden upon the agency. Since the rate base method is the only method which the courts have sanctioned as a means of determining a just and reasonable rate, several years would probably elapse before the hearings could be concluded and the certificate issued. Extended proceedings would needlessly force producers to pay shut-in royalties to maintain leases while the proceedings were pending, cause waste by the flaring of casinghead gas and, in certain cases, require producers to pay additional sums to prevent leases, which are capable of production, from lapsing.

The *Seaboard* case²⁶⁹ illustrates the commission's position prior to the *CATCO* decision. In the *Signal* case considerable evidence had been presented showing that prices in the area were lower than the initial rate and that the initial rate would adversely affect the *status quo* of the existing rate structure due to favored-nation clauses. In its *Seaboard* opinion the commission limited the application of the *Signal* holding to cases presenting substantially similar fact situations. Further, the commission stated that even in an appropriate case there must be some rational basis for substituting a particular "conditioned rate" for the price proposed by the parties to the gas sales contract. The opinion recites that the method of determining the conditioned price "must have some real or substantive relation to the object sought to be obtained" and that some standard of reasonableness must be formulated before the use of rate conditions will be workable. The commission further stated that the primary means for the protection of the consumer against excessive rates is afforded by the rate provisions of the act.

The dissenting opinion of Commissioner Connole states that the commission must consider the initial price and the effect of such price in its public convenience and necessity determination. His opinion advocates the use of rate conditions to control initial prices, and attempts to formulate a method which could be used to test producer prices in certificate cases. The dissent prescribes a system by which the "going price" or the average price negotiated in a given area over a given period of time is determined and advocates the use of this data to test initial rates. The commissioner states that the producer and other parties could introduce other evidence of a

order issued July 1, 1955, Docket No. G-3864, 4 Oil & Gas Rep. 1431; In the Matter of Lenor M. Josey, Inc., order issued September 13, 1955, Docket No. G-8709; In the Matter of Albert Plummer, order issued September 29, 1955, Docket No. G-2578.

²⁶⁹ In the Matter of Seaboard Oil Co., 19 F.P.C. 416 (1958). The Seaboard decision was recently affirmed in *United Gas Improvement Co. v. FPC*, ___F.2d___ (3rd Cir. 1959).

general nature to substantiate a price higher or lower than the going price. However, this "going" field price method is synonymous with the fair field price, weighted average price, and commodity value methods which the *City of Detroit* case and the *Bel Oil* case rejected as a means of proving the reasonableness of producer rates in rate proceedings. If producers are not allowed to use these methods in a rate proceeding to substantiate rates, it is believed that the commission should not use them to strike down initial prices in a certificate proceeding.

In the *Seaboard* case the examiner held that, while the burden of proving all elements in a certificate case is on the producer-applicant, the injection of the rate condition issue shifts the burden of proof to the party raising the issue. Hence, the proponent of the rate condition must assume the burden of proving that the attachment of the condition is required by the public interest. The commission affirmed the examiner's ruling. Another decision elaborates further:

We are of the view that if the applicant proves there is a market for the gas at the proposed price and that the project is economically feasible at the proposed price . . . it has sustained its burden of going forward with the evidence, and in the absence of evidence showing that the proposed price or rate adversely affects the public convenience and necessity, the applicant has made out a prima facie case, and a certificate should issue to it.²⁷⁰

In *Oklahoma Natural Gas Co. v. FPC*²⁷¹ an interstate transmission company and several producers filed certificate applications with the commission requesting authorization for the sales by the producers to the pipeline and the construction and operation of the necessary facilities. Oklahoma Natural, a wholly intrastate company, was among the many intervenors. The intervenors opposed the issuance of the certificates and, in the alternative, requested that the certificates be conditioned at a price which was claimed to be the prevailing price in the area. The commission, however, found that the proposed sales were required by the public interest and that the factual situation could be distinguished from that of the *Signal* case. Thus, the producers' certificates were issued without rate conditions. Oklahoma Natural petitioned the District of Columbia Circuit for review.

²⁷⁰ In the Matter of Hope Natural Gas Co., 19 F.P.C. 405, 407 (1958).

²⁷¹ 257 F.2d 634 (D.C. Cir. 1958). See Florida Economic Advisory Council v. FPC, 251 F.2d 643 (D.C. Cir. 1957), wherein the court stated: ". . . this inquiry may be resolved in a rate proceeding rather than in a proceeding for a certificate of public convenience and necessity, and the Commission did not abuse its discretion in declining to consider the matter in the instant proceeding. The rates are subject to the Commission's continuing jurisdiction, and, whenever sufficient reason appears, they may be taken up." 251 F.2d at 646.

Oklahoma Natural contended that the commission erred by granting the producers' certificates without rate conditions upon the following grounds: (1) the initial rate exceeded the prevailing price in the area; (2) the prohibition against sales that are not just and reasonable is all-inclusive and applicable to any and all sales; (3) the provisions of section 4(a) are applicable to certificate proceedings; (4) section 4(a) imposes a mandatory duty upon the commission to insure that the initial rate is just and reasonable when a party to the proceeding raises a substantial question as to its reasonableness; (5) the commission did not enter express findings to support the reasonableness of the initial rate; and (6) the commission's findings were not supported by the record. The court rejected each of Oklahoma Natural's contentions and dismissed the petition.²⁷²

In the *Trunkline* case²⁷³ the commission issued certificates permitting sales at a rate above the area level, fully realizing that such rates would activate favored nation clauses in other contracts. The commission stated that the fact that the proposed rate is required by the public convenience and necessity must be established by substantial proof; it found that the record contained the requisite proof. The commission reviewed the prices in the area and found that the proposed rate was one-half cent per Mcf. above what it considered to be the going price. Had price alone been considered, the commission would have conditioned the certificate, thereby requiring a rate reduction of one-half cent per Mcf., but it held that the sales were required by the public convenience and necessity at the proposed rate due to the large volumes to be sold, the absence of escalations during the first ten years of the contractual term, and the fact that the pipeline could not purchase such gas for a lesser price. The commission recognized that "considerable weight must be given to initial contracts which have been freely negotiated between willing sellers and buyers in a competitive mar-

²⁷² In support of the decision, the court stated:

The statute makes the issuance of a certificate dependent upon a finding of 'public convenience and necessity,' and it delegates to the Commission the power and duty to make that finding. The Commission, by its expert knowledge of and continuing contact with the natural gas industry, is qualified to make the determinations of fact and the evaluations of policy which the issuance of a certificate requires. . . . The granting or denial of a certificate of public convenience and necessity is a matter peculiarly within the discretion of the Commission. . . . 'Just as the Commission has authority to impose conditions upon the issuance of a certificate so, too, it has authority to refuse to impose conditions. . . .' Section 4(a) states the substantive objective of the Act, that rates be reasonable; it does not specify the procedure by which this objective is to be attained. That procedure is prescribed by §§ 4(d), 4(e) and 5(a). The Commission cannot be required to convert every certificate proceeding into a rate proceeding.

²⁷³ In the Matter of Trunkline Gas Company, —F.P.C.— (1959), Opinion No. 321, issued May 22, 1959, Docket No. G-15394.

ket, and which may well reflect the value of the gas in the particular market and under the circumstances of the particular transaction more accurately than any other evidence which may be adduced."

This was the status of the cases prior to the Supreme Court's *CATCO* decision. In the *CATCO* case, the gas sales contracts provided an initial price of 22.4¢ per Mcf. for natural gas produced offshore. The examiner recommended the issuance of certificates conditioned to a rate of 18¢ per Mcf. The commission concurred with the examiner's decision, and the certificates were conditioned accordingly; however, the order permitted the producers to file notices of change to place the 22.4¢ rate into effect one day after the date of initial deliveries. Thus, the producers would receive that portion of the price which exceeded 18¢ per Mcf. subject to refund. The producers refused to accept the conditional certificates and, on rehearing, the commission issued permanent certificates without rate conditions after finding the pipeline's reserve requirements outweighed the objectionable price.²⁷⁴

On review, the United States Court of Appeals for the Third Circuit construed the producers' certificate applications as limitations on the commission's power to consider whether the initial rate was in the public interest. The court held that Congress had not given the commission the power to inquire into the issue of public convenience and necessity when the producer circumscribes the scope of the inquiry and that the commission cannot conduct a limited inquiry in a certificate proceeding or consider an application which requires the commission to forego the consideration of a factor that may be an essential element in the formulation of its judgment. Also, the court stated that producers must be willing to perform the proposed services and conform to the provisions of the act, that the producers' action indicated they were not willing to comply with the latter requirement, and that "this itself would require the denial of the applications."²⁷⁵

The Supreme Court, in *Atlantic Ref. Co. v. Public Service Comm'n*,²⁷⁶ affirmed the Third Circuit's decision but repudiated the portion of the decision discussed above. The Court held that the filing of a certificate application is, in essence, a proposal and does not constitute a dedication to interstate markets; thus the producers were at liberty to reject the certificates and cancel the contracts.

The Supreme Court recognized that the act does not require the

²⁷⁴ In the Matter of Continental Oil Co., 17 F.P.C. 732, 17 F.P.C. 880 (1957).

²⁷⁵ Public Service Commission v. FPC, 257 F.2d 717 (3rd Cir. 1959).

²⁷⁶ *Supra* note 262.

commission to determine a just and reasonable rate in a certificate proceeding and that such determination is not prerequisite to the issuance of a certificate. Moreover, the court reaffirmed its decision in the *Mobile* case²⁷⁷ which held that rates are established initially by contract, that initial rates may only be modified at the conclusion of a section 5(a) proceeding, that initial rates are not subject to suspension, and, in effect, that natural gas companies are entitled to the initial rate during the time the section 5(a) proceeding is pending. But the Court held that the element of price is of prime importance in the public convenience and necessity determination and that the commission has a duty to guard the public interest between the date of initial deliveries and the date a section 5(a) proceeding is concluded. Thus, when the initial price is contrary to the public interest, the commission must either deny the application or condition the certificate in such manner as to protect the consuming public.

The opinion states that it was the purpose and intention of Congress to create a single, comprehensive, and effective regulatory scheme under which *all* rates are subject to modification by the commission "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges." The Court concluded that Congress did not intend to deny the consuming public protection between the date of initial deliveries and the conclusion of the section 5(a) proceedings, or to give the natural gas company the windfall gain resulting from the long delay. Congress' comprehensive "regulatory scheme" was interpreted to include the power to condition certificates under section 7(e) to provide the consuming public with complete protection from exploitation by natural gas companies.

The Court stated that the exercise of this power under section 7(e) is not an encroachment upon the *Mobile* doctrine, ". . . but merely the exercise of that duty imposed upon the Commission to protect the public interest in determining whether the issuance of the certificate is required by the public convenience and necessity. . . ." Also, the opinion states that the commission does not determine the reasonableness of the initial rates or set aside the price agreed upon by the parties, but it ". . . so conditions the certificate that the consuming public may be protected while the justness and reasonableness of the price fixed by the parties is being determined under other sections of the Act." The provisions of section 7(e) are there-

²⁷⁷ *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956).

fore invoked "to hold the line awaiting adjudication of a just and reasonable rate."

This decision places the burden of proof on the producer to show that the initial price is required by the public convenience and necessity, and, in the absence of such showing, it requires the commission to deny the application or to condition the certificate to protect the consumer interest. If the producer fails to make the necessary showing "prerequisite to the issuance of the permanent certificate" and the commission imposes a rate condition, the producer has effectively been denied the right to establish the rate initially, and it is the writer's opinion that the *Mobile* doctrine has been modified to this extent.

It is not clear at this date what type of evidence which must be introduced by the producer to sustain the burden of proving that the initial rate is required by the public convenience and necessity. In several contested certificate cases the commission has requested or required the producers to supplement their certificate applications with the following information: (a) the current level of prices being paid by the purchaser in the area; (b) the current level of prices being paid by the purchaser under other contracts containing terms and provisions generally comparable to those under consideration; (c) data comparing the contract with contracts covering the sales described in (a) and (b) above with respect to quality and conditions of delivery; (d) the effect of the proposed price upon the prices paid by the purchaser under other contracts; and (e) any cost information which the producer or the purchaser may desire to submit, together with statements setting forth the reasons for the variance between the initial price and those currently being paid by the purchaser in the area. If the initial rate is not higher than one or more other rates in the area and will not activate favored-nation clauses, the commission will probably require non-cost evidence similar to that described in items (a) through (d) above. In the event the initial rate will adversely affect other rates in the area, the producer will probably be required to present cost evidence to avoid a rate condition.²⁷⁸

The commission has imposed rate conditions in two instances; in the *Signal* case the rate was conditioned to a specific level with no provision of the issuing order authorizing a change in rate, but in the *CATCO* case the producers were permitted to file a notice of

²⁷⁸ The *CATCO* decision infers that the producer should have introduced evidence showing the difference in costs between the *CATCO* gas and other offshore gas in order to justify the higher price for the former sale.

change and collect the difference between the contractual price and conditioned rate subject to refund. Under the *Signal* condition, the producer's only remedy would be to petition the commission alleging that prices in the area have been increased and to request that the commission modify the rate condition and allow an increase in rate. On the other hand, the *CATCO* condition permits the producer to receive the questionable portion of the contract price, subject to refund, and to attempt to justify the entire rate in subsequent proceedings. Also, the effective date upon which the producer receives the entire contractual price is delayed substantially by the *Signal* type of condition if it is subsequently found to be just and reasonable. The type of condition which the commission will impose in future cases is unknown at this date, but it would appear that the *CATCO* type of condition would be more logical since the Supreme Court, in its *CATCO* decision, was striving to hold initial rates at the just and reasonable level. However, the commission may eventually formulate some method of testing the reasonableness of initial rates in certificate proceedings which is much simpler and less time consuming than the method employed in rate cases today, thereby permitting the commission to make its rate determination and establish the initial rate in the order issuing the certificate of public convenience and necessity.

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