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ADOPTION OF FEDERAL POWER COMMISSION PRICE-CHANGING RULES WITHOUT EVIDENTIARY HEARING: STATUTORY COLLISION

by

*John L. FitzGerald**

TWO recent cases decided by the United States Courts of Appeals for the Ninth and Tenth Circuits have reached contrary conclusions with respect to the authority of the FPC to ban prospectively indefinite escalation clauses in independent producers' contracts by general rulemaking procedures conducted under section 4 of the Administrative Procedure Act. The rules provide for rejection without evidentiary hearing of (1) any future contract filed by an independent producer of natural gas if such contract contains a so-called "indefinite price-changing" escalation clause providing for rate increases over the comparatively long-term period of gas sales and (2) any application filed by such a producer for a certificate of public convenience or necessity supported by such a contract. In both cases the FPC rejected an application for a certificate of convenience and necessity on the grounds that the underlying contract contained pricing provisions not permissible under Order 232 as amended by Order 232A of the Commission and that the rejection was required by Order 242 of the Commission. The principal concern of this Article is with the permissible use of rule-making in lieu of adjudication within the purview drawn by the courts in the two proceedings.¹

I. BACKGROUND

The FPC maintained, until the Supreme Court ruled otherwise

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¹ This Article basically is a study and analysis of selected basic problems raised by the two circuit cases. The focal issue is the scope and method of exercise of the rulemaking power under the Natural Gas Act in the setting of the price-changing rules discussed. The compass of the analysis has made detailed consideration of the Administrative Procedure Act, 60 Stat. 237 (1946), 5 U.S.C. § 1001 (1958), unnecessary.

in the *Phillips*² case, that it had no jurisdiction over an independent producer of natural gas. However, after *Phillips* the courts further determined that the conditioning power under section 7(e) of the Natural Gas Act³ was no different for independent producers than it was for pipeline companies⁴ and that independent producers could not file for rate increases under section 4 of the act in contravention of provisions of contracts voluntarily entered into with purchasers.⁵

The consequence of the courts' decisions that an independent producer was subject to the Natural Gas Act and that the powers of the FPC were the same as applied to the independent producer⁶ or the pipeline company has been (1) to require the producer to obtain a certificate of public convenience and necessity under section 7 of the act⁷ subject to the conditioning power of the Commission⁸ prior to consummating any sale of gas in interstate commerce and (2) to subject any changes in the initial rate schedule approved by the certificate of public convenience and necessity to

² *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

³ 52 Stat. 821 (1938), 15 U.S.C. § 717 (a)-(w) (1958).

⁴ *Signal Oil & Gas Co. v. FPC*, 238 F.2d 771 (3d Cir. 1956).

⁵ *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956). An important distinction was made in this case, re-emphasized later in *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103 (1958), that the FPC statute, unlike the ICC statute, left the initiation of rates to the persons regulated, subject to filing with and review by the FPC.

⁶ The FPC's most recent definition (1962) of an independent producer is: "An 'independent producer' as that term is used in this part means any person as defined in The Natural Gas Act who is engaged in the production or gathering of natural gas and who sells natural gas in interstate commerce for resale, but who is not engaged in the transportation of natural gas (other than gathering) by pipeline in interstate commerce." Order 243, 27 F.P.C. 341, 342 (1962).

⁷ 61 Stat. 459 (1947), 15 U.S.C. § 717f (1958). Section 7 provides, *inter alia*, for the construction, extension, or abandonment of facilities and for certificates of convenience and necessity.

Section 7(c) provides:

[N]o natural-gas company . . . shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission . . . unless there is in force . . . a certificate of public convenience and necessity

[T]he Commission shall set the matter for hearing . . . and the application shall be decided in accordance with the procedure provided in subsection (e). . . . 52 Stat. 825 (1938), as amended, 56 Stat. 83 (1943), 15 U.S.C. § 717f(c) (1959).

Section 7(e) provides:

[A] certificate shall be issued to any qualified applicant . . . if it is found that the applicant is able and willing properly to . . . perform . . . and to conform to . . . this chapter and the requirements, rules, and regulations of the Commission . . . and that the proposed . . . sale . . . is or will be required by the present or future public convenience and necessity The Commission shall have the power to attach . . . such reasonable terms and conditions as the public convenience and necessity may require. 56 Stat. 84 (1942), 15 U.S.C. § 717f(e) (1958).

⁸ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959) (frequently referred to as "CATCO").

the provisions of sections 4⁹ and 5¹⁰ of the act, *e.g.*, to the Commission's power to determine whether they are just and reasonable. The Commission's powers of conditioning or of denying in these respects are exercisable after a hearing as provided in sections 4, 5, and 7 of the act.

Producers of gas for sale in interstate commerce sell such gas under long-term contracts varying in duration from twenty to fifty years.¹¹ Furthermore, the Commission has declared such long-term contracts desirable and appropriate in the public interest.¹² It is and has been customary for such contracts to include clauses for price increases over the period of years covered; such increases are specified in the contract or are determinable from contract provisions on the basis of future market prices, costs, and other contingencies. Each new application for interstate sale is subject to the filing and review requirements of section 7 of the act, which confers rulemaking authority on the Commission and which contains hearing provisions¹³ with respect to the determination of the public convenience and necessity. Additionally, price increases pursuant to the contract clauses must be filed with the Commission before becoming effective

⁹ 52 Stat. 822 (1938), 15 U.S.C. § 717(c) (1962). Section 4 provides for rates and charges, schedules, and the suspension of revised rates.

Section 4(a) provides:

[A]ll rates and charges . . . and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable and any such rate or charge that is not just and reasonable is declared to be unlawful.

52 Stat. 822 (1938), 15 U.S.C. § 717c(a) (1958).

Section 4(b) provides, *inter alia*, that no company shall (1) make or grant any undue preference or (2) maintain any unreasonable difference in rates, etc., as between localities or classes of service. 52 Stat. 822 (1938), 15 U.S.C. § 717c(b) (1958).

Section 4(c) provides for the filing, under such regulations as the Commission prescribes, of all rates and charges together with all contracts in any manner affecting or relating thereto. 52 Stat. 822 (1938), 15 U.S.C. § 717c(c) (1958).

Section 4(d) provides:

[U]nless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and the public. 52 Stat. 822 (1938), 15 U.S.C. § 717c(d) (1958).

Section 4(e) provides for hearing upon the filing of the rate, charge, classification, or service; for suspension up to five months; for the posting of bond to refund any amounts collected and not finally approved by the Commission; and for the imposition of the burden of proving such rate or charge is just and reasonable upon the applicant seeking an increased rate or charge. 76 Stat. 72 (1962), 15 U.S.C. § 717c(e) (1962).

¹⁰ 52 Stat. 823 (1938), 15 U.S.C. § 717(d) (1958). Section 5 provides for fixing rates and charges on the Commission's own motion. Section (a):

Whenever the Commission, after a hearing . . . shall find that any rate, charge, or classification . . . is unjust, unreasonable, unduly discriminatory, or preferential . . . 52 Stat. 823 (1938), 15 U.S.C. § 717(d) (1958).

¹¹ Order 232, 25 F.P.C. 379, 381 (1961) (separate statement of Commissioner Kline, concurring in part, dissenting in part, in Order 232).

¹² *Id.* at 380, 609.

¹³ See note 7 *supra*.

and, in this connection, must meet the statutory tests upon Commission review under section 4¹⁴ of the act. Section 4 also empowers the Commission to issue rules. Rates are thereafter reviewable in a hearing under section 5 pursuant to the Commission's regulatory authority over existing rates.¹⁵ The standards under section 4 for increases in rates are that they be just and reasonable and that they grant no continuing undue preference. Similarly, the standards under section 5, which provides for continuing supervision by the Commission over existing rates, are that they be just and reasonable and that they not be preferential.

The Commission has statutory authority under section 16,¹⁶ *inter alia*, to prescribe such rules and regulations as it finds necessary or appropriate to carry out the provisions of the act. The Commission has authority under section 14,¹⁷ *inter alia*, to undertake investigations to aid in prescribing rules or regulations and, in this connection, to take evidence and to compel testimony and the production of records.

On April 4, 1956, the FPC issued notice¹⁸ of rulemaking in which it proposed for consideration and submission of views a regulation to prohibit the filing of contracts entered into by producers for sale of gas in interstate commerce that contained either automatically-activated pricing clauses tied to buyers' increased rates and pricing indices on resale by the purchaser or "favored nation" clauses. Written comments were requested and received from affected persons. The so-called "favored nation" clauses, according to the FPC,¹⁹ provided for an increase in the price paid by the purchasing interstate transporter to the applicant producer if the latter or any other producer in the same field or other area of production received a higher price from the same or another transporter or if a bona fide offer to purchase gas was made to the applicant producer or any other producer within such areas.

No action was taken in the rulemaking proceeding until 1961. During this period covering almost five years, the Commission annually recommended amendments to the Natural Gas Act to authorize or clarify its authority with regard to the elimination of clauses in independent producers' contracts of sale to interstate gas transmission companies providing for changes of price to the pur-

¹⁴ See note 9 *supra*.

¹⁵ See note 10 *supra*.

¹⁶ 52 Stat. 831 (1938), 15 U.S.C. § 717o (1958).

¹⁷ 52 Stat. 828 (1938), 15 U.S.C. § 717m (1958).

¹⁸ Notice 5-153, 21 Fed. Reg. 2388 (1956).

¹⁹ *Ibid.*

chaser.²⁰ However, the act has not been amended in accordance with these recommendations.

II. THE RULES

On March 3, 1961, the Commission issued Order 232²¹ as the result of the rulemaking proceeding. This order amended section 154.91(a) of the General Rules and Regulations (18 C.F.R. § 154.91(a)) by adding definitions of "definite escalation clauses" and "indefinite escalation clauses,"²² and section 154.93 (18 C.F.R. § 154.93) by providing that "indefinite escalation clauses," as defined, tendered for filing on or after April 1, 1961, would be inoperative and of no effect at law.

Order 232 by its definition of "indefinite escalation clause," read together with the definition of "definite escalation clause," proscribed any contractual provisions for price increases except those (1) set forth in definite amount and time in the contract or (2) providing for reimbursement to the seller for changes in production, severance, or gathering taxes levied upon him. The order was retroactive in its applicability to contracts executed prior to April 1, 1961, but filed at some time thereafter. As pointed out by the commissioner who dissented in part, the order precluded any contractual provision for price redeterminations through negotiation or arbitration between seller and buyer after a reasonable period such as five years from the date of a contract.²³ Significantly, on the same day that Order 232 was issued, the Commission announced its decision in an adjudicatory proceeding in which it expressed the general conclusion that indefinite escalation clauses were contrary to the public interest.²⁴

Order 232 was greeted by the filing of many objections. It was amended less than a month later by Order 232A,²⁵ again issued in rulemaking after Commission allowance of a brief time for submission of views.²⁶ This order (1) removed the retroactive feature of Order 232 and (2) added a third exception to the proscribed price increase provisions. This exception met in some degree the dissenting commissioner's criticism reflected above by excepting the following contractual provision:

²⁰ 1960 FPC Ann. Rep. 15-17; 1959 FPC Ann. Rep. 12-13, 18-19; 1959 FPC Ann. Rep. 15-16; 1957 FPC Ann. Rep. 17-18, 25-26; 1956 FPC Ann. Rep. § 367, at 17-19.

²¹ Order No. 232, 25 F.P.C. 379 (1961).

²² *Id.* at 380.

²³ *Id.* at 381 (separate statement of Commissioner Kline, concurring in part, dissenting in part in Order 232).

²⁴ Pure Oil Company, 25 F.P.C. 383 (1961).

²⁵ Order 232A, 25 F.P.C. 609 (1961).

²⁶ *Ibid.*

3) [P]rovisions that, once in five-year contract periods during which there is no provision for a change in price to a specific amount [paragraph (2)], change a price at a definite date by a price-redetermination based upon and not higher than a producer rate or producer rates which are subject to the jurisdiction of the Commission, are not in issue in suspension or certificate proceedings, and are in the area of the price in question.²⁷

Many independent producers filed applications for rehearing with respect to Order 232A, but were dismissed by the Commission on the basis that the applications were not authorized by section 19 of the act. The dismissals were affirmed by the courts.²⁸ On October 10, 1961, the Commission issued notice²⁹ of further amendment to section 154.93 (18 C.F.R. § 154.93) and other regulations as amended by Order 232A. Thereafter, the Commission issued Order 242.³⁰ By this order the Commission added nothing of substance to the foregoing prohibitions, but (1) provided for administrative rejection of contracts or of applications for certificates of public interest, convenience, and necessity which failed to comply with the order and (2) thus, gave effect to a technical distinction between "freedom to contract" and "freedom to file with the Commission."³¹ In the notices and orders there appears the finding that long-term gas sale contracts with pipeline companies are "desirable" and "in the public interest" or "in the interest of the consumer,"³² accompanied by the finding that "indefinite" escalation provisions (all those not exempted by the new rules) are not in the public interest. Applications for rehearing were filed and denied.³³ Three gas producers whose contentions were considered on the merits in the litigation analyzed in this Article filed contracts or applications for certificates with the Commission that were subject to the prohibitions of the orders that

²⁷ Order 232A revised the Commission's Rules, 18 C.F.R. § 154.93, as follows: *Provided*, That in contracts executed on or after April 3, 1961, for the sale or transportation of natural gas subject to the jurisdiction of the Commission, any provision for a change of price other than the following provisions shall be inoperative and of no effect at law; the permissible provisions for a change in price are:

(1) provisions that change a price in order to reimburse the seller for all or any part of the changes in production, severance, or gathering taxes levied upon the seller;

(2) provisions that change a price to a specific amount at a definite date; and [third provision which is set forth in the text above]. *Id.* at 610.

²⁸ *Sun Oil Co. v. FPC*, 304 F.2d 293 (5th Cir. 1962), *cert. denied*, 371 U.S. 861 (1962); *Texaco, Inc. v. FPC*, 317 F.2d 796 (10 Cir. 1963), *rev'd*, 32 U.S.L. Week 4370 (U.S. 1964).

²⁹ Notice _____, 26 Fed. Reg. 9732 (1961).

³⁰ 27 F.P.C. 339 (1962).

³¹ *Id.* at 340.

³² See, e.g., Order 232, 25 F.P.C. 379, 380 (1961); Order 232A, 25 F.P.C. 609 (1961).

³³ See, e.g., 27 F.P.C. 666 (1962).

have been described. These filings were rejected, and petitions for review were filed in the Ninth and Tenth Circuits.³⁴

III. THE ADMINISTRATIVE REASONS SUPPORTING THE RULES

The FPC made the following statements in promulgating Order 232:

General public notice of this proposed rule-making was given by publication in the Federal Register . . . and mailing notices to interested parties. . . .

In response to such notice, numerous suggestions and comments were submitted by interested parties All such suggestions and comments have been carefully considered, but, for reasons set forth in our findings, we adhere to the rule as originally proposed with certain changes made thereto.

The Commission finds:

(1) The natural gas industry and natural gas service are aided and developed by the use of long-term contracts for the sale of natural gas by producers . . . and it is desirable and appropriate in the public interest that long-term contracts be utilized as a basis for considerations of supply and service expansion. . . .

(2) Long-term gas supply contracts containing provisions for rate changes dependent or based in part on 'indefinite escalation clauses' as herein defined, have contributed to instability and uncertainty concerning prices of gas and service expansion by natural gas companies. As found by us in the proceeding of *The Pure Oil Company* . . . these indefinite escalation provisions are contrary to the public interest. Such escalation provisions, therefore, are undesirable, unnecessary, and incompatible with the public interest for the due and proper development of natural gas service by natural gas companies.

(3) It is necessary and appropriate in the public interest and in the proper administration of the Natural Gas Act that § 154.91(a) . . . be amended . . . to define clearly the amendment necessitated by our findings in subparagraph (2) hereof.³⁵

In issuing Order 232A which amends Order 232, the FPC said:

Since March 3, interested persons have submitted views and comments concerning the amendments to our regulations. Upon consideration of

³⁴ "Indefinite" price changing clauses have been upheld as valid exercises of the contract making power in the following respects: spiral escalation clauses (*Wisconsin v. FPC*, 373 U.S. 294, 303-04 (1963)); "favored nations clauses" (*Texas Gas Transmission Corp. v. Shell Oil Co.*, 363 U.S. 263 (1960)); agreement binding the customer to the "going rate" as fixed by *ex parte* filings (*United Gas Pipeline Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103 (1958)); price related to the weighted average of royalty payments in a defined area (*Phillips v. FPC*, 258 F.2d 906 (10th Cir. 1958)); price fixed by the ratio to increased rates received by the pipeline company (*Kerr-McGee v. FPC*, 260 F.2d 102 (10th Cir. 1958)); and the "prevailing field price" plus gathering charges (*Cities Serv. Gas Producing Co. v. FPC*, 233 F.2d 726 (10th Cir. 1956)).

³⁵ 25 F.P.C. 379, 380 (1961). The issue of the proposed rulemaking was "also fully tried, briefed, and argued before the Commission in *The Pure Oil Co.* . . . in which decision is being issued this day. . . ." *Id.* at 380 n.1.

such comments and upon our own further consideration, we find it necessary and appropriate to modify the amendments promulgated by Order No. 232.

We reaffirm our earlier findings that . . . indefinite escalation provisions are, in general, contrary to the public interest. However, it also appears that elimination of all indefinite escalation provisions would be too restrictive. . . . Therefore . . . we should permit future contracts to contain limited price-redetermination provisions. . . .³⁶

In promulgating Order 242, the FPC stated:

Public notice of proposed rule making was given by publication . . . and by mailing copies. . . . In response to such notice, numerous comments were submitted. These comments have been carefully considered but, for the reasons set forth below, we adhere to the substance of the amendments as originally proposed.

A number of parties contend that the promulgation of these regulations would be unlawful and beyond the powers granted by the Commission. . . . We conclude . . . that sections 4, 5, and 7 of the Natural Gas Act contemplate that the Commission will refuse to approve contractual provisions found adverse to the public interest. Section 16 of the Act . . . authorizes the Commission to issue rules and regulations of general applicability found necessary or appropriate to carry out the provisions of the Act.

Protection of the public interest is the touchstone of our regulatory powers under the Natural Gas Act. . . . To be sure, the proposed rule will have impact upon contractual practices which have been fairly widespread. But the real issue is not one of 'freedom of contract'; the question is whether the rule is rationally related to a condition which requires correction if regulatory objectives embraced by the statute are to be achieved. . . .

We held in the *Pure Oil* case that indefinite escalation clauses are contrary to the public interest and restated this conclusion in Order No. 232A. . . . These filings bear no apparent relationship to the economic requirements of the producers who file them. . . .

Filings under indefinite escalation clauses have created a significant portion of the administrative burdens under which this Commission is laboring today. . . . Accordingly, in protecting the public against waves of increases which have no defensible basis, we also serve the need . . . of making the tasks of regulations more manageable.³⁷

It should be noted that the FPC made particular reference in its justification of the orders to its adjudicatory decision entered after hearing before an examiner³⁸ in the *Pure Oil* case.³⁹ This decision was issued the same day that the Commission issued Order 232. It is significant that this proceeding is the only adjudication by the FPC which involved the general policy question. The decision resulted

³⁶ 25 F.P.C. 609 (1961).

³⁷ 27 F.P.C. 339 (1962).

³⁸ The Examiner's decision appears at 25 F.P.C. 392 (1959).

³⁹ The Commission's decision in *The Pure Oil Company* appears at 25 F.P.C. 383 (1961).

from a hearing held upon an application for rate increases founded on escalation clauses contained in Pure Oil Company's contracts with a pipeline purchaser. The Commission denied the application for proposed increased rates, ordered certain refunds, and condemned the specific escalation clauses involved in the proceeding as well as indefinite escalation clauses generally as contrary to the public interest.

The Commission, however, refused to declare the particular escalation clauses before it in *Pure Oil* void or voidable⁴⁰ because of its expressed conviction that the clauses were so material to the contracts containing them that the contracts would fall with the clauses and the Pure Oil Company then would be enabled to file for rate increases whenever it felt justified in doing so.⁴¹

No independent producer other than Pure Oil was a party to the proceeding although several consumer or distributor participants were admitted as intervenors. The escalation clauses were not utterly indefinite; they were subject to contractual standards in their applica-

⁴⁰ The Commission previously had severed this issue insofar as decision thereon by the Examiner was concerned and had reserved its determination to the Commission. *Id.* at 385.

⁴¹ *Id.* at 388-89. The Commission cited *United Gas Pipeline Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956), and *United Gas Pipeline Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103 (1958). In *Mobile* after entering into a ten year contract with United, a pipeline company and a natural gas company, to obtain gas at the price of 10.7¢ per mcf, a distributor of natural gas to consumers in Mobile, Alabama, entered into a ten year contract to supply Ideal Cement Company, an industrial consumer, with gas at a price of 12¢ per mcf. United subsequently filed, unilaterally, a new rate schedule under § 4 of the Natural Gas Act raising the rate to 14.5¢ per mcf. Mobile objected, but the Commission sustained the filing. The Third Circuit held United could not file the increased rate and held Mobile entitled to a return of the amounts paid in excess of the contract rate. The Supreme Court said, in part:

[W]e hold that the Natural Gas Act does not give natural gas companies the right to change their rate contracts by their own unilateral action.

In construing the Act, we should bear in mind that it evinces 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 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: to establish *ex parte*, and change at will, the rates offered to prospective customers; or to fix by contract, and change only by mutual agreement, the rate agreed upon with a particular customer. 350 U.S. 332, 337-43 (1956). (Emphasis added.)

In the *Memphis* case United sought to file rate schedules increasing its pipeline rates under contracts providing in part that "All gas delivered hereunder shall be paid for by Buyer under Seller's Rate Schedule . . . or any effective superseding rate schedules, on file with the Federal Power Commission." Thus, this case differs from the *Mobile* case in which the rate was a definite amount for the contract period. The FPC accepted the filing, but the court, under the *Mobile* decision, directed the FPC to reject the rates. The Supreme Court reversed and said:

United bound itself to furnish gas to these customers during the life of the agreements *not* at a single fixed rate, as in *Mobile*, but at what in effect amounted to its current 'going' rate. Contractually this left United free to change its rates from time to time, subject, of course, to the procedures and limitations of the Natural Gas Act. 358 U.S. 103, 110 (1958).

tion.⁴² The holding of the examiner's initial decision in the case was that the rate increases provided for *did not conform* to the contractual standards, and it was upon this ground, as supported by substantial evidence, that the Seventh Circuit affirmed the FPC decision in the proceeding.⁴³ The FPC, however, had chosen the proceeding⁴⁴ as a vehicle for policy utterances (which the court found unnecessary to consider) appropriate to various *forms* of escalation clauses:

Considering all the circumstances, we are of the opinion that the two-party favored nation clauses in Pure's contracts with El Paso, and indefinite escalation clauses generally,⁹ are contrary to the public interest. From the beginning of Commission regulation of independent producers under the *Phillips* decision in 1954,⁴ the undesirable and injurious aspects of such escalation provisions generally have been forcibly impressed on us and proceedings were early instituted looking to the elimination of such provisions.⁵ And although the record in this case was made with special reference to Pure's two-party provisions, by reasonable implication it confirms our conclusion based upon our experience with other types of indefinite escalation provisions, that such provisions generally are contrary to the public interest.⁴⁵

The Commission's footnote 3, describing forms of escalation clauses in use, is set out in the note below.⁴⁶ Footnote 4 is the citation to

⁴² FPC Examiner Law, in his initial decision (25 F.P.C. 392 (1959)), described the applicable factors as follows:

The contracts filed as Pure's Rate Schedules Nos. 1 and 28 each provide that in determining whether the price payable under such other contract or agreement is 'higher' than the price 'payable for gas under this agreement,' due consideration shall be given to the provisions of the said agreement as compared with such other contract or agreement as to quality and quantity of gas, delivery pressures, gathering and compressing arrangements, provisions regarding measurement of gas including deviation from Boyle's Law, taxes payable on or with respect to such gas, and all other pertinent factors. The contract filed as Pure's Gas Rate Schedule No. 3 differs from the contracts filed as Rate Schedules Nos. 1 and 28 in that in determining whether the price payable for gas under another contract is higher than the price paid under the agreement, 'quantity' is not included within the due consideration clause, the term 'compressing' obligations is used instead of 'compressing arrangements' and the words 'except quantity' appear at the end of the clause after the word 'factors.' *Id.* at 393.

⁴³ *Pure Oil Co. v. FPC*, 299 F.2d 370 (7th Cir. 1962).

⁴⁴ 25 F.P.C. 383, 387-92 (1961).

⁴⁵ *Id.* at 388.

⁴⁶ In contrast to two-party favored nation clauses such as Pure's, which are activated by higher prices paid to any other supplier by the same purchaser, under three-party favored nation clauses prices are activated by higher prices paid to any other supplier by any purchaser. In addition to the above-described types of escalation clauses, several other types of escalation clauses, applicable in specified areas, are frequently encountered in producer gas sales contracts. *Periodic escalation clauses* generally provide that the price currently paid under the contract shall be increased by specific amounts at certain definite times in the future. *Redetermination clauses* generally provide that the price currently paid under the contract shall be subject to upward adjustment at certain specified times to reflect the average of the highest prices

the *Phillips* decision; footnote 5 is a reference to the 1956 notice of rulemaking. No other supporting citations appear.

The Commission supports its general policy against indefinite escalation clauses by a series of arguments attributed to the hearing record. Thus, the clauses are "inherently unreasonable" because:

[P]rices are subject to triggering if . . . [the purchaser] pays any other producer within the specified area a higher price. As indicated previously, under Pure's provisions, the company's prices are subject to triggering if El Paso pays any other producer within the specified area a higher price. There need be no economic or other substantial justification for the increase; the mere fact that a higher price is paid to some other producer would be sufficient to activate the increase. In our view, such an artificial ground for a proposed increase, operating in such a mechanical and arbitrary manner, and lacking any substantial relationship to the factors which bear on the value of gas or on a determination of a reasonable level of rates for it does not constitute a proper basis for filing proposed increased rates or a sufficient justification for our giving effect to such a filing, at least if the rate contained therein is in excess of those in our producer price Policy Statement 61-1, as amended. And although other types of indefinite escalation provisions are triggered by other kinds of mechanisms, they are in principle subject to these same objections.⁴⁷

Since the escalator clauses of Pure Oil (under the terms of the contract) were not activated automatically by higher prices paid by its purchasers to sellers other than Pure, as found by the examiner and the Commission under the issue directly involved in the *Pure Oil* hearing, *i.e.*, the justification urged for the increase was found not to fall within the permissive standards of the escalation clauses themselves, the price-triggering conclusion of the Commission lacks warrant in the record.

The Commission states further that if Pure's escalation clauses result in price increases, a chain reaction takes place in regard to other producers' contracts containing escalation clauses, one such filing following another. Here, the Commission specifies evidence adduced by the purchaser in the proceeding that such a reaction is probable because of spiral escalation clauses in the purchaser's contracts with Phillips Petroleum Company. Having credited this evi-

then paid by buyers to other supplies [sic] for gas delivered under substantially similar terms and conditions. *Spiral escalation clauses* generally provide that in the event the price which the buyer receives for the gas is increased, the price concurrently paid by the buyer to the supplier under the contract shall be increased in proportion to the buyer's increase. Other similar types of clauses, the nature of which is largely self-explanatory, include bona fide offer type of favored nation clauses, commodity index adjustment clauses, renegotiation clauses, and tax adjustment clauses. *Ibid.*

⁴⁷ *Id.* at 389.

dence, the Commission by footnote⁴⁸ states, however, that the spiral escalation clauses have been eliminated by amendment from Phillips' contracts.

There can be no doubt of the general existence of some chain reaction possibility. Nonetheless, in adopting this line of reasoning, the Commission disregards the presence of contractual standards controlling and defining the escalation provisions in the very proceeding before it.

When, however, the Commission contemplates its workload—as the application of contractual standards to specific market conditions takes its foreseeable toll of supervisory staff time—the Commission gives direct consideration to the contractual standards.

In addition, it is true, as staff contends, that the tremendous number of escalation increases we are required to pass on has given rise to a very heavy administrative burden on the Commission and on our staff. The difficulties in dealing with such proposed increases result not merely from the large number of such increases; they flow also from the complexity of many of the controverted contractual provisions we are required to interpret and apply. According to staff, a comparison of all the factors listed in the contracts involved herein would necessitate many dozen different comparisons. At the least, as this case demonstrates, the interpretation and application of such clauses involve controverted factual problems and difficult legal questions. Of course, the importance of considering administrative difficulties lies in the fact that the time and effort spent in dealing with escalation increases is disproportionate, and furthermore becomes unavailable for matters of perhaps greater public importance.⁴⁹

The Seventh Circuit⁵⁰ sustained the Commission in *Pure Oil* because there was substantial evidence in the record that the rate increases did not comply with the contractual conditions precedent to the exercise by Pure of the escalation rights.⁵¹ Obviously, the FPC staff, and a reviewing court in more limited ways later, must measure the relevance of the factors urged by Pure for the exercise of the escalation right by taking into consideration, *inter alia*, the contractual standards in relation to the rate of increase proposed. At least this much administrative burden was entailed, putting to one side the ultimate appraisal of the reasonableness of the proposed rate of increase that the statute ineluctably compels the Commission to consider. This administrative burden, however, has not been made a statutory element of rate review, and, hence, its quantum, however

⁴⁸ *Id.* at 389 n.7.

⁴⁹ *Id.* at 390.

⁵⁰ *Pure Oil Co. v. FPC*, 299 F.2d 370 (7th Cir. 1962).

⁵¹ That the judicial affirmance in *Pure Oil* is thus limited is recognized by the 1962 FPC Ann. Rep. 119.

appealingly and forcefully phrased, would not constitute substantial evidence supporting a finding that escalation clauses *generally* contravene the public interest, if indeed such administrative burden qualifies as evidence.

Finally, the Commission decision in *Pure Oil* turns to the basic evidence and argument of the applicant in defense of its escalation provisions. The evidence and argument is stated by the Commission as follows:

Pure, in taking the position that its escalation provisions are not contrary to the public interest, relies heavily on evidence adduced by its witnesses Foster and Dorau. Basically, these witnesses sought to justify these provisions as proper means of pricing producer sales by testimony that such so-called 'flexible forward pricing' provisions are the product of competing forces of supply and demand operating in a free market, and that by giving effect to free market influences in fixing prices for sales, they direct gas resources to their most efficient and socially desirable uses. According to Pure, such provisions thereby assure the long-term gas supply contracts and financial commitments which underlie pipeline development and service to the public. Without long-term supply contracts, future supplies of gas cannot be assured, Pure argues, and the risks of pipeline projects and difficulties of financing are greatly increased. Also, producers for their own protection must be able to employ favored nations clauses if they are going to enter into such long-term contracts, said Pure. The company contends that in the face of rising trends in prices and costs generally and the decline in the value of money, an unchanged gas price would result in substantial liquidation of the investment values of producers, with consequent adverse effects on the ability of producers to command investment and to maintain supplies of gas.⁵²

The Commission disposes of the producer's contention—basic to the FPC's condemnation of escalator clauses generally—initially in tones of dismissal under preceding arguments.⁵³ It then discounts the "free market" argument on two grounds, (1) the lack of consideration in escalator clauses to the market generally as distinguished from a particular sale under similar conditions and (2) the presence of state governmental proration and conservation controls.⁵⁴ The Commission concludes that the escalation provision has "outlived whatever economic function" it may have had in the past under present conditions of high level gas prices and numerous available purchasers.⁵⁵ The responsiveness of this conclusion to the Pure Oil contention will be discussed in the light of the three exceptions

⁵² 25 F.P.C. at 390.

⁵³ *Ibid.*

⁵⁴ *Id.* at 390-91.

⁵⁵ *Id.* at 391.

in Order 232A that constitute the Commission's determination of when an apparent relationship exists between an "indefinite" escalation clause in a long-term gas sale contract and "the economic requirements of the producers who sell the gas."

Pure also stressed the importance of an incentive to explore for gas and to maintain supplies in interstate flow; it contended that elimination of the clauses would require provisions in contracts for higher fixed prices and more frequent applications for price increases.⁵⁶ The Commission answered⁵⁷ in such terms as, "If additional incentives are found necessary, measures can be taken to supply them. . . ."; as to higher price predictions similar answers are expressed in dismissing them as "most unlikely" and projecting instead "proposals . . . solidly grounded on a basis having a rational connection to the factors of significance in determining proper price for gas. . . ." Only in this last projection does the Commission appear to confront the basic argument of Pure that entering into long-term contracts encouraged by the Commission policy is causally pertinent to the Commission-reserved general escalation issue. It is fair to say that generalizations such as "proposals . . . solidly grounded on a basis having a rational connection to the factors of significance . . ." leave something to be desired if judged by the test of reasoned conclusions.⁵⁸ It is also dubious whether the producer's reference to conditions of present supply and demand contribute much more in the way of a reasoned disposition of the long-term contractual contention.

The three exceptions provided by the Commission to the escalation proscriptio; *viz.*, (1) specifically provided price increases at definite future dates stipulated in the contracts, (2) provision for reimbursement of seller for changes in certain taxes, and (3) price increases at five-year intervals under price-redetermination between the parties (such price not to be higher than a rate in the area involved that is not in issue in certificate or suspension proceedings); would seem to be the conception by the Commission in its statement in the *Pure Oil* decision of "proposals . . . solidly grounded on a basis having a rational connection to the factors of significance in determining the proper price for gas."

⁵⁶ *Ibid.*

⁵⁷ *Ibid.*

⁵⁸ 25 F.P.C. 392 (1959). This comment relates only to the "general" issue, the Commission's findings which were relied upon in the sequence of Orders 232, 232A, and 242. Such findings were in the nature of obiter dictum in the *Pure Oil* decision for, as observed *supra*, the Commission's findings under the specific issue, *e.g.*, the lack of relationship of the *increased rate proposed* by Pure Oil to the contractual escalation standards, were supported by substantial evidence.

The first standard, that of specific price increases at definite future dates provided in the producers' contracts (if otherwise feasible) scarcely seems consistent with the Commission reiteration in each of its orders that price flexibility is necessary for the effectuation of its long-term contract policy. The second standard, *viz.*, price increase accommodation to changes in tax levies, is consistent with such a policy but only partial in its reach. The third standard possesses the characteristics of a contractually-imposed price freeze because the Supreme Court in the *Mobile* decision laid down the rule that a producer could not apply for a price increase exceeding a price to which he had committed himself by contract.⁵⁹ In filing for a price increase during a five-year period representing a redetermination under such a contractual provision, one producer would seem limited by the past successes of another springing perhaps from factually unrelated conditions. It is questionable whether such an imposed standard upon long-term contractual provisions is on more solid ground in its "rational connection to the factors of significance" in determining the proper price for gas.⁶⁰

The general policy decision against indefinite escalation clauses—that the Commission reserved for its own decision—thus was dealt with by a finding largely conclusionary and removed from the context of the proceeding. The Commission's repeated reference to immediate triggering of the Pure escalation clauses by each higher sale of gas ignored the conditions precedent in the contracts.⁶¹ Pure's misapplication of the contractual provisions was relevant only to the permissibility of the particular increases, not to a producer's need of or the public harm occasioned by such provisions themselves. The Commission's marked obfuscation of this issue may be traceable to a warranted impatience with all that adds to a heavy workload, including interpretations of escalation provisions.⁶² Seemingly, the root of such

⁵⁹ *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956).

⁶⁰ See *United Gas Improvement Co. v. FPC*, 283 F.2d 817, 823-24 (9th Cir. 1960), *cert. denied sub. nom.*, *Superior Oil Co. v. United Gas Improvement Co.*, 365 U.S. 879 (1961).

⁶¹ *The Pure Oil Co.*, 25 F.P.C. 383 (1961).

⁶² A total of 6,597 rate filings seeking field price changes were made by independent producers during fiscal 1962, compared with 7,915 filings the previous year. . . .

During the year the Commission acted on 1,550 increases based on contract escalation provisions and renegotiation of prior existing contracts, and on 4 increases involving State taxes. Of this total, 746 increases aggregating about \$6,428,493 yearly were allowed without suspension, and 808 increases, totaling \$7,501,816 were suspended. The Commission also disposed of 188 increases, amounting to \$10,515,222 per year, representing filings which after suspension were either allowed, disallowed, or withdrawn by the companies. This left 4,458 increases involved in 2,902 dockets, for \$164,870,541 annually, pending

impatience is to be found in the "administrative burden" factor, and out of this factor substantive policy should not be fashioned that is not otherwise authorized by the regulatory statute.⁶³

To the objection of the producers, apparently at least in part addressed to the intrusion upon freedom of contract involved, as may be gathered from the relatively brief reference thereto made in Order 242, the Commission merely answered that this was not the real issue; rather, said the Commission, the rule meets the test—"whether the rule is rationally related to a condition which requires correction if regulatory objectives embraced by the statute are to be achieved."⁶⁴

This, it would seem, partakes of an exercise in short shrift on so basic a question. As a reason supporting an act of Commission discretion, it is no reason at all. Moreover, that some question of freedom of contract is presented is self-evident, a fact neither blunted nor dismissed merely by being turned aside. Last, it was assumed that the application of the "rational relationship" rule was a limitation judicially constructed for purposes of court review of agency rules or policy. It comes as a surprise that this rule of the courts may be substituted by the administrative agency for the very exercise of reasoned expert judgment in deference to which the courts invoke the rule. As was said by a dissenting judge in another context of rulemaking review: "Our review of the merits of Commission decisions is limited. One of the justifications for the limitation falls away if the parties are not afforded a full opportunity to be heard before the Commission itself. . . ."⁶⁵

The rulemaking process followed here by the FPC may be compared with the evolution of a FCC rule as described in a recent decision of the United States Court of Appeals for the District of Columbia. In *Van Curler Broadcasting Corp. v. United States*,⁶⁶ the validity of a rule of the FCC was in question. After a rulemaking proceeding under section 4(b) of the Administrative Procedure Act, the National Table of Assignments of Television Channels was amended to add channel 10 to Vail Mills, New York. The Court said:

Since the Commission did not summarily depart from established principles or program, but on the contrary followed a course clearly

as of June 30, 1962. Of the 188 increases disposed of after suspension, the Commission allowed \$7,232,084 of the proposed \$10,515,222 in annual increases. 1962 FPC Ann. Rep. 105.

⁶³ See note 93 *infra*.

⁶⁴ 27 F.P.C. 339, 340 (1962).

⁶⁵ Judge Fahy, dissenting, in *Owensboro on the Air, Inc. v. United States*, 262 F.2d 702, 709-10 (D.C. Cir. 1958).

⁶⁶ 236 F.2d 727 (D.C. Cir.), *cert. denied*, 352 U.S. 935 (1956).

anticipated and provided for in its basic Sixth Report, its action can in no sense be deemed arbitrary or capricious. . . . The conclusion reached by the Commission is clearly stated. The basis and purpose of the order are ample and understandably, even though succinctly, stated and are within the considerations prescribed by the statute as criteria for Commission action. The order is also consistent with the provisions of the act dealing with the distribution of licenses. The *given reasons* are rational and support the conclusion. Having reached the foregoing conclusions the function of the court is at an end in a case such as this . . .⁶⁷ (Emphasis added; footnotes omitted.)

IV. THE LITIGATION

The Tenth Circuit decided the first appeal from a rejection by the FPC of a contract filed with it by a natural gas company for the sale of gas to a pipe line purchaser; the sales contract contained an indefinite price changing clause.⁶⁸ The court held (1) that the re-

⁶⁷ *Id.* at 729-30.

⁶⁸ The contractual provisions with respect to escalation of gas prices over the period of the contract, rejected by the Commission in *Texaco, Inc.*, follow:

Redetermination Clause. (2) At least six (6) months prior to the beginning of the third five (5) year period of the delivery term and at least six (6) months prior to the beginning of the fourth five (5) year period of the delivery term [20 years], Buyer and Seller shall endeavor to agree upon a renegotiated price to be paid during the succeeding five (5) year period in lieu of the price as provided herein. The parties hereto shall, for each of the periods respectively, upon facts existing six (6) months prior to each such period, determine and fix as the renegotiated price for such ensuing period the average of three (3) prices, each of which gives the highest price provided to be paid by one of the three (3) different purchasers of gas for re-sale in other states for ultimate public consumption paying the highest prices to producers for gas being produced from a field or fields lying wholly or partly within Texas and Beaver Counties, Oklahoma, under agreements arrived at by arm's length bargaining, which agreements are in existence without condition of authorization of any regulatory authority not then granted six (6) months prior to the beginning of such period, between such producers and such purchasers (non-affiliated with such producers); provided, however, no such agreements shall be considered which provide for a yearly quantity greater than the quantity purchased by Buyer from Seller hereunder during the preceding year. The price so fixed shall be fixed in cents per thousand (1,000) cubic feet for the five (5) year period based upon the determinable prices in such agreements and provided further that such price shall not be less than the price provided for such period herein by Paragraph (1) hereof. In the event the contracts considered in determining the price hereunder contained provisions varying from the corresponding provisions of this agreement with respect to differences in tax allowances, methods of computation of quantities, and any other differences in pressure base or payment for gathering, compression, quality, dehydration or any other matter having a bearing on price, then the variations in such provisions shall be taken into account and appropriate adjustments in the stipulated prices set out in such contracts shall be made to compensate for such variations to arrive at an adjusted price which will cover deliveries and receipt of gas under conditions comparable to those set out herein. Brief for Petitioner, pp. 5-6, *Texaco, Inc. v. FPC*, 317 F.2d 796 (10th Cir. 1963), *rev'd*, 32 U.S.L. Week 4370 (U.S. 1964).

The reference to price as provided in paragraph (1) of the contract is explained at page 2 of the Brief for Respondent FPC in the proceeding: "The contract . . . provides

jection constituted invalid agency action because it was not founded upon any evidence that the court could review and (2) that the rule providing for such rejection was invalid because the Commission, pursuant to general statutory rulemaking authority, could not regulate in conflict with specific provisions of the Natural Gas Act prescribing hearings for initial certification and rate review. The court also decided that the rules did not contain the statutory findings required by the substantive statutory provisions.⁶⁹

Basically, the Tenth Circuit in the *Texaco* decision found that there was no authority under sections 4, 5, and 7 of the Natural Gas Act to act upon the price increase clauses without a hearing and that section 16 of the act, which empowers the Commission to make rules and regulations to carry out the provisions of the act, was not a source of power to regulate in conflict with the substantive provisions of the act. Significantly, the Tenth Circuit relied on *FCC v. ABC, Inc.*⁷⁰ The court pointedly said: "[W]e have no way of determining the factual basis for . . . [the Commission's] findings because we have before us no record of facts to sustain them."⁷¹

The Ninth Circuit, some months later, decided the second such appeal from a Commission rejection action on essentially similar facts.⁷² The court held that (1) the Commission has statutory power

for a price of 17 cents for Mcf for the first five-years; 18-1/2 cents for the second five-year period; 20 cents for the third five-year period and 21-1/2 cents for the fourth five-year period. . . ." Brief for Respondent, p. 2, *Texaco, Inc. v. FPC, supra*.

⁶⁹ *Texaco, Inc. v. FPC, supra*, note 68.

⁷⁰ 347 U.S. 284 (1954). In this case the Supreme Court rejected a rule of the Commission that attempted to go beyond the Congressional grant of authority with respect to lotteries.

⁷¹ *Texaco, Inc. v. FPC*, 317 F.2d 796, 806 (10th Cir. 1963), *rev'd*, 32 U.S.L. Week 4370 (U.S. 1964).

⁷² The contractual provisions with respect to escalation of gas prices over the period of the contract rejected by the Commission in the *Superior Oil* case follow:

Redetermination Clause. Seller shall have the right at its option, to request a redetermination of the price provided in Section 7 of this Article to be paid for any one or more or all (but not part) of the periods set out in (b), (c), (d) and (e) above. Any such request made with respect to any of such periods shall be made in writing during the six (6) months immediately preceding the commencement of such period. If Seller shall make any such request, representatives of Buyer and Seller shall promptly meet and attempt to determine the then reasonable market price of the gas deliverable hereunder. In making such determination, consideration shall be given to all pertinent factors. The price so determined by Buyer and Seller shall be the price applicable during the entire period with respect to which the same was determined; provided that if such price shall be less than the price provided in Section 7 of this Article with respect to such period, the price during such period shall be as provided in Section 7. 322 F.2d 601, 603-04 n.5.

Favored-Nation Clause. Buyer agrees that the price to be paid from time to time to Seller hereunder for Residue Gas shall never be less than the price being paid by Buyer to others for comparable gas delivered under comparable conditions within the area shown on Exhibit 'B' attached hereto. *Id.* at 604 n.6.

The Commission makes no objection to a third price escalation provision, save in the

to issue general rules and regulations, (2) the rules in question, tested by the factual premise under which the Commission supported it, were valid as rationally related to statutory objects of Commission regulation, and (3) the rejection was permissible because the gas producer presented no special justification to the Commission that would require a hearing (under the certification and rate review provisions) on the issue of waiver or modification of the rules in his behalf.⁷³ The court's opinion, which is most carefully and tightly written, confined the result reached to the issue raised by the proceedings before the court. The reasoning of the court in reaching its result points, however, in the direction of subordinating statutory requirements of an evidentiary hearing to the general rulemaking authority of administrative agencies. This question becomes no less serious or substantive by the presence of a caveat that the persons affected may pray for relief under limited waiver provisions of the agencies's rules of practice. Therefore, a serious substantive and procedural question is raised.

The Ninth Circuit in the *Superior Oil* case reached a result opposite to that of the Tenth Circuit by taking up the arguments advanced by the producer in that case *seriatim* and essentially on the authority of *U.S. v. Storer Broadcasting Co.*⁷⁴ disposing of all but the question of the FPC's substantive authority. It first passed upon the question of whether, *assuming* that the FPC had the substantive authority to reject the price-changing provisions of the contract, it could do so by rulemaking rather than through *ad hoc* proceedings requiring an adjudicatory hearing. The court, relying on *Storer*, in effect concluded that anything which can be done by adjudicatory hearing can be done through rulemaking.

Next, the court took up the constitutional question of interference with rate and certificate filings. It concluded that if statutory hearing requirements could be met by substantive rulemaking procedures—with flexibility because of possible amendment or waiver under Agency Rules of Practice and Procedure⁷⁵—the constitutional re-

particular that it conditioned its grant of certification upon a decrease by Superior of the initial rate from 20¢ per Mcf to 17.7¢. The provision, prior to Superior's acceptance of such condition, is described as follows:

The pricing terms . . . called for an initial price of 20 cents per Mcf for the first five years commencing with the date of initial delivery under the original contract. It provided for a price of 21 cents per Mcf for the second five-year period, 22 cents per Mcf for the third five-year period, 23 cents per Mcf for the fourth five-year period, and 24 cents for Mcf thereafter if the contract remained in effect. . . . *Id.* at 603 n.4.

⁷³ *Superior Oil Co. v. FPC*, 322 F.2d 601, 617 (9th Cir. 1963), *cert. denied*, 32 U.S.L. Week 3385 (U.S. 1964).

⁷⁴ 351 U.S. 192 (1956).

⁷⁵ 12 Fed. Reg. 8473 (1947), as amended, 27 Fed. Reg. 9499, 11001 (1962).

quirements of due process also could be met by such provisions. The court said this implicitly was decided in the affirmative in the *Storer* case.

Finally, the court dealt with the question of the substantive authority to reject by rule contracts containing these price-changing provisions. Here, the court could not rely on *Storer*. By rather strained reasoning,⁷⁶ the court took the Supreme Court's holding in *Atlantic Ref. Co. v. Public Serv. Comm'n*,⁷⁷ which held that in a section 7 certificate proceeding the FPC had power to scrutinize *initial* prices in deciding public convenience and necessity, and *assumed* that the FPC must also have power to scrutinize price-changing clauses (applicable over the life of a gas sale contract) that might trigger future rate filings. The reasoning is dubious for (1) the ground set forth by the Supreme Court to support its finding does not seem present as to price-changing clauses⁷⁸ and if it is, (2) the source of the power of general rejection by rulemaking is not thereby established.⁷⁹

The *Storer* case was decided by the Supreme Court in 1956.⁸⁰ It involved an appeal from a rule of the FCC. The application of *Storer* for a permit to construct and operate a sixth television station was dismissed without hearing by the FCC on the basis of a "multiple ownership" rule. That rule limited the number of television station ownerships in any one person to five, for the stated purpose of preventing a concentration of communications control contrary to the public interest. *Storer* claimed that his right of hearing, provided by the Communications Act prior to denial of a license application, could not be abrogated by a rule, though he conceded the right of Congress to withhold such right if Congress determined a grant of an application would be contrary to the public interest (thus conceding that the Commission action presented a question of statutory rather than of constitutional due process).

⁷⁶ *Superior Oil Co. v. FPC*, 322 F.2d 601, 617-18 (9th Cir. 1963).

⁷⁷ 360 U.S. 378 (1959).

⁷⁸ In *Atlantic Ref. Co. v. Public Serv. Comm'n (CATCO)*, 360 U.S. 378 (1959), the Supreme Court held that the FPC should be rigorous under § 7 of the act in conditioning initial certificates as to initial prices set forth in gas sales contracts pursuant to the statutory standard of public interest, convenience, and necessity because the Commission's power to review such rates subsequently on its own motion under § 5 did not include the power to require a refund as in the case of increases in existing rates under § 4.

⁷⁹ It is elementary that administrative rules and regulations must find their source in statutory authority. *U.S. v. Grimaud*, 220 U.S. 506, 521-22 (1911) (sustaining regulations promulgated for the protection of national forests by the Secretary of Agriculture); *Pedersen v. Benson*, 255 F.2d 524 (D.C. Cir. 1958) (finding invalid a licensure system imposed by the Secretary of Agriculture in relation to an imported giraffe).

⁸⁰ *United States v. Storer Broadcasting Co.*, 351 U.S. 192 (1956).

The Supreme Court said that Congress had provided with care for fair opportunity by open competition in the use of broadcasting facilities, a requirement directly related to rules respecting public protection against ownership concentration, although express authorization for the specific limitations contained in the rules did not exist. The Court's opinion refers to the broad general rule-making authority provided by sections 4(i) and 303(r) of the Communications Act (quite similar in import to that of section 16 of the Natural Gas Act, as remarked by the Ninth Circuit opinion in *Superior*).⁸¹ *Storer* meets directly the contention of statutory clash between the exercise of rulemaking authority and the statutory hearing provision by (1) reference to and exposition of the substantive statutory provision relative to competition, (2) emphasis upon previous Commission use of concentration of control as a policy factor, as upheld in *NBC v. United States*⁸² and *FCC v. Allentown Broadcasting Corp.*,⁸³ and (3) reference to the need for considering the context of the act. The Court said: "Courts are slow to interfere with their [specialized agencies'] conclusions when reconcilable with statutory directions. . . ."⁸⁴ The Court pointed out that under the FCC's Rules of Practice and Procedure a waiver or exception to the rules could be requested, but that sufficient justification for such waiver or exception would be a prerequisite to a full hearing in view of the extensive administrative hearings conducted by the Commission before promulgating the rules.

The *Storer* decision, insofar as it sustained summary rejection of an application, did not pronounce a new doctrine. Before *Storer* there had been other cases upholding the power of an agency to dismiss applications or other matters without according a statutory opportunity for hearing if for reasons of law or authorized regulation they did not qualify for agency consideration.⁸⁵ What was new in the decision was this: a policy rule was issued in an authorized area of regulation, but was subject to attack for arbitrariness because it provided an absolute numerical proscription without hearing; however, the rule was strengthened measurably in withstanding such attack because of the hearing flexibility afforded by the waiver provisions contained in the Agency's Rules of Practice and Procedure.

It would appear that in the context of the present discussion the

⁸¹ *Superior Oil Co. v. FPC*, 322 F.2d 601, 612 (9th Cir. 1963).

⁸² 319 U.S. 190 (1943).

⁸³ 349 U.S. 358 (1955).

⁸⁴ 351 U.S. 192, 203 (1956).

⁸⁵ *FCC v. WJR*, 337 U.S. 265 (1949); *Air Line Pilots Ass'n, Int'l v. Quesada*, 276 F.2d 892 (2d Cir. 1960), 286 F.2d 319 (D.C. Cir.), *cert. denied*, 366 U.S. 962 (1961); *Capitol Broadcasting Co. v. FCC*, 324 F.2d 402 (D.C. Cir. 1963).

Storer case received an emphasis greater than was warranted in *Superior*. The undue emphasis is caused by taking from *Storer* one of its elements and virtually disregarding another interdependent element. Thus in *Storer*, as has been observed, the Supreme Court carefully went into the question of statutory authorization to issue the *kind* of rule in issue—a legal question; then the Supreme Court considered the question of arbitrariness of the *rule as issued*—a question of the reasonableness of an agency's application of a granted power. It was in the latter connection that the Supreme Court gave weight to the procedural right under the agency rules of practice to apply for a waiver of the particular rule. According to the reasoning of the Supreme Court, such an application for waiver, properly supported, would require approval by the agency or an adjudicatory hearing before denial.⁸⁶ Therefore, the possibility of an arbitrary impact of a numerical ceiling rule was diminished adequately by force of the agency's own procedures. However, this reasoning was distinct from the statutory power to enact a rule of this kind which the Court determined on the basis of independent considerations.

The Ninth Circuit opinion in this connection considered solely the *general* rulemaking provision of the Communications Act and disregarded the more specific rulemaking provisions of the act that were reflected in the *Storer* decision. The specific rulemaking provisions would seem to demonstrate substantial differences in the enabling legislation of the FCC and the FPC. Moreover, the Ninth Circuit opinion ignored the Supreme Court decision in *FCC v. ABC, Inc.*, which indicated quite clearly that a commission's authority cannot go beyond that granted by Congress.

A brief comparison of the Communications Act and the Natural Gas Act shows that the Communications Act is a more pervasive scheme of regulation with a much more comprehensive grant of authority to the FPC. The Natural Gas Act is a far more narrow grant of authority. Sections 4 and 5 permit the Commission to reject proposed rate increases or to modify existing rates if they are not just and reasonable or if they are unduly discriminatory or preferential. Section 7 permits the denial of a certificate if the Commission is

⁸⁶ Unfortunately, the language of the Supreme Court in *Storer* also contains reference to the possibility of requesting an "amendment" of the rule. The Court undoubtedly had no intention of depriving the applicant from showing special justification for obtaining an adjudicatory hearing and subsequent judicial review upon the basis of substantial evidence. However, the word "amendment" could imply that the applicant may be restricted to submission of written views according to the established procedure for rules amendment under § 4 of the Administrative Procedure Act. 60 Stat. 238 (1946), 5 U.S.C. § 1003 (1946); see note 101 *infra*.

unable to find that it is "required by the present or future public convenience and necessity." Each section is subject to express hearing requirements.

It is true that both section 4(i) of the Communications Act⁸⁷ and section 16 of the Natural Gas Act⁸⁸ authorize the respective Commissions to make such rules and regulations as may be necessary in the execution of the administrative functions concerned. It is also true that, as the Natural Gas Act in its area of concern, the Communications Act contains express provision for hearing before denial of a broadcast license application.⁸⁹ However, the Communications Act—in sections 303, 307, 308, 313, 314, 315, and 317—grants the administering agency authority to act by rule and regulation on many substantive matters⁹⁰ including the qualification of licensees. Thus, there is no question that the *substantive* rulemaking authority of the FCC is more specific than that granted the FPC.⁹¹

⁸⁷ "The Commission may perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions." 48 Stat. 1066 (1934), 47 U.S.C. § 154(i) (1960).

⁸⁸ 52 Stat. 822 (1938), 15 U.S.C. § 717o (1962).

⁸⁹ 48 Stat. 1085 (1934), 47 U.S.C. § 309(b) (1960).

⁹⁰ Section 303(g) (48 Stat. 1082 (1934), 47 U.S.C. § 303(g) (1962)) provides that the Commission, except as otherwise provided, shall from time to time as public convenience, interest or necessity require: study new uses for radio and generally encourage the larger and more effective use thereof in the public interest. Section 307(a) and (b) (48 Stat. 1083 (1934), 47 U.S.C. § 307(a) (1962); 48 Stat. 1083 (1934), 47 U.S.C. § 307(b) (1962)) provide for a grant of a license if the public interest will be served, and that in the grant of application, modifications, and renewals of licenses, the Commission shall make "such distribution of licenses, frequencies, hours of operation, and of power among the several States and communities as to provide a fair, efficient, and equitable distribution of radio service to each. . . ." Section 308(b) (76 Stat. 63 (1962), 47 U.S.C. § 308(b) (1962)) provides that applications must set forth "such facts as the Commission by regulation may prescribe as to the citizenship, character, and financial, technical and other qualifications of the applicant to operate the station; the ownership and location . . . the frequency and the power . . . the purpose for which the station is to be used; and such other information as it may require. . . ." Section 3(h) (48 Stat. 1065 (1934), 47 U.S.C. § 153(h) (1956)) provides that a person engaged in radio broadcasting shall not be deemed a common carrier. Section 313 (74 Stat. 893 (1960), 47 U.S.C. § 313a (1960)) provides that all laws of the United States relating to unlawful restraints, combinations, contracts, or agreements in restraint of trade are applicable to "interstate . . . radio communications. . . ."

⁹¹ See also *Dyestuffs & Chemicals, Inc. v. Flemming*, 271 F.2d 281 (8th Cir. 1959), wherein the Secretary of Health, Education and Welfare was sustained in removing by an order, issued after rulemaking proceedings but without adjudicatory hearing, certain food colors for coloring such products as butter and oleomargarine. The Secretary acted under a statute (68 Stat. 517 (1954), 21 U.S.C. § 346(b) (1958)), providing in part: "The Secretary shall promulgate regulations providing for the listing of coal-tar colors which are harmless and suitable for use in food" The Secretary refused the petitioner, producer of the removed colors for some years under departmental certification, an adjudicatory hearing requested under a further statute providing for such hearing as to a regulation issued upon making specific objections and stating the grounds therefor. 52 Stat. 1055 (1938), 21 U.S.C. § 371(e) (1960). The Court held that the objections made must be adequate to raise issues. It will be noted that the statute under which the regulation was promulgated was substantive in its content. The Court cited the *Storer* decision.

In *Denver Union Stock Yard Co. v. Producers Livestock Marketing Ass'n*, 356 U.S. 282

In evaluating *Storer* as authorizing the use of rules to avoid hearings, the breadth of FCC authority was important. The *Storer* case held no more than that, with respect to a factor which clearly had been made an element of public interest under the Communications Act, the Commission reasonably could handle the matter by rulemaking plus the flexibility of a waiver provision rather than the *ad hoc* approach of adjudication. The Supreme Court found that the concentration of control of communication facilities was a legitimate factor of public interest in the context of the Communications Act which the Commission was authorized to consider either in adjudicatory or rulemaking proceedings. Not only could the Court point to numerous provisions of the Communications Act as the source of substantive authority but—and this is significant—the particular element of the public interest had been judicially sustained in a number of cases previously appealed.⁹²

In seeking to find substantive authority for the FPC, the Ninth Circuit greatly expanded the Supreme Court decision in the *Atlantic Ref. Co. (CATCO)* case.⁹³ The Supreme Court in that case interpreted section 7 as (1) authorizing (indeed requiring) the FPC to scrutinize initial rates in a public convenience and necessity proceeding to the extent necessary to protect the consumer against exces-

(1958), the statute made it the duty of every market agency "to furnish upon reasonable request, without discrimination, reasonable stockyard services at such stockyard," and defined the nature of the "stockyard services." 72 Stat. 1750 (1958), 7 U.S.C. § 201(b) (1959). The respondent was registered as a market agency with several stock yards having widely separated marketing areas. One such yard published a regulation prohibiting market agencies registered with it from diverting business to other markets. The respondent complained that the regulation was illegal on its face. In this case the Secretary of Agriculture, under the Packers and Stockyards Act (42 Stat. 159 (1921), 7 U.S.C. § 181 (1921)), had taken the contrary position that the respondent must come forward with evidence. The Supreme Court held for the respondent. The *Storer* decision was cited, in view of the provision for "hearing" in the statute (42 Stat. 165 (1921), 7 U.S.C. § 210 (1959)), the court observing that a hearing would be futile when the statute obviously required the market agency to furnish its services without discrimination to the various stockyards of which respondent was a member.

⁹² As early as 1937 the FCC found that the multiple ownership of radio facilities had adverse implications to the public convenience and necessity. *In re* Community Broadcasting Co., 4 F.C.C. 422 (1937); *In re* Martinsburg Broadcasters Co., 11 F.C.C. 419 (1946); *In re* Finger Lakes Broadcasting Co., 11 F.C.C. 528 (1946); *In re* Orolhlich Bros., 11 F.C.C. 700 (1946); *In re* Bamberger Broadcasting Co., 11 F.C.C. 211 (1946). The propriety of this articulation of the meaning of the statutory standard of public convenience and necessity was judicially approved by numerous court decisions prior to *Storer*. *Clarksburg Pub. Co. v. FCC*, 225 F.2d 511 (D.C. Cir. 1955); *Scripps-Howard Radio v. FCC*, 189 F.2d 677 (D.C. Cir. 1951); *Plains Radio Broadcasting v. FCC*, 175 F.2d 358 (D.C. Cir. 1949). Indeed, the *Storer* case itself recognizes that the Supreme Court had in *FCC v. Allentown Broadcasting Co.*, 349 U.S. 358 (1955), agreed that improper concentration of control was an element of public interest. 351 U.S. 192, 203 n.12 (1956).

⁹³ *But see*, for an apparent extension of this reasoning, *United Gas Improvement Co. v. FPC*, 283 F.2d 817 (9th Cir. 1960), *cert. denied sub nom.*, *Superior Oil Co. v. United Gas Improvement Co.*, 365 U.S. 879 (1961). *United Gas*, however, does not extend *CATCO* in such a manner as to form a substantive basis for the price-changing rules in question here.

sive costs which might otherwise ensue during the period between first deliveries under initial rates and a final order in a section 5 proceeding and (2) authorizing the FPC to condition the grant of a certificate under section 7 upon acceptance of specific lowered initial rates.⁹⁴ The court found that the basic congressional intent was to protect the consumer against unjust and unreasonable prices and that the lack of this implied power would defeat the clear intent of Congress. No such reasoning supports the assumption by the Ninth Circuit that section 7 likewise implies power to proscribe price-changing clauses; these clauses merely *permit* the producers to file for increased prices which can only be charged *if* the FPC finds them just and reasonable under section 4.⁹⁵ Thus, the Ninth Circuit decision seems to extend congressional intent and, at least inferentially, give some weight to administrative convenience as a factor supporting the avoidance of the hearing requirements.⁹⁶

In addition, it is questionable whether the Ninth Circuit opinion is correct in its conclusion that *Storer* implicitly disposed of the constitutional question of due process under the fifth amendment. It is clear that in *Storer* no property right was involved; the only matter involved was the license *privilege* to use the radio spectrum under certain circumstances.⁹⁷ There the Supreme Court could well

⁹⁴ *Wisconsin v. FPC*, 373 U.S. 294, 304 (1963).

⁹⁵ See note 9 *supra*.

⁹⁶ *Superior Oil Co. v. FPC*, 322 F.2d 601, 620. However, difficulties of administration do not justify administrative extension of statutory meaning. *Addison v. Holly Hill Fruit Prod., Inc.*, 322 U.S. 607 (1944); *Phelps Dodge Corp. v. NLRB*, 313 U.S. 177 (1941); *Kessler v. FCC*, 326 F.2d 673, 687 (D.C. Cir. 1963); *NLRB v. Transco Chem. Corp.*, 303 F.2d 456 (D.C. Cir. 1962); *Mississippi River Fuel Corp. v. FPC*, 202 F.2d 899, 902-03 (3d Cir. 1953).

The court early in its discussion appears to have accepted the FPC rationale in *Pure Oil Co. v. FPC*, 299 F.2d 370 (7th Cir. 1962), as though the court in that case sustained the FPC's conclusions as to the undesirability of certain price-changing clauses. In fact the Seventh Circuit in that case merely sustained the Commission's ultimate finding that on the facts of record the *price-changing clause had not been triggered* within the triggering standards provided by the terms of the contract and therefore did not permit the filing of a new rate.

⁹⁷ See, e.g., § 304 of the Communications Act (48 Stat. 1083 (1934), 47 U.S.C. § 304 (1934)) which provides:

No station license shall be granted by the Commission until the applicant therefor shall have signed a waiver of any claim to the use of any particular frequency or of the ether as against the regulatory power of the United States because of the previous use of the same, whether by license or otherwise. See also Section 307(d) of the Act (47 USC 307(d) limiting broadcast license terms to three years; Section 301 (47 USC 301) providing that no license shall be construed to create any right beyond its terms, conditions and periods; and Section 309(h) (47 USC 309(h) further providing that a station license "shall not vest in the licensee any right to operate the station nor any right in the use of the frequencies designated in the license beyond the term thereof. . . .

See also *Transcontinent Television Corp. v. FCC*, 308 F.2d 339 (D.C. Cir. 1962).

This is not to deprecate the right to a fair and adequate administrative procedure that should be recognized in persons who, due to our much-regulated economy, must be

conclude that if Congress had authorized and granted the right to a hearing in certain circumstances it could also, by an adequately directionalized grant of authority to the Commission to issue rules, permit handling of those questions in instances falling within the specific grant by rulemaking rather than adjudication. In the natural gas field, however, as was pointed out by the Tenth Circuit in *Texaco*, the Supreme Court has stated that the Natural Gas Act did not "abrogate private rate contracts as such."⁹⁸ A constitutional question clearly would be presented had Congress granted the FPC authority to regulate initial contracts without the due process of an adjudicatory hearing.⁹⁹ The grant of authority to modify producer's initial contracts *after hearing* on the normal standards of rate making, *i.e.*, "just and reasonable," would comply with the due process requirement. However, the elimination of the adjudicatory hearing either by Congress or, as here, by the legislative rulemaking of the FPC could well run afoul of the constitutional proscription. In the *Superior Oil* decision the court said:

If the explicit amendment and repeal provisions and the implicit waiver provision of the agency's rules are sufficient to meet the requirements of the express statutory provisions pertaining to hearings (and we have held that they are), it would seem that they are also sufficient to meet the procedural requirements of the Due Process Clause of the Fifth Amendment.¹⁰⁰

If Congress specifically has set forth both provisions for adjudicatory proceedings and rulemaking authority, it can well be held that with respect to specific areas of congressional grant of authority the agency may handle certain matters as it administratively determines

certificated or licensed by the Government before they may pursue an occupation or venture into a business. Their procedural rights are, generally, lesser in degree because in most instances they have difficulty in establishing a property right or an enforceable personal freedom unless the legislature has acted in their behalf. Professor Jaffe makes the case well for such persons:

It is true, of course that the Government because of its guarantee of air carrier deficits is making an investment. But the certification process excludes any private investment whether or not the applicant seeks a subsidy. The actions of the CAB are much more—and much less—than a private decision to invest. They involve a determination whether A or B or neither shall invest, on pain of use of force if the losing party persists in flying airplanes for profit despite the Government veto. It is this total exclusion from the field on pain of penalty which distinguishes 'regulation' from a grant or loan which may, of course, be denied without formal procedure. It may well be that formal procedure impedes the best exercise of judgment in these areas of licensed activity. But the citizen will find it difficult to tolerate a power to exclude him and admit his neighbor if the power is exercised *in camera*. . . . Jaffe, *The Effective Limits of the Administrative Process: A Reevaluation*, 67 Harv. L. Rev. 1105, 1130 (1954).

⁹⁸ *United Gas Co. v. Mobile Gas Corp.*, 350 U.S. 332, 338 (1956).

⁹⁹ Cooper, *Administrative Agencies and the Courts* 72-74 (1951).

¹⁰⁰ *Superior Oil Co. v. FPC*, 322 F.2d 601, 614 (9th Cir. 1963).

is desirable, either by rulemaking under the procedures prescribed in section 4 of the Administrative Procedure Act¹⁰¹ or by the *ad hoc* approach.¹⁰² However, this is not a complete answer to a question of due process involving the taking of a property right.¹⁰³ Furthermore, the attempt of the Ninth Circuit to distinguish the *Morgan* case,¹⁰⁴ as a rate-fixing case, is not entirely convincing because the price changing clauses of the contracts are the only means whereby the producer may request any changes in the rates at which the gas is sold.

The Ninth Circuit opinion, then, appears to be open to the serious questions (1) that it is founded largely upon a Supreme Court decision resting upon independent sources of rulemaking power possessed by the FCC, a basis not discernibly present in the case of the FPC and (2) that a constitutional question of due process was met by the reasoning of the same Supreme Court decision in which no constitutional issue was present.¹⁰⁵

¹⁰¹ Section 4 of the Administrative Procedure Act (60 Stat. 238 (1946), 5 U.S.C. § 1003 (a) (1958)) provides in pertinent part:

[With exceptions not pertinent] (a) Notice.—General notice of proposed rule making shall be published in the Federal Register . . . and shall include (1) a statement of the time, place, and nature of public rulemaking proceedings; (2) reference to the authority under which the rule is proposed; and (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved. . . .

(b) Procedures.—After notice by this section, the agency shall afford interested persons an opportunity to participate in the rulemaking through submission of written data, views, or arguments with or without opportunity to present the same orally, in any manner; and after consideration of all relevant matter presented, the agency shall incorporate in any rules adopted a concise general statement of their basis and purpose. Where rules are required by statute to be made on the record after opportunity for an agency hearing, the requirements of sections 7 and 8 shall apply in place of the provisions of this subsection.

¹⁰² *Logansport Broadcasting Corp. v. United States*, 210 F.2d 24, 27 (D.C. Cir. 1954); see also Baker, *Policy by Rule or Ad Hoc Approach—Which Should It Be?*, 22 Law & Contemp. Prob. 658 (1957).

¹⁰³ *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 606-07 (1944). The solutions in this event should not necessarily be sought in such polarized procedures as (1) a full-scale evidentiary hearing for each company or (2) a § 4 (Administrative Procedure Act) "written views" proceeding for all companies. Hearings may take other forms consistent with the subject matter and the substance of the right asserted. For a discussion of the problems involved, see Fuchs, *Constitutional Implications of the Opp Cotton Mills Case With Respect To Procedure and Judicial Review in Administrative Rule-Making*, 27 Wash. U.L.Q. 1 (1941).

¹⁰⁴ *Morgan v. United States*, 304 U.S. 1 (1937). This case involved the fixing by the Secretary of Agriculture of maximum rates to be charged by market agencies at the Kansas City Stock Yards. The controlling statute provided for a hearing. A hearing was held. This decision reversed the government decision for failure to accord due process of law because its order was based on grounds of which the respondents were given inadequate notice prior to or during the hearing.

¹⁰⁵ *United Gas Pipeline Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103, 113-14 (1958); *Willmut Gas & Oil Co. v. FPC*, 294 F.2d 245, 250 (D.C. Cir. 1961), cert. denied, 368 U.S. 975 (1962). Moreover, it may be noted that in the *Storer* decision the Court was meticulous in its regard for the appropriate protection of statutory

The Commission's contention in both proceedings was that it possessed general regulatory power under section 16 and that this power read in the context of the act as a whole extended to the matters covered in other sections of the act, in this case sections 4, 5, and 7.¹⁰⁶ In the orders that underlie the litigation, its position was expressed in terms of necessity and appropriateness in the public interest and in the proper administration of the Natural Gas Act.¹⁰⁷ Furthermore, the Commission concluded:

[S]ections 4, 5 and 7 of the Natural Gas Act contemplate that the Commission will refuse to approve contractual provisions found adverse to the public interest. Section 16 of the Act, of course, authorizes the Commission to issue rules and regulations of general applicability found necessary or appropriate to carry out the provisions of the Act.¹⁰⁸

As the opinion of the Tenth Circuit points out, however, sections 4, 5, and 7 set forth hearing procedures for their implementation; they bestow substantive powers and duties upon the Commission dependent for their effectuation upon the expressed statutory mode of exercise of these powers and duties.¹⁰⁹ To depart from the statutory

hearing rights, as witnessed by the reservation in the opinion that one who failed to meet the requirements of the rule in issue could seek a waiver and consequent adjudicatory hearing upon special justification shown (a condition fully recognized and preserved by the Ninth Circuit opinion). Thus, notwithstanding the strength of the delegated rulemaking authority, the Supreme Court, in avoidance of the arbitrary effect of a numerical ceiling rule in special circumstances, did not go the full distance in upholding a pervasive regulation. Inherent in the escalator rule litigation, however, as we have seen, are difficult problems: rulemaking control asserted from a general rule making delegation and from the very sections that provide for *ad hoc* hearings and on the very subjects of concern therein; and invocable property rights recognized by past decisions—to make gas supply contracts and to operate under such contracts subject to the statutory standards.

¹⁰⁶ Pertinent provisions of these sections are set out in notes 7-9 *supra*.

¹⁰⁷ Order 232, 25 F.P.C. 379 (1961); Order 232A, 25 F.P.C. 609 (1961).

¹⁰⁸ Order 242, 27 F.P.C. 339 (1962).

¹⁰⁹ The Tenth Circuit based its holding in this regard upon *FCC v. American Broadcasting Co., Inc.*, 347 U.S. 284, 290 (1954); *FPC v. Panhandle E. Pipeline Co.*, 337 U.S. 498 (1949); *Addison v. Holly Hill Fruit Prod., Inc.*, 322 U.S. 607, 617-18 (1944); *Willmut Gas & Oil Co. v. FPC*, 294 F.2d 245 (D.C. Cir. 1961), *cert. denied*, 368 U.S. 975 (1962). In the *Willmut* case as stated in the Ninth Circuit opinion that distinguished the case, adjudication rather than a rulemaking was involved. The court in *Willmut*, in meeting a contention of one of the parties, however, said:

Section 16 of the Act speaks in broad and general terms. . . . But the broad power granted by this statutory language does not authorize an order, rule or regulation which would nullify or restrict the right of a natural gas company to change the rate under which it offers to furnish service, subject only to the requirement of section 4(d) of the Act that it notify the Commission of the changes, so that it may proceed under Section 4(e). . . . 294 F.2d at 250.

In the *Panhandle* case the Supreme Court affirmed the refusal of an injunction sought by the FPC to prevent assignment of leaseholds by Panhandle as endangering its ability to serve its customers under its certificate from the FPC. The holding was that jurisdiction over gas reserves, in the framework of the statute, remained with the states. The Court spoke to FPC's argument for its regulatory authority under § 16 as follows: "The power to do the things appropriate to carry out the provisions of the Act can hardly be taken to rescind a prohibition against certain actions." 337 U.S. at 508. The *American Broad-*

course of procedure "precludes the possibility of any effective judicial review."¹¹⁰ Moreover, the court said sections 4 and 5 permit modification of contracts by the Commission, but this does not include Commission power to make contracts.¹¹¹ The Commission's orders speak in ultimate terms with respect to these substantive problems found by the Tenth Circuit as conclusive of the absence of administrative authority for the rulemaking action taken.¹¹² It is open to serious question, therefore, whether the orders constitute a rational basis supporting the rules adopted.¹¹³

Another basic point of departure between the two courts of appeals decisions appears in their difference in approach to the method of judicial review of the rules. The Ninth Circuit stated that only a legal question was presented.¹¹⁴ The rules would be considered on the basis of the factual premise presented by the Commission. This factual premise did not include the rulemaking transcripts, which were not filed with either court. In the Tenth Circuit proceeding one petitioner stated that the FPC had refused to file the rulemaking records.¹¹⁵ The appeal in the Ninth Circuit was decided upon a stipulated record.

The Court in the Tenth Circuit proceeding observed:

Summary rejection of the Texaco and Pan American contracts without a hearing deprives the court of any record upon which the rejection may be sustained, other than the general orders which are attacked . . . the Commission has successfully maintained that these general orders are not subject to direct court review. This bootstrap operation of the Commission, in practical effect, circumvents court review of the basic question—the propriety of indefinite price-changing clauses.¹¹⁶

The Tenth Circuit thus said clearly that rejection (adjudicatory action), or the rules on which the rejection was based (rulemaking), did not present purely a legal question but a question of substance

casting case is referred to in note 70 *supra*. The *Addison* case reversed the Administrator of the Wage and Hour Division who construed the words "area of production" in the act that he administered as empowering him not only to designate territorial boundaries but also the number of employees working in a particular establishment.

¹¹⁰ 317 F.2d 796, 807 (10th Cir. 1963), *rev'd*, 32 U.S.L. Week 4370 (U.S. 1964).

¹¹¹ *Id.* at 805. The distinction traces to the point made in *Mobile* wherein the more specific regulatory authority of the Interstate Commerce Commission was compared. See note 5 *supra*.

¹¹² See notes 107-08 *supra*.

¹¹³ See *Logansport Broadcasting Corp. v. United States*, 210 F.2d 24, 27 (D.C. Cir. 1954).

¹¹⁴ 322 F.2d at 619.

¹¹⁵ Brief for Pan American Petroleum Corp. on Answer to Revised Motion to Dismiss Reply of Petitioner, p. 11, *Texaco, Inc. v. FPC*, 317 F.2d 796 (10th Cir. 1963), *rev'd*, 32 U.S.L. Week 4370 (U.S. 1964).

¹¹⁶ *Texaco v. FPC*, *supra* note 115, at 804-05.

to be reviewed upon evidence in a record before the court.¹¹⁷ Equally clearly, the Tenth Circuit's statement is influenced by its judgment that the rulemaking subject matter is governed by provisions requiring an evidentiary hearing. It follows that an administrative rule-making record consisting only of briefs and written views and statements which constituted the unfiled administrative transcripts in these proceedings would not meet the objection raised by the Tenth Circuit.¹¹⁸

The Ninth Circuit's restricted review of the rules, pursuant to a question of law designation, may be compared with the broader review accorded in *Storer* by the Supreme Court. In the latter case the entire rulemaking record was filed both in the court of appeals and in the Supreme Court.¹¹⁹ The Supreme Court, at one point,

¹¹⁷ 63 Stat. 107 (1949), 15 U.S.C. § 717r(b) (1958) provides:

Any party to a proceeding . . . aggrieved by an order issued by the Commission . . . may obtain a review of such order in the court of appeals of the United States . . . by filing in such court . . . a written petition . . . the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28 . . . such court shall have jurisdiction . . . to affirm, modify, or set aside such order in whole or in part . . . The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. . . .

28 U.S.C. § 2112(a) (1958) provides: "[T]he several courts of appeals shall have power to adopt . . . rules . . . prescribing the time and manner of filing and the contents of the record. . . ." 28 U.S.C. § 2112(b) (1958) specifies: "[T]he record to be filed in the court of appeals in such a proceeding shall consist of the order sought to be reviewed or enforced, the findings or report upon which is based, and the pleadings, evidence, and proceedings before the agency, board, commission, or offices concerned . . . or such portions thereof as the rules of the court of appeals might require."

See also 73 Stat. 9 (1948), 28 U.S.C. § 501 (1959); Fed. R. Civ. P. 72-76 (especially R. 75(o)); 9th Cir. R. 34; 10th Cir. R. 34(7). 9th Cir. R. 34 pertains to the "Review or Enforcement of Orders of Administrative Agencies, Boards, Commissions and Officers." 9th Cir. R. 10 "Appeals, Return and Record" specifies that "the clerk of the . . . Commission shall transmit to the clerk of this Court the original files designated by the respective parties as the record on appeal or review."

10th Cir. R. 34(7) pertains to the "Transcript in Review and Enforcement Proceedings—Time for Filing—contents—Abbreviation by Stipulation or Order." It provides: "[T]he transcript of the record on review shall include the entire record in the proceeding before the agency, board, commission or officer when so required by the applicable statute." Fed. R. Civ. P. 72-76 apply to Appeals. Rule 75(o) requires the appellant to serve a "designation of the portions of the record, proceedings, and evidence to be contained in the record on application . . ."

¹¹⁸ The orders and regulations of the FPC, unless determinative of a petitioner's status, are not subject to review under § 19(b). *Magnolia Petroleum Co. v. FPC*, 236 F.2d 785 (5th Cir. 1956), cert. denied, 352 U.S. 968 (1957). When they are given definitive impact against the petitioner by an order assertedly based upon them, a petition for review lies. *Sun Oil Co. v. FPC*, 304 F.2d 293 (5th Cir. 1962); see also *United Gas Pipeline Co. v. FPC*, 181 F.2d 796 (D.C. Cir.), cert. denied, 340 U.S. 827 (1950).

¹¹⁹ 351 U.S. 192 (1956), Joint Appendix.

referred to the extensive administrative hearings held¹²⁰ and, at another point, to matters presented by the respondent during the administrative proceeding.¹²¹ Moreover, in *Storer* the Court cited repeatedly the case of *FCC v. NBC*,¹²² a rulemaking case in which this statement was made by the Court: "Our duty is at an end when we find that the action of the Commission was based upon findings supported by evidence, and was made pursuant to authority conferred by Congress. . . ."¹²³

As stated by Professor Kenneth Culp Davis, there are three elements for consideration by a court in reviewing a rule.¹²⁴ The first, the question of legal power to make the rule under the statute itself, was raised in the present proceedings. The second, more frequently an issue and in issue in the present proceedings, is the validity of the rule as a rational exercise of agency discretion. The third is whether the rule was issued pursuant to proper procedure.

As to the second element, the scope of judicial review should be broader than the opinion of the Ninth Circuit would seem to indicate. The court's consideration should not be narrowed to the rationality of the agency's ultimate conclusions or a statement—however limited—designated by the agency as its "factual premise" for the rule. When factual considerations are at issue, agency conclusions are slim ma-

¹²⁰ *Id.* at 205.

¹²¹ *Id.* at 193-94. In *Storer*, as emphasized by this footnote and footnote 92, the Court gave consideration to the reasonableness of the FCC rules on the basis of a rulemaking record. This is evident from its attention to a position of *Storer* expressed in that record as filed with the Court. The scrutiny of the Court then was not limited to an ultimate conclusion of the FCC (compare earlier portions of this Article for a description of the ultimate character of the FCC findings) or a "factual premise" of that agency untested by context or adverse contention. Insofar as the administrative procedure is concerned, neither the FCC nor the FPC held an adjudicatory hearing as a part of the rulemakings.

¹²² 319 U.S. 190 (1943). This case was decided before enactment of the Administrative Procedure Act in 1946.

The exhaustive preliminary investigations and procedural care undertaken prior to the promulgation of an agency rule have been weighed by the courts. In *Atlas Powder Co. v. Ewing*, 201 F.2d 347 (3d Cir.), *cert. denied*, 345 U.S. 923 (1953), the Federal Security Administrator issued an order establishing a standard of identity for bread under the Food, Drug and Cosmetic Act, 52 Stat. 1046 (1938), 21 U.S.C. § 341 (1958). The statute required such regulations, as in his judgment would promote honesty and fair dealing in the interest of consumers, establishing for any food a reasonable standard of identity, quality, and fill of containers. Further, it provided that if optional ingredients were permitted by the Secretary he should designate them, and they should be named on the label. After an extensive investigatory hearing, during which the petitioners attempted to prove that the standard of identity for bread should include their bread softeners as optional ingredients, the Secretary refused to change the standard for this purpose. On appeal the court held that substantial evidence in the record of the proceeding sustained the findings of the Secretary that the option sought would tend to deceive consumers of the bread that it was fresher than it was. The court said further: "[T]he fact that administrative action has been dominated by great caution but serves to emphasize the reasonableness of the Administrator's conduct. . . ." 201 F.2d at 355.

¹²³ *FCC v. NBC*, 319 U.S. 190, 224 (1943).

¹²⁴ 1 Davis, *Administrative Law*, § 5.05, at 314-15 (1958).

terials upon which to test whether agency action is unreasonable, arbitrary, or capricious. An agency's "factual premise" may be quite unresponsive to the data, views, and evidence brought together in a proceeding designed for the twin purpose of assisting the agency and according the participants a fair opportunity to be heard.

This is not intended to imply, of course, that the aggrieved person contesting the rule may not face presumptions of regularity or reasonableness as to which he needs to raise a substantial question. It is to say that the court should not limit its own review to such confines as deprive it of the materials that may be required to make a judgment respecting rationality of the rule.

This should hold especially true when the rules, though broad in nature and founded in policy, have immediate, direct, and permanent effect upon the rate provisions of gas sales contracts. Past decisions of the Supreme Court prevent the producer from filing for a rate higher than is provided in his contract. By submitting to the stipulated "price-changing" provisions, as Order 242 designates them,¹²⁵ the producer irrevocably commits himself to the contractual ceilings determined under these changed price rules.

As stated by Judge Fahy in *Capital Transit Co. v. Public Utilities Comm'n.*¹²⁶

But the evidence and findings must bring the situation within these tests if they are to apply. Even were we to assume the evidence should support such findings as to the entire urban zone the Commission itself should first make them on the basis of its own consideration of the evidence. . . . The Commission does refer in its opinion to the fact that the urban zone has been extended from time to time. . . . The Commission also states the record indicates that it is desirable and equitable. . . . But we are not justified in translating these general statements either into findings of similarity of costs and revenues . . . or into other terms which support the reasonableness of rates in that part of the urban zone. . . . *The importance and character of the subject* call for findings which reflect the *subsidiary and ultimate bases* for the action taken . . . or . . . other factors by which the reasonableness of the District rates can be judged. . . .

The basic problem is whether rates fixed by the Commission for the District are on a higher level than they reasonably and justly should be due to other sources not bearing their fair share of revenues. We do not now decide whether this is the fact or not. But when the problem lies across jurisdictional lines and is not solved by the permissible formulae of allocating as between jurisdictions . . . the method

¹²⁵ 27 F.P.C. 339, 340 (1962).

¹²⁶ 213 F.2d 176, 183-84 (D.C. Cir. 1954). The case involved review of a rate proceeding in which a power company, by virtue of serving customers in the District of Columbia, Virginia, and other interstate consumers, was subject to regulation by the FPC and the Public Utilities Commissions of the District of Columbia, Maryland, and Virginia.

which is adopted must be rationally manifested in findings and conclusions, the former grounded in evidence and the latter in evidence and reasoning, which enable the court to support the District rates alone. The burden upon Transit to sustain its attack upon the orders, see *King v. United States* [344 U.S. 254] is carried when such findings, essential to adequate review, are lacking. . . . *The statutory duty of this court to review questions of law implies the necessity for such findings.* . . .¹²⁷ (Emphasis added.)

V. CONCLUSIONS

In leading decisions dealing with the review of administrative rules of similar import, there is precedent for judicial cognizance of the procedural fairness that has attended the promulgation of the rules. Thus in a rulemaking of the seriousness discussed in this Article, judicial affirmance of the rules as possessing a rational basis might well take into consideration whether the regulations are the product of a careful weighing of all pertinent factors involved from the standpoint of the public and of the persons regulated.¹²⁸ The rules are broad and of a policy character, and therefore the Commission should not be limited to action of a purely *ad hoc* nature. However, the statutory policy providing for evidentiary hearings should be observed. In such a situation of apparent need for accommodation of statutory provisions for rulemaking and for adjudication, it is suggested that one of two administrative courses of action should be required. The first—as instanced by such rule review decisions as the *Assigned Car Cases*,¹²⁹ *SEC v. Chenery Corp.*,¹³⁰ *Illinois Commerce Comm'n v. United States*,¹³¹ *NBC v. United States*,¹³² and *United*

¹²⁷ The *Texaco* decision, 317 F.2d 796, 805-06 (10th Cir. 1963), *rev'd*, 32 U.S.L. Week 4370 (U.S. 1964), stated that such findings as the FPC made in Orders 232, 232A, and 242 were "not made in the language of the statutory standards of 'just and reasonable' and 'public convenience and necessity'." In the absence of an evidentiary hearing, such findings would present greater difficulty as applicable to fair and reasonable pricing terms of these long-term contractual relationships.

¹²⁸ The Supreme Court has expressed the general congressional intent in drafting the Natural Gas Act, 52 Stat. 833 (1938), 15 U.S.C. § 717(a)-(w) (1938):

It seems plain that Congress, in so drafting the statute was not only expressing its conviction that the public interest requires the protection of consumers from excessive prices for natural gas, but was also manifesting its concern for the legitimate interests of natural gas companies in whose financial stability the gas-consuming public has a vital stake. . . . *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103, 113 (1958).

The provision for "hearing" in the sections of the Natural Gas Act cited in this Article means a full hearing, e.g., an adjudicatory or evidentiary hearing. *Willmut Gas & Oil Co. v. FPC*, 294 F.2d 245, 250-51 (D.C. Cir. 1961), *cert. denied*, 368 U.S. 975 (1962). Though the rulemaking power of the Commission under § 16 of the act is broad, the power must be exercised in light of the initial rate-making and rate-changing powers of the natural gas companies which are undefined and unaffected by the act. *Id.* at 250.

¹²⁹ 274 U.S. 564 (1926).

¹³⁰ 332 U.S. 194 (1947).

¹³¹ 292 U.S. 474 (1934).

¹³² 319 U.S. 190 (1943).

*States v. Storer Broadcasting Co.*¹³³—is the establishment of the bases for the rule by a series of adjudicatory hearings that developed the full outlines of the problem and foundation facts for its solution by the exercise of expert administrative discretion. The second is the initiation by the agency of a broad investigatory hearing at which representative evidence is taken, though not necessarily as a matter of individual adjudication. The latter procedure is illustrated by such cases of rulemaking litigation as *American Trucking Ass'ns, Inc. v. United States*;¹³⁴ *NBC v. United States*;¹³⁵ *New York v. United States*;¹³⁶ *Pacific States Box & Basket Co. v. White*;¹³⁷ *Willapa-point Oysters, Inc. v. Ewing*;¹³⁸ and *Logansport Broadcasting Corp. v. United States*.¹³⁹

On an issue of such grave economic significance the regulation of the agency should rest upon an adequate rationale. That rationale, because it is determinative of economic facts and projections both broad and individual in their characteristics and impact, should be based in turn upon competent, relevant, and material factual premises. Under either of the two suggested procedures, these should be obtainable with adequacy. In all likelihood they would not be under the procedure followed by the FPC, which neither took the form of an investigatory type rulemaking nor was preceded by judicially affirmed policy based on a number of adjudicatory proceedings. In fact its reliance upon what amounts to its own dicta in the *Pure Oil* case and its failure to cite other cases are indicative of this basic weakness.

It is not suggested that in each of the cases mentioned the procedure was the *sine qua non* for a judicial decision upholding the agency rulemaking. It is suggested that in each case the court gave consideration to the evidence developed in the course of determining the agency regulation to be a rational exercise of its authority. It is further suggested that effective judicial review makes desirable either of these forms of procedure in circumstances involving the immediate, serious, and major economic effects found in these rules.

It is believed that the desirable becomes the essential when a reconciliation of the grant of authority to make regulations and a grant of authority to review rates and contracts is required by express and pertinent differences in statutory procedure as discussed in the course of this Article. The Court of Appeals for the

¹³³ 351 U.S. 192 (1956).

¹³⁴ 344 U.S. 298 (1953).

¹³⁵ 319 U.S. 190 (1943).

¹³⁶ 331 U.S. 284 (1947).

¹³⁷ 296 U.S. 176 (1935).

¹³⁸ 174 F.2d 676 (9th Cir.), cert. denied, 338 U.S. 860 (1949).

¹³⁹ 210 F.2d 24 (D.C. Cir. 1954).

District of Columbia recently indicated the strength of the rule-making section of the Natural Gas Act in an appeal involving statutory reconciliation, unattended, however, by the issue of statutory right to hearing.¹⁴⁰ The same court, also recently, effected a reconciliation with respect to an FCC rule. The Court upheld an FCC rule that eliminated a television frequency that had been licensed to a private corporation, because the license term extended only for three years and the Commission postponed the effect of the rule upon the existing licensee to the end of his license term.¹⁴¹

A similar reconciliation would appear to be available in the present problem area.¹⁴² The Commission has both rulemaking and investigatory power. Its rules under consideration are of a broad policy character, an inherent element of a regulatory rule. They cover the subject of future price increases by contract, the regulation of which Congress confided to the Commission subject to express standards and procedures. The procedural requirements stipulate the holding of hearings as the method of this exercise of regulation.

As has been seen, no hearing preceded the issuance of the rules being considered. An appropriate form of hearing consonant with the policy considerations involved and the substantive impact of the policy determined would seem an antecedent condition to the issuance of rules if reconciliation of the statutory provisions is to be effected.¹⁴³ That result could be attained, as earlier indicated, by a representative sampling of *ad hoc* adjudicatory hearings or by an investigatory

¹⁴⁰ Public Serv. Comm'n v. FPC, 327 F.2d 893 (D.C. Cir. 1964).

¹⁴¹ Transcontinental Television Corp. v. FCC, 308 F.2d 339, 344 (D.C. Cir. 1962).

¹⁴² Dean Newman has recently said:

Most important of all, we need further analyses where Professor Davis has shown us that our work to date is mostly exploratory. To illustrate: Has he not proved that 'More harmful than helpful is the proposition . . . that hearings are required for judicial functions but not for legislative functions . . .' If that be true, do we not desperately need some learned scrutiny of our mystique regarding 'hearing on the record'?

Newman, *The Literature of Administrative law and the New Davis Treatise*, 43 Minn. L. Rev. 637, 650 (1959). (Footnote omitted.)

¹⁴³ This need was recognized by the Report of the Committee on Rulemaking to the Administrative Conference of the United States, September 18, 1962, when it said: "Individualized determinations on the basis of a record after a hearing having many adjudicatory characteristics have in the past been thought to be required when an agency was fixing maximum rates, since a rate set at too low a level would result in confiscation of private property. . . ." *Id.* at 6.

The Committee made certain recommendations to the Conference, which were adopted (Final Report of the Administrative Conference of the United States to the President, December 15, 1962, Recommendation No. 19), one of which pertained to "Reducing the Number or Scope of Rate Proceedings Prior to Hearing" and involved such considerations as requiring rate applicants to submit detailed data justifying rate filings of general importance; developing standardized data relating to such matter as costs admissible as prima facie proof in rate cases; encouraging negotiated settlement of rate cases; and "attempting by rulemaking, general policy statements, or the reasoning in opinions to formulate reasonably specific standards or principles to be applied in rate cases." *Id.* at 19.

hearing, each or both laying the foundation for rules responsive to facts, economic data, and reasoned expert judgment. Without this foundation a power that has been bestowed by the Congress subject to extending the right of full and fair hearing will have been exercised informally under lesser safeguards and less reliable information for administrative decision, and it may be added, upon analysis of the rulemaking procedure followed, with undue restriction of the scope of judicial review.¹⁴⁴

Regardless of (1) the Commission's judgment that the public interest per se requires adoption of the rules in question or (2) the administrative burdens that the Commission has sought to eliminate or minimize by these rules, the procedure followed by the Commission in reaching this result raises questions of grave concern relative to government by edict in lieu of government through regulation pursuant to authorized statutory process.

† [Editor's Note: The Supreme Court, on April 20, 1964, 32 U.S.L. Week 4370 (U.S. 1964), decided the *Texaco* case, reversing the Tenth Circuit. This Article, prepared before the Supreme Court rendered its opinion, is published without change. The Court virtually adopted the theory of the Ninth Circuit's decision in *Superior Oil v. FPC*. This latter decision has been analyzed at length in this Article. Much of that which is said regarding *Superior Oil* is applicable to the *Texaco* decision by the United States Supreme Court.]

¹⁴⁴ In the words of Professor Jaffe, judicial review thereby does no more than assert itself primarily to protect "the clear statutory purpose." Jaffe, *Judicial Review: Question of Law*, 69 Harv. L. Rev. 239, 261 (1955). See also Cooper, *Administrative Agencies and the Courts*, 342-44 (1951).

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