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NOTES & COMMENTS

NATURAL GAS RATE REGULATION: THE CONFLICT IN THE APPLICATION OF THE JUST AND REASONABLE STANDARD

On July 28, 1976, the Federal Power Commission (FPC) established a rate level that tripled the price of "new" natural gas.¹ The increase is the largest in FPC history. Its impact will be immense; the increased cost to the consuming public over the next year could be as great as 3.5 billion dollars.² The new rate level was an attempt to alleviate the present gas shortage,³ which is part of the overall energy crisis. As such it was only one of a series of actions⁴ taken by the FPC over the last five years in an effort to fulfill its duty to set just and reasonable prices for the sale of natural gas imposed by the Natural Gas Act.⁵

1. The new rate is \$1.42 per mcf (thousand cubic feet) for natural gas from wells commenced and gas dedicated to interstate commerce on or after January 1, 1975 (post January 1, 1975 gas). Opinion 770-A, 41 Fed. Reg. 50,199 (1976). The previous rate, established in 1974, was \$.50 per mcf for post January 1, 1973 gas. 18 C.F.R. § 2.56a (1976).

2. The original estimate of the cost by the FPC was about \$1.5 billion or an increase of about \$15.60 for the average residential consumer over the year following the increase. [1976] EN. USERS REP. (BNA), No. 155, at A-232. However, utility companies have estimated that the cost will approach \$4 billion or an increase of about \$40 per consumer. Wall St. J., Oct. 20, 1976, at 8, col. 2.

3. Beginning in 1968, the amount of natural gas distributed in the United States has exceeded that added to reserves. [1976] EN. USERS REP. (BNA), No. 146, at G-1. For data pertaining to reserves, production and future demand, see FPC, BUREAU OF NATURAL GAS, NATURAL GAS SUPPLY AND DEMAND 1971-1990 (1972).

4. See notes 90-122 *infra* and accompanying text.

5. 15 U.S.C. §§ 717-717w (1970).

All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, 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.*

15 U.S.C. § 717c (emphasis added). Section 717d provides:

Both the FPC and courts reviewing its actions have understood that the duty to set just and reasonable prices entails two competing objectives. First, the FPC is to insure a proper supply of natural gas so that service to the customer is maintained.⁶ Second, it is to insure that the price at which service is supplied is kept low to protect the consumer.⁷ However, the FPC and reviewing courts have disagreed concerning which goal should predominate. As the supply of natural gas has dwindled, the Commission's efforts to fulfill its duty have increasingly emphasized the first objective, the improvement of supply in order to maintain consistent service to present customers.⁸ Most of these actions have been frustrated when reviewed as a result of the prevailing judicial assumption, fixed in the early years of the Act, that the FPC's duty to insure just and reasonable rates is primarily intended to serve the second objective, the protection of the consumer from unreasonable prices.⁹

In view of the success of previous attacks, it is likely that judicial reaction to the present increase will be hostile. Because it far exceeds past rate changes, the action will probably be interpreted as a de facto deregulation of interstate natural gas prices and thus an abdication by the FPC of its duty to maintain just and reasonable rates.¹⁰ The

Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is *unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: Provided, however, That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.*

(emphasis added).

6. See, e.g., *Mobil Oil Corp. v. FPC*, 417 U.S. 283 (1974); FPC, STAFF REPORT No. 2, NATIONAL GAS SUPPLY AND DEMAND 1971-1990 (1972).

7. See, e.g., *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *In re City of Cleveland v. Hope Natural Gas Co.*, 3 F.P.C. 150 (1942).

8. See, e.g., Order No. 428, 45 F.P.C. 454 (1971) (small producer exemption).

9. See, e.g., *Texaco v. FPC*, 474 F.2d 416 (D.C. Cir. 1972), *rev'd in part*, 417 U.S. 380 (1974).

10. The new rate level bears a striking resemblance to the unregulated intrastate market price. The new rate level, which took effect in September, 1976, is \$1.42 per mcf, while the average interstate price was \$1.26 per mcf in the first half of 1975, \$1.29 per mcf in the second half of 1975, and \$1.57 per mcf in the first half of 1976. [1976] EN. USERS REP. (BNA), No. 153, at G-1 to G-2; [1976] EN. USERS REP. (BNA), No. 170, at G-1.

likelihood that the rate order will be overturned underscores the need to examine both the options open to the FPC and the judicial interpretation of the Natural Gas Act in order to find a means of breaking the present impasse. The stakes are high; continued conflict is bound to exacerbate the natural gas shortage and further impede the formation of a national gas policy.¹¹ Even though the winter of 1976-1977 brought home the realities of the shortage to the public,¹² the emergency legislation enacted in response is only intended to solve short-term supply problems.¹³ A resolution of the rate controversy is prerequisite to a solution of the long-range problems manifested in the present crisis.

Since the ability of the FPC to respond to present economic conditions is limited by past judicial conceptions of what constitutes a just and reasonable rate, it is appropriate to historically examine the Commission's actions and judicial reaction to them to determine if the assumptions underlying those reactions have continuing validity. In order to make this examination, the traditional bases for regulation first will be sketched.

I. DEFINING THE CONFLICT: THE ECONOMIC AND CONSTITUTIONAL CONSIDERATIONS IN THE REGULATION OF NATURAL GAS

Regulation of natural gas was not only a political decision to protect the consuming public, but also a logical economic action. A consistent supply of power at a non-prohibitive rate is one of the

11. Martin, *The Poverty of American Energy Policy*, 12 TULSA L.J. 65 (1976); Williams, *Some Ingredients of a National Oil and Gas Policy*, 27 STAN. L. REV. 969 (1975).

12. While the effects of the winter of 1976-1977 cannot yet be fully assessed, it is clear that the severe cold weather coupled with the gas shortage caused a major disaster. There were seventy-five weather-related deaths and the economies of 17 eastern states were seriously affected because over 2 million persons were laid off work. Unfortunately the crisis will not end with winter because of the significant drain on natural gas reserves. It is estimated that some industrial users will be without gas until the middle of April, 1977. [1977] EN. USERS REP. (BNA), No. 181, at 4-5; [1977] EN. USERS REP. (BNA), No. 182, at 6-7; Wall St. J., Feb. 1, 1977, at 1, col. 3; Wall St. J., Feb. 2, 1977, at 1, col. 3.

13. Emergency National Gas Act of 1977, Pub. L. No. 95-2, [1977] EN. USERS REP. (BNA), No. 182, at 31-34. The legislation has two basic provisions. Section 4 gives the President power to order interstate pipelines to share gas and transport supplies to gas-poor areas of the country. This power will terminate April 30, 1977. Section 6 allows the President to authorize purchases of gas by interstate pipelines at rates above the present level if these prices are "fair and equitable" until August 1, 1977.

The emergency legislation's approach to the supply problem appears sound, but its effect will at best be limited. It does nothing to change the Natural Gas Act or alter the Federal Power Commission's duty to insure just and reasonable rates. After emergency legislation lapses, the Commission will be in exactly the same position that it was in prior to the winter of 1976-1977.

infrastructure services, along with transportation and communication, which are prerequisite to a modern industrial state.¹⁴ To protect their general economic welfare, all developed countries regulate their power industries.¹⁵

The second economic rationale for natural gas regulation is based on the danger inherent in the gas industry's market structure. Because all the gas used in the United States can be transported satisfactorily by a few pipelines and there is little competitiveness at points of distribution, the natural gas industry has been characterized as either a natural monopoly¹⁶ or oligopoly and, as a result, a prime target for regulation. As a natural monopoly, the bargaining position of a natural gas company in an unregulated market allows it to exploit the public through excessive charges. However, unlike the situation in other sectors of the economy, the welfare of the consumer is not improved if a competing enterprise enters the market to share in the high profits enjoyed by the original natural gas company. In this case competition is undesirable because it effects an extreme misallocation of resources.¹⁷

14. 1 A. KAHN, *THE ECONOMICS OF REGULATION* 11 (1971) [hereinafter cited as KAHN]; Posner, *Taxation by Regulation*, 2 BELL J. ECON. & MANAG. SCI. 22, 39 (1971).

The American system of public utility regulation plays a vital role in the national economy by making possible the dominance of private enterprise in the operation of the industries which are of a monopoly character. Of all our basic industries only the mails are exclusively government-owned and operated. The railroads, the airlines, the motor transport industry, the maritime industry, the telephone and telegraph industries, the radio and television broadcasting systems and the electric power and natural gas industries, are all either wholly or predominantly in private hands, despite the fact that *they are the foundation of our industrial economy* and by their nature are not subject to the same forces of competition as other commercial enterprises.

Address by Joseph C. Swider, former FPC Chairman, Chicago Law Club (Feb. 4, 1965) (emphasis added), reprinted in A. PRIEST, *PRINCIPLES OF PUBLIC UTILITY REGULATION* 4 (1969) [hereinafter cited as PRIEST].

15. A. HANSON, *THE MANAGEMENT OF PUBLIC UTILITIES BY LOCAL AUTHORITIES* I 14 (International Union of Local Authorities monograph No. 89, 1966).

16. The term [natural monopoly] does not refer to the actual number of sellers in a market but to the relationship between demand and the technology of supply. If the entire demand within a relevant market can be satisfied at lowest cost by one firm rather than by two or more, the market is a natural monopoly, whatever the actual number of firms in it. If such a market contains more than one firm, either the firms will quickly shake down to one through mergers or failures, or production will continue to consume more resources than necessary.

Posner, *Natural Monopoly and Its Regulation*, 21 STAN. L. REV. 548, 548 (1969).

17. Since, by definition, *see* note 16 *supra*, "the entire demand within a relevant market can be supplied at lowest cost by one firm," competition by a second firm necessarily involves expending more capital than is necessary for the needed service. The historical solution to this problem of gaining the advantages of natural monopoly without its incumbent disadvantages has been regulation. *See* H. ADAMS, *THE RELATION OF THE STATE TO INDUSTRIAL ACTIVITY* 57-133 (1887), *excerpted in* W. JONES, *REGULATED INDUSTRIES* 1-5 (2d ed. 1976).

As a result of its natural monopoly aspects and its significance for industrial development, the natural gas industry has been classified as a public utility.¹⁸ As a public utility, some well established constitutional principles govern how it can be regulated. Because public utilities are "property affected with the public interest," regulation of the rates that they can charge does not, alone, constitute a denial of property without due process.¹⁹ The more significant issue of whether a rate could be set so low as to be confiscatory was answered by the Supreme Court in *Smyth v. Ames*.²⁰

In *Smyth* stockholders of the Union Pacific Railway challenged the Nebraska rate setting procedure for railroads, arguing that the rates set for the company under the procedure were so low that the resulting limitation of their profits constituted a denial of due process. The Court, agreeing with the plaintiffs, held that an enterprise such as the railroad is "entitled to ask a fair return upon the value of that which it employs for the public convenience."²¹ In effect, the Court established the minimum threshold of a regulated rate. This minimum guarantees a property owner the recovery of the costs of operating a regulated enterprise, including a set profit. Thus, while property "affected with the public interest" can be regulated, the property owner cannot be forced to lose money on his enterprise.

18. Jurenev, *Marketing of Petroleum and Natural Gas*, in *ECONOMICS OF THE MINERAL INDUSTRIES* 330, 346 (E. Robie ed. 1964).

19. *Munn v. Illinois*, 94 U.S. 113, 126 (1877). Under *Munn*, "property" became clothed with a public interest when used in a manner which affected the public at large. When one devoted his property to a use which affected the public, he was said to have, in effect, granted the public an interest in that property, and submitted to public control for the common good. After *Nebbia v. New York*, 291 U.S. 502, 537 (1934) ("So far as . . . due process is concerned, . . . a state is free to adopt whatever economic policy may reasonably be deemed to promote public welfare, and to enforce that policy by legislation adapted to that purpose."), the question of when property becomes affected with the public interest has become one of only historical interest. Cf. *Tyson v. Banton*, 273 U.S. 418, 446 (1927) (Holmes, J., dissenting) ("[T]he notion that a business is clothed with a public interest and has been devoted to the public use is little more than a fiction intended to beautify what is disagreeable to the sufferers.").

20. 169 U.S. 466 (1898).

21. *Id.* at 547.

[I]n order to ascertain . . . [the fair value of the property being used by an enterprise for the convenience of the public], the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of property.

Id. at 546-47.

In contrast to the minimum rate requirements of due process, the Natural Gas Act, by inclusion of the just and reasonable standard, also sets a maximum on the rates that can be charged for natural gas. Even though the purposes such a maximum serve, insuring proper service and protecting the consumer, are clear, how they should be translated into a concrete standard is uncertain.

What constitutes a reasonable maximum for rates charged by a public utility can usually be established with relative ease. In most instances the costs of rendering service are easily ascertained and fairly constant. From the costs of an enterprise consumer rates are computed that give utility investors a reasonable rate of return on their investments.²² Rate making for the natural gas industry, however, is complicated because of its unique nature; while the industry may appropriately be considered a public utility, it also has many of the characteristics of a commodity market.²³

Even though it may not fulfill a technical definition of a commodity,²⁴ gas has commodity aspects because its production responds to market demand in much the same way as manufactured goods. Thus, since gas is useable from the time it is piped out of the ground, its value

22. Public utility commissions evaluate two qualitative factors before making a rate determination. The rate base, which is an amount equal to the capital investment, is assessed first. The methods used to determine the value of rate bases have been the subject of controversy. See notes 52-57 *infra* and accompanying text. A certain rate of return, designed to make investment in that utility as desirable as investment in non-regulated enterprises having similar risks, is then multiplied by the rate base to compute the returns to be given investors. The rates to be charged are determined by apportioning the necessary return and the operating costs of the enterprise over all the services offered.

Electrical service is an example of a public utility which conforms easily to this pattern. Because its fixed capital costs, resulting from the initial purchase of generating and transmission facilities, do not fluctuate and its variable costs, such as the purchase of primary fuels, represent a small portion of the cost of its service, the consumer rates computed by the relevant public utility commission should insure the electrical utility both that it can recover its costs and show a profit approximating the intended rate of return for some time in the future. F. SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 523-27 (1970).

23. A commodity market exists when six factors are present: (1) a free flow of the commodity to market, (2) large-scale supply and demand, (3) homogeneous trading units, (4) standardization of grades, (5) the commodity must be storable, and (6) uncertainty of supply and demand. S. ANGRIST, *SENSIBLE SPECULATING IN COMMODITIES* 26 (1972). Except for the regulation of natural gas prices at the point of production, the natural gas industry conforms to the above criteria.

24. Commodities have been defined as "tangible things capable of satisfying human wants. The term is applied to common articles of commerce and trade. It does not include land, natural resources, or services. The term is ordinarily used in a narrower sense than economic goods, which includes services." B. HORTON, *DICTIONARY OF MODERN ECONOMICS* 60 (1948).

is closely linked to the market demand for all forms of raw energy,²⁵ as well as to the costs of its production. As a result, formulas used to determine other public utility rates, concerned only with the problem of allocating a service and restraining the rates charged for it, are inappropriate in the regulation of natural gas, where the duty to insure service inherently requires the encouragement of an adequate supply of the commodity.²⁶ Such a supply may not be produced if the prices paid for natural gas are kept artificially low.

25. The United States relies primarily on four fuels: oil, natural gas, coal and uranium.

[C]oal, oil, natural gas, and uranium are sufficiently substitutable in their use by electric utilities to support the conclusion that they trade in the same economic market. . . . [T]here is credible evidence that the decisions of sellers in the natural gas producing industry, in terms of output, cannot be made in isolation from fuel prices and output in the larger energy market.

The Natural Gas Industry: Hearing Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 93rd Cong., 1st Sess. 76 (1973) (statement of John N. Nassikas).

The commodity nature and substitutability of the primary fuels is shown by the effects of regulation on the production of natural gas. The prices of uranium and coal are not controlled. The price of oil is set under the Emergency Petroleum Act of 1973, 15 U.S.C. 751 (Supp. III). Because the control of oil prices is designed to promote energy independence, its rates have not been kept as low as those for natural gas, which have been fixed under a traditional public utility rationale. As a result, natural gas has been made relatively attractive and increased demand has caused its increased production:

	Oil	Gas	Coal	Uranium, Geothermal & Hydropower
1950	33%	20%	43%	2%
1975	30%	37%	25%	8%

DEPT. OF THE INTERIOR, ENERGY PERSPECTIVES 2 at 59 (1976).

26. The natural gas industry is a hybrid of a pure commodity producing industry and a public utility. The production phase of the industry is similar to the production of other primary fuels. See note 25 *supra*. The transmission and distribution phases of the industry are natural monopolies and closely resemble other public utilities. The rate problem arises from the fact that the two aspects cannot be treated distinctly; to insure realistic consumer rate control all phases of the industry must be regulated. See *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 685 (1954).

The FPC and the courts have approached the industry as a public utility despite its commodity-production aspects. This approach has proven to be at odds with the goals of natural gas regulation: fair rates and assured service. To insure service, an adequate supply of gas must be maintained through continuous exploration and development. To promote exploration and development, an adequate rate of return must be guaranteed the investor. Public utility rate procedures assume a constant cost which fluctuates only slightly over the long run. See note 22 *supra*. Such an assumption is justified for a natural monopoly, but not for gas exploration in which capital investment will not necessarily net any return. As a result of nonproducing or high-cost wells, the costs of gas exploration are highly unpredictable. Because their returns on the producing wells they do discover are limited by the inappropriate assumption of predictable variable costs, borrowed from the regulation of other industries, gas producers are not encouraged to increase supply. Thus, the public utility approach does not help achieve the goal of providing adequate service to the consumer. MacAvoy, *The Regulation-Induced Shortage of Natural Gas*, 14 J. LAW & ECON. 167 (1971).

Any regulation of natural gas should reflect both the commodity and public utility aspects of the industry. Unfortunately, the judiciary has relied on concepts of just and reasonable rates which were developed for the regulation of industries which fit the public utility model without tempering them with ideas based on the commodity characteristics of natural gas. The result has been to ignore the goal of insuring adequate service.

II. THE EVOLUTION OF THE CONFLICT

The present dilemma concerning the application of the just and reasonable standard is the result of the interaction of four elements: (1) the availability of gas supplies adequate to meet consumer demand, (2) the scope of the FPC's jurisdiction over the natural gas industry, (3) the formulas and approaches used by the Commission to insure just and reasonable rates and (4) the judicial interpretation of the statutory requirement that all rates charged for natural gas be just and reasonable. As long as gas supplies were sufficient to meet consumer demand and the FPC's jurisdiction did not include all of the natural gas industry, application of the just and reasonable standard presented no problem. Because there was no shortage, rate controls had essentially one objective, consumer protection, and the FPC and the courts basically agreed on the means of achieving that goal. This relationship among the four elements characterizes the formative stage of the FPC's development. The conflict appeared in the second stage of the Commission's development, when the FPC's and the courts' interpretation of the Natural Gas Act's duty diverged as gas supplies began to dwindle. To understand these two distinct periods and the significance of the shift, the historical roots of the Act and the expansion of the FPC's jurisdiction will be described.

A. THE FORMATIVE PERIOD: 1938-1971

In 1924 the Supreme Court created the need for federal regulation when it reviewed *Missouri v. Kansas Natural Gas Co.*²⁷ to determine if a producer state could constitutionally fix the rates on gas sold for consumption in other states. The Court held that a state could not fix such rates, even in the absence of federal regulation, because the rates would directly burden interstate commerce. Four years later the Court handed

27. 265 U.S. 298 (1924).

down a similar decision dealing with the interstate transmission of electricity.²⁸

In response to these decisions, the Senate ordered the Federal Trade Commission to investigate the industrial use of electricity and natural gas.²⁹ The result was a study filling approximately 100 volumes.³⁰ These reports led directly to passage of the Federal Power Act³¹ in 1935 and the Natural Gas Act in 1938. By demonstrating the importance of the natural gas industry to the economy, the reports provided cogent justification for the federal regulation of natural gas in the vacuum left by the Supreme Court.³²

1. *The Expansion of the FPC's Jurisdiction*

The scope of the FPC's rate jurisdiction has been an exceedingly involved question due to the complexity of the industry, which has three distinct phases: production, transmission and distribution. There was no debate over the total regulation of transmission companies' pipelines.³³ Controversy centered around the significance of the Act's exclusion of "production and gathering" from its scope.³⁴

While there is relatively little physical difference between producers, they were forced into four legal classifications by the FPC, depending either on who owned them or where their gas was sold. Integrated producers were defined as companies which were involved in

28. *Public Util. Comm'n v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927).

29. S. Res. 83, 70th Cong., 1st Sess., 69 Cong. Rec. 3054 (1928).

30. S. Doc. No. 12, 70th Cong., 1st Sess. (1928-1936).

31. 16 U.S.C. §§ 792-828c (1970).

32. See Davis, *The Influence of the Federal Trade Commission's Investigations on Federal Regulation of Interstate Electric and Gas Utilities*, 14 GEO. WASH. L. REV. 21 (1945). See also DeVane, *Highlights of Legislative History of the Federal Power Act of 1935 and the Natural Gas Act of 1938*, 14 GEO. WASH. L. REV. 30 (1945); Kitch, *Regulation of the Field Market for Natural Gas by the Federal Power Commission*, 11 J. LAW & ECON. 243 (1968) [hereinafter cited as Kitch]; Note, *Legislative History of the Natural Gas Act*, 44 GEO. L.J. 695 (1956); Note, *Federal Price Control of Natural Gas Sold to Interstate Pipelines*, 59 YALE L.J. 1468 (1950) [hereinafter cited as *Federal Price Control*].

33. H.R. REP. NO. 709, 75th Cong., 1st Sess. 1-2 (1937).

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

15 U.S.C. § 717(b) (1970) (emphasis added). 15 U.S.C. § 717a(6) (1970) states: "Natural-gas company" means a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale."

both gas production and pipeline transmission for interstate resale. Independent producers were those not affiliated with a particular transmission company which sold gas to pipelines that in turn resold the gas in foreign states. Producers who sold gas directly to distributing companies and then contracted with pipelines to transport the gas were said to be involved in direct sales. The final category of producers were all those operating in the intrastate market. These intrastate producers were specifically exempted from FPC jurisdiction so that individual state regulation would not be disturbed.³⁵

In 1940 the FPC made its first interpretation of the statutory exemption for the production and gathering of natural gas. After examining "(a) the language of the Act as a whole, without other evidences of Congressional intent, (b) the report of the Congressional committees recommending the legislation, and (c) the expressions of individual Congressmen in the course of the debate on the bill,"³⁶ the Commission concluded that it was not the intent of Congress to regulate those companies who were involved in production and gathering, when such activities were consummated by the sale of natural gas into interstate commerce, and held independent producers outside of its jurisdiction.³⁷ The order subsequently led the FPC to contradictorily treat independent producers as normal private enterprises, while classifying integrated producers as part of a utility and thus within the FPC's jurisdiction.³⁸

The imposition of price control on the field-market for natural gas represented an important departure for American economic regulation; price control over a commodity producing industry had never before been administered by a permanent federal regulatory agency.³⁹ The Supreme Court affirmed the Commission's order,⁴⁰ but reserved judgment on the status of independent producers under the Act.⁴¹ Following the apparent tenor of the Court's opinion, the FPC issued an order

35. 15 U.S.C. § 717a(6) (1970).

36. *In re* Columbian Fuel Corp., 2 F.P.C. 200, 203 (1940).

37. *Id.* at 208.

38. *In re* Interstate Natural Gas Co., 3 F.P.C. 416 (1943). This controversy grew out of *Interstate Natural Gas Co. v. Louisiana Pub. Serv. Comm'n*, 33 F. Supp. 50 (preliminary injunction denied), 34 F. Supp. 980 (1940), in which the corporation successfully resisted state ordered regulation because over 99% of its sales were interstate.

39. See Kitch, *supra* note 32, at 243.

40. *Interstate Natural Gas Co. v. FPC*, 331 U.S. 682 (1947).

41. *Id.* at 690 n.18. "The Federal Power Commission has not asserted jurisdiction over all sales taking place in the natural gas fields even though [such sales are] in interstate commerce [because the gas involved is purchased] for resale for ultimate public consumption. . . . We express no opinion as to the validity of the jurisdictional tests employed by the Commission in these cases." *Id.*

announcing that it would not regulate sales of independent producers unless Congress mandated the action.⁴²

The FPC maintained this position four years later when it exempted Phillips Petroleum Company from its jurisdiction.⁴³ To the surprise of the FPC, the Supreme Court overturned the *Phillips* ruling and held the jurisdictional distinction between independent and integrated producers invalid.⁴⁴ The Court reasoned that since "protection of consumers against exploitation at the hands of natural gas companies was the primary aim of the Natural Gas Act,"⁴⁵ the distinction had no basis in the statute. Both the independent and integrated producer were within the purview of the Act because both had an impact on the price paid for natural gas by the consumer.

The final category of producers to be brought under the FPC's jurisdiction were those participating in direct sales. These producers, although not subject to FPC rate control,⁴⁶ had to apply for the certificate of public convenience and necessity required to transmit any gas in the interstate pipeline system.⁴⁷ These certificates enabled producers to sell gas directly to end users and allowed the transmission companies to perform the delivery function at a set charge.

In 1959 the FPC first denied a direct sales application.⁴⁸ The decision was based on two grounds. First, the price set between the producer and the end user would exert an upward pressure on rates in other interstate contracts. Secondly, the purchasing company's end use was deemed inferior. In sustaining this action,⁴⁹ the Supreme Court, in effect, approved indirect rate regulation over direct sales, even though this type of regulation was unauthorized by the Act. With the decision, the FPC's control over prices for all natural gas moving in interstate commerce was complete.

2. *The Evolution of the Just and Reasonable Standard*

When the FPC began regulating natural gas pipelines it had to choose between two approaches. It could adopt a common carrier type

42. Order No. 139 (1947), reprinted in *Federal Price Control*, supra note 32, at 1482 n.86. The Commission put its opinion into effect; see *In re Fin-Ker Oil and Gas Prod. Co.*, 6 F.P.C. 92 (1947).

43. *In re Phillips Petroleum Co.*, 10 F.P.C. 246 (1951).

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

45. *Id.* at 685.

46. See 15 U.S.C. 717b (1970).

47. 15 U.S.C. 717f (1970).

48. *Transcontinental Gas Pipe Line Corp.*, 21 F.P.C. 138 (1959).

49. *FPC v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1 (1961).

of regulation and set rates that applied to the whole industry,⁵⁰ or a public utility approach and treat each company as a separate unit.⁵¹ While the FPC opted for the public utility approach used by the states in the regulation of natural gas prices, its rate making methods were innovative.

At the FPC's inception, the states regulated the sale of natural gas under the *Smyth v. Ames* "fair value" test and fixed prices in order to give utilities a certain rate of return based on the "reproduction or trended costs" of capital investment.⁵² In 1942 the FPC dramatically changed public utility regulation by allowing only "actual legitimate costs"⁵³ to be used as the basis for the rate of return. This departure from traditional rate procedures, which became known as the "prudent investment approach,"⁵⁴ was approved in *FPC v. Hope Natural Gas*.⁵⁵

Writing for the majority in *Hope*, Justice Douglas noted that Congress had not provided a formula defining just and reasonable rates. In the absence of a specific standard, he reasoned that the "end result" of protecting the consumer, rather than a fixed formula, should control.⁵⁶ In light of this definition of just and reasonable, Justice Douglas determined that the FPC's new approach did not create returns so small as to be unconstitutionally confiscatory or violative of the Natural Gas Act.

The prudent investment approach, which in effect defined a new minimum threshold for investor's returns in public utility regulation, established two significant trends. First, the move was clearly consumer

50. An example of common carrier regulation is the Interstate Commerce Commission which sets rate schedules that apply uniformly to all firms hauling goods. See 49 U.S.C. § 15 (1970).

51. Because the goal of rate regulation under such an approach is the limitation of the regulated industry's profits, see note 17 *supra* and accompanying text, public utility commissions assume that each regulated enterprise has unique costs and determines its consumer rates individually.

52. Reproduction costs are the value of the assets of the regulated enterprise at the time of the rate determination. Thus, they are calculated by determining what the replacement of the capital investment would cost in the present market. See *Smyth v. Ames*, 169 U.S. 466, 544 (1897).

53. Actual legitimate costs include only the original cost of the capital investment less depreciation in the rate base. Reproduction costs are rejected because they are too conjectural. See *In re City of Cleveland v. Hope Natural Gas Co.*, 3 F.P.C. 150, 167 (1942).

54. Bonbright, *Contributions of the Federal Power Commission to the Establishment of the Prudent Investment Doctrine of Rate-making*, 14 GEO. WASH. L. REV. 136 (1945); Hale, *Utility Regulation in the Light of the Hope Natural Gas Case*, 44 COLUM. L. REV. 488 (1944); PRIEST, *supra* note 14, at 494.

55. 320 U.S. 591 (1944).

56. *Id.* at 603. "The fact that the method employed to reach that result may contain infirmities is not then important." *Id.* at 602.

oriented.⁵⁷ Secondly, as in state natural gas regulation, the individual firm's profit margin was the focus of rate making.⁵⁸ This second characteristic quickly became a required aspect of FPC rate making. For example, in response to the prudent investment approach, the Eighth Circuit Court of Appeals held: "The rate of return not only may be, but in a utility case must be, the largely determinative factor of reasonableness. . . . The value of the service to users is neither a reasonable rule nor supported by judicial decisions."⁵⁹

The first problems with the Commission's rate making procedure occurred simultaneously with the expansion of its jurisdiction. One problem presented by the regulation of integrated producers was complex; while they consummated sales in interstate commerce, these companies also had shares in certain intrastate markets. The FPC therefore was forced to make an arbitrary allocation of costs to companies between the regulated interstate sales and unregulated intrastate sales.⁶⁰

A second problem was created when all independent producers were brought within the FPC's rate making jurisdiction by the *Phillips* decision and required to meet the just and reasonable standard. Up to this time, the FPC had been operating on an individual company basis, like any other public utility commission. After the inclusion of independent producers in the FPC's jurisdiction, the Commission was deluged with applications for rate determinations and the approach took on new significance. The size and complexity of the task literally overwhelmed the FPC's administrative process; some 2,900 applications for individual rate determinations were received between 1954 and 1962.⁶¹ Processing the application of the Phillips company alone took 82 hearing days, filled 10,626 pages with testimony and involved 235 exhibits.⁶²

57. The use of actual legitimate costs as opposed to reproduction costs diminished the rate base of operating companies. Because the rate of return for gas producers was fixed, the use of actual legitimate costs reduced the price of natural gas to the consumer.

58. Even so, the adoption of a uniform price system was not foreclosed by the Court in *Hope*. See Justice Jackson's dissent, 320 U.S. at 652-53. The dissent is enlightening both for its prophetic quality and perceptive analysis. Jackson predicted the future problem in rate making, making the commodity versus service distinction. Justice Jackson argued that emphasis should shift from the producer to the product, clearly articulating the future dilemma: "The unfortunate effect of judicial intervention in this field is to divert the attention of those engaged in the process from *what is economically wise to what is legally permissible*." *Id.* at 652 (emphasis added).

59. *Mississippi River Fuel Corp. v. FPC*, 121 F.2d 159, 164 (1941).

60. *In re Mississippi River Fuel Corp.*, 4 F.P.C. 340 (1945).

61. C. HAWKINS, *THE FIELD PRICE REGULATION OF NATURAL GAS* 37 (1969).

62. Breyer & MacAvoy, *The Natural Gas Shortage and the Regulation of Natural*

The administrative delay between the time of application and the rate hearing, required by the duty to insure just and reasonable standards, had the effect of freezing natural gas prices.⁶³ The business exigences of the interstate gas market, however, required a more immediate response. The FPC's solution was a compromise procedure, permitting gas sales to be made under temporary certificates of convenience and necessity subject to approval at a subsequent rate hearing.⁶⁴ These certificates were issued merely on a prima facie showing by the seller that the rates satisfied the just and reasonable standard under the traditional public utility approach.

Less than two years after *Phillips*, the rate making process began to reflect economic, as well as administrative, shortcomings. The problem was strikingly illustrated when four corporations applied for permanent certificates of convenience for the sale of offshore Louisiana gas to a pipeline servicing a New York utility without attempting to justify the price under the reasonable rate of return formula.⁶⁵ Because the price was the highest the transmission company had ever paid, the FPC twice determined there was insufficient evidence to grant permanent certificates.⁶⁶ When the corporations threatened to withhold the gas from interstate commerce unless the certificates were issued, the FPC relented.⁶⁷ The court of appeals reversed the Commission's decision, because the certification of the sale at the increased rate violated the Natural Gas Act,⁶⁸ and the Supreme Court affirmed under slightly different theory.⁶⁹

Taking judicial notice of the delays incumbent in full rate determinations, the Court held that the just and reasonable standard was applicable to rate, but not certification, proceedings. Thus the FPC was told that rate hearings were necessary prerequisites to rate changes. The Court based its insistence on a full rate determination in part on the assumption that producers had no other market in which to sell their

Gas Producers, 86 HARV. L. REV. 941, 954 (1973) [hereinafter cited as Breyer & MacAvoy]. By 1960 the Commission had completed only ten of the thousands of applications they had received. *Id.*

63. Johnson, *Producer Rate Regulation in Natural Gas Certification Proceedings: CATCO in Context*, 62 COLUM. L. REV. 773, 795-807 (1962).

64. See 15 U.S.C. § 717c(e) (1970).

65. *Continental Oil Co.*, 17 F.P.C. 563 (1957).

66. 17 F.P.C. at 574, *reheard*, 17 F.P.C. 732 (1957).

67. *Continental Oil Co.*, 17 F.P.C. 880 (1957).

68. *Public Serv. Comm'n v. FPC*, 257 F.2d 717 (3d Cir. 1958).

69. *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378, 391, 394 (1959) (generally referred to as *CATCO*).

gas, since 90% of all gas was moving in the interstate market.⁷⁰ This state of affairs would change radically in the coming years as the intrastate market continued to grow.⁷¹ As a result of the decision, the FPC was faced with the dilemma of holding the line on prices through temporary public convenience and necessity certificates or conducting full-fledged rate determinations. The first option had considerable economic drawbacks and the latter was proving administratively impossible.

At the same time, the FPC was coming under fire for its overall performance from Congress. In 1960 the Landis Commission concluded "the Federal Power Commission without question represents the outstanding example in the federal government of the breakdown of the administrative process."⁷² In an attempt to extricate itself from the dilemma, the FPC fashioned a new type of producer regulation.

The Commission directly repudiated its former rate making procedure in 1960. In a decision again involving the Phillips Petroleum Company,⁷³ the FPC found that the traditional original cost "prudent investment" rate base was an unworkable method for setting rates because producers of gas "cannot, by any stretch of the imagination, be properly classified as traditional public utilities."⁷⁴ The decision signaled a change in focus from an analysis of each producer's costs to an industry-wide approach for determining the value of gas.⁷⁵ The new approach to rate making was to divide the country into five areas⁷⁶ and

70. *Id.* at 394.

71. See note 108 *infra*.

72. SUBCOMMITTEE ON ADMINISTRATIVE PRACTICE AND PROCEDURE OF THE SENATE COMM. ON THE JUDICIARY, 86TH CONG., 2D SESS., REPORT ON THE REGULATORY AGENCIES TO THE PRESIDENT-ELECT 54 (Comm. Print 1960).

73. Phillips Petroleum Co., 24 F.P.C. 537 (1960).

74. *Id.* at 542. In support of this conclusion the Commission relied on Justice Harlan's dissent in *Sunray Oil Co. v. FPC*, 364 U.S. 137, 159 (1960):

A pipeline performs a service akin to those traditionally performed by public utilities. The independent producer, on the other hand, is unique among the objects of public-utility regulation because it is not engaged in rendering a service to the public in the conventional sense of that concept, but rather simply in selling a commodity which it owns.

Id. at 160.

75. 24 F.P.C. at 546. The Commission noted that this change was partially due to the administrative burden of the former procedure: "[I]f our present staff were immediately tripled, and if all new employees would be as competent as those we now have, we would not reach a current status in our independent producer rate work until 2043 A.D. . . ."

76. The five areas were (1) the Permian Basin (Texas and part of New Mexico); (2) southern Louisiana (including the offshore area in the Gulf of Mexico); (3) Hugaton-Anadarko (part of Oklahoma and Kansas); (4) Texas Gulf Coast; and (5) Southwest (Mississippi, Arkansas, and parts of Alabama, Texas and Oklahoma).

determine the rate on the basis of area data.⁷⁷ The Supreme Court concurred with the FPC's switch in tactics, stating that it shared "the Commission's hopes that the area approach may prove to be the ultimate solution."⁷⁸

A second innovation which followed the FPC's rejection of public utility concepts was the adoption of two price ceilings, one for "new" natural gas and a lower ceiling for "old" gas.⁷⁹ The theory behind the two-tier system was that lower prices for old gas would deprive producers of unjust rents, benefiting consumers, and that higher prices for new gas would encourage enough additional gas production to meet future consumer demands.⁸⁰ The Commission issued its first full rate determination using the two-tier approach in 1965.⁸¹ The Supreme Court sustained the rate order, noting that as long as the Commission rate was in a "zone of reasonableness"⁸² the approach was appropriate. Finding the FPC's past approaches shortsighted, the court expressed hope that two prices "may be used so as both to provide an incentive for exploration and to restrict to reasonable levels producers' profits."⁸³

Area rates and the two-tier price levels were both attempts to resolve the legal dilemma. Area rates gave a better reflection of the economic needs of the producer industry than the former individual cost analysis. The two-tier price system was theoretically intended to guard the public interest through assurance of just and reasonable rates. The FPC was attempting to balance the consumer and investor interests.

The FPC's problems, however, were soon complicated; "[q]uietly, almost unnoticed, sometime in the middle Sixties, the United States

77. Interim rates were established along the guidelines of previous contracts. FPC, No. 61-1, STATEMENT OF GENERAL POLICY, 24 F.P.C. 818 (1960). For further analysis of FPC area rate action, see Searls, *Decision of Federal Power Commission in Phillips Petroleum Company Case and Effect on Producers of Commission's Statement of General Policy No. 61-1 as amended*, 12 OIL & GAS INST. 1, (Matthew Bender 1961); Landis, *Theoretical and Practical Considerations with Reference to Price Regulation in Production and Transmission of Natural Gas*, 13 OIL & GAS INST. 401 (Matthew Bender 1962).

78. *Wisconsin v. FPC*, 373 U.S. 294, 310 (1962).

79. Opinion No. 468, 34 F.P.C. 159, 185-88 (1965). See generally Breyer & MacAvoy, *supra* note 62, at 959.

80. 34 F.P.C. at 186.

81. Permian Basin Area Rate Proceeding, 34 F.P.C. 159 (1965). See generally Mosburg, *The Permian Decision—A Study in Group Regulation*, 19 OKLA. L. REV. 133 (1966); Note, *New Approaches By the FPC to the Regulation of Natural Gas Producers: an Evaluation*, 17 VAND. L. REV. 1200 (1964).

82. Permian Basin Area Rate Cases, 390 U.S. 747, 797 (1968), citing *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585 (1942).

83. 390 U.S. at 799.

became a have not energy nation.”⁸⁴ Against this background, the fact that low gas prices were not bringing forth adequate reserves to meet the market demand became increasingly evident. In December, 1968, spokesmen for transmission and distribution companies joined in asking for higher gas prices to stimulate exploration.⁸⁵ The producers were accused of crying “wolf” at the prospects of a gas shortage and former FPC chairman, Lee C. White, even characterized the prospects as a “myth”.⁸⁶ The FPC staff, however, recognized the impending shortage in a 1969 report noting the downward trend of the gas reserves to the gas production ratio.⁸⁷

As the shortage increased in magnitude, area rates with the two-tier price levels became economically obsolete. With the focus on maintaining just and reasonable prices, the FPC had created a flourishing, unregulated intrastate market and an industry with no incentive to expand.⁸⁸ It had achieved its goal of protecting the consumer’s purse,⁸⁹ but only at the expense of other consumers’ ability to acquire gas for new needs.

B. THE PERIOD OF CONFRONTATION 1971-1976: THE FPC AND THE COURTS STRUGGLE WITH THE SHORTAGE

The first indication of the FPC’s official recognition of the natural gas shortage was its requirement that all interstate pipelines report

84. Gooch, *Current Developments in FPC and Natural Gas Matters*, 23 OIL & GAS INST. 99 (Matthew Bender 1972).

85. FPC, 1975 REPORT, NATIONAL GAS SURVEY, Vol. 1, at 102.

86. Heady, *Gas Producer Regulation in a New Environment*, 24 OIL & GAS INST. 1, 3 (1973).

87. FPC, A STAFF REPORT ON NATIONAL GAS SUPPLY AND DEMAND (1969). Nineteen sixty-eight was the first year that production and consumption of natural gas exceeded the amount added to reserves through exploration and recalculation of present gas fields. In simple terms, it signaled that unless the ratio changed toward more reserves the U.S. would run out of gas.

88. For the natural gas industry to expand or even keep pace with demand, additional reserves must be found. However, the exploration and producing segments of the industry contracted between 1954-1971. The contraction was drastic—in 1954 there were 2,687 active drilling rigs and by March, 1971 only 828. Geophysical activity, always a prelude to exploratory drillings, shrank from a post-war peak in 1953 of 8,673 to a low of 2,521 by 1970. Exploratory wells dwindled from a 1956 peak of 16,207 to a low of 7,539 by 1970. *Hearings on Consumer Energy Act of 1974 Before the Senate Committee on Commerce*, 93rd Cong., 1st Sess., pt. 1, at 321 (1973).

89. The regulation of prices at the gas wellhead by the Federal Power Commission (the FPC) has been a measure of “welfare” policy since its inception by Supreme Court decree in 1954. As with local rent controls, or maximum charges for medical services paid for by the state, gas price restrictions were put into effect to “keep prices down for the consumer.”

MacAvoy, *Regulation-Induced Shortage of Natural Gas*, 14 J. LAW & ECON. 167, 167 (1971) (footnote omitted).

whether their supplies would be adequate to assure deliveries to customers; if a pipeline anticipated a shortage, it was required to file a curtailment plan.⁹⁰ Shortly thereafter, the FPC began to change its policies regarding the supply of natural gas. Recognizing that it was entering a new period,⁹¹ it attempted to rebalance the interests of the consumer and the investor, in light of the shortage, consistent with the just and reasonable standard. The result was an effort to increase the supply of natural gas to meet the present demand of customers. Even though this trend was clearly in the consumer's best interests, twenty-three years of regulatory precedent restricted the alternatives available to the FPC. An examination of several of the Commission's actions and the judicial response to them serves to highlight the present legal dilemma; as the FPC has moved to increase the supply of natural gas to meet consumer needs, it has consistently encountered resistance paradoxically based on the just and reasonable standard designed to protect the consumer's interest.

The small producer exemption was one of the FPC attempts to increase the supply of natural gas. Under the exemption small pro-

90. Order No. 431, 49 F.P.C. 85, reprinted in *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 623-24 (1972).

The curtailment plans have been a major part of the FPC policies to reduce the effects of the natural gas shortage. There are two distinct problems in a shortage situation: one is excessive demand, the other inadequate supply. Curtailment plans are an attempt by the FPC to deal with excessive demand through allocation. While curtailments are a major controversy in the field of natural gas regulations, the area will not be covered in this paper. The just and reasonable standard is almost entirely used to evaluate the FPC's efforts to increase supply which is the focus of this paper. However, a recent case involving both curtailments and the just and reasonable standard was *Mississippi Power & Light Co. v. United Gas Pipe Line Co.*, 532 F.2d 412 (5th Cir. 1976). In that case, the circuit court ruled that the FPC had the authority to order compensation between curtailed and non-curtailed customers. This compensation plan evidently does not violate the just and reasonable standard because it is a surcharge rather than a rate. For further analysis of curtailments see Tiano, *The Limits of Federal Regulation of Natural Gas Curtailments*, 64 GEO. L.J. 27 (1975); Comment, *FPC Natural Gas Allocation: Curtailment in Context*, 50 TEXAS L. REV. 1370 (1972).

91. *The emergence of a natural gas shortage during the past two years marks a historic turning point—the end of natural gas industry growth uninhibited by supply considerations.* Not only has the Nation's proven gas reserve inventory for the lower 48 states been shrinking for the past three years, but major pipeline companies and distributors in most parts of the country have been forced to refuse requests for additional gas service from large industrial customers and from many new customers. For practical short-term purposes we are confronted with the fact that current proven reserves in the lower 48 states, as reported by the American Gas Association, have dropped from 289.3 trillion cubic feet in 1967 to 259.6 in 1970, a 10.3 percent drop within a three-year period. Furthermore, approximately 95 percent of this proven reserve inventory is already committed to gas sales contracts and is therefore unavailable for sales to new customers or for increased volumes to old customers.

FPC, STAFF REPORT NO. 2, NATIONAL GAS SUPPLY AND DEMAND 1971-1990, at ix (1972) (emphasis added).

ducers were, in effect, deregulated.⁹² Soon after the order went into effect it was challenged as violative of the just and reasonable standard. As a result, the District of Columbia Circuit Court of Appeals in *Texaco, Inc. v. FPC*⁹³ overruled the Commission. Although the circuit court took judicial notice of the two factors on which the FPC based its decision, that "a critical gas shortage faces the nation" and that "small gas producers have historically accounted for as much as 80% of new exploration,"⁹⁴ its conclusion reflected past case law. The court found that "whatever the wisdom of the policy [of increasing supply to meet consumer needs] at this critical juncture of our national energy source problems, [it could not] hold that non-regulation [was] the statutory equivalent of regulation."⁹⁵ Thus, the FPC was held to a duty to insure that all rates were just and reasonable, which it had violated by the non-regulation of small producers.

The Supreme Court took a different tack on review.⁹⁶ The Court reasoned that small producer deregulation in itself did not violate the Natural Gas Act because the exemption insulated the public from unreasonable rates,⁹⁷ and because small producers were still subject to indirect regulation through the Act's certification procedures.⁹⁸ However, the Court remanded the order for a clear definition of the just and reasonable standard to be applied in certification proceedings. The Court's decision also stressed that "the prevailing price in the marketplace cannot be the *final measure* of 'just and reasonable' rates."⁹⁹ Even though the Court left the door open for the use of market prices as one of the factors to be considered in rate making,¹⁰⁰ it still insisted that the

92. Order No. 428, 45 F.P.C. 454 (1971). The order applied to producers with annual natural gas sales not exceeding 10,000,000 mcf.

93. 474 F.2d 416 (D.C. Cir. 1972).

94. *Id.* at 418.

95. *Id.* at 423. The argument that "the *Commission* would no longer be regulating rates, the *market mechanism* itself would, in effect, dictate small producer prices which were 'just and reasonable'" was also rejected. 474 F.2d at 422.

96. *FPC v. Texaco, Inc.*, 417 U.S. 380 (1974).

97. The small producer exemption included a refund section for unreasonably high rates. 45 F.P.C. 457 (1971). This refund was to be made by the pipeline company to the consumer and the small producer would incur no liability. Since the consumers' interests were protected, the purpose of the Act was fulfilled. *See* 417 U.S. at 392.

98. Small producers could now be put in the same class as producers making direct sales. The Commission still had to approve certificates of convenience and necessity before the gas could go into the system. The Commission could deny an application if the contract price was too high. *See* notes 48 & 49 *supra* and accompanying text.

99. 417 U.S. at 397 (emphasis added).

100. 417 U.S. at 399, *citing* Southern La. Rate Area Cases, 428 F.2d 407, 441 (5th Cir.), *cert. denied*, 400 U.S. 950 (1970).

older definition of just and reasonable be substantially complied with in setting rates.

A second illustration of the present impasse was provided by judicial reaction to an FPC procedure termed Optional Certification,¹⁰¹ under which an individual producer could sell gas at a price above the area ceiling. The procedure was initiated as a "safety valve mechanism"¹⁰² to enable pipelines to procure more supplies. In its first application, the FPC fixed a price that was 70% greater than the established area rate.¹⁰³

Even though the validity of the order depended on a judicial redefining of the just and reasonable standard, the Supreme Court had earlier indicated that it was prepared to do so. In *Mobil Oil Corp. v. FPC*¹⁰⁴ the Court apparently endorsed the use of non-cost factors to protect the public's interests, both "existing and foreseeable,"¹⁰⁵ holding that consideration of such factors in rate making did not, of itself, violate the just and reasonable standard. In effect, the Court seemed to recognize the existence of a new maximum threshold for the "zone of reasonableness" unrelated to the return to the investor and entirely concerned with procuring supplies for the consumer.

Despite *Mobil Oil*, the FPC's first Optional Certification order was overturned on review.¹⁰⁶ Expressing doubt concerning the relevance of *Mobil Oil*,¹⁰⁷ the D.C. Circuit Court of Appeals found the use of non-cost factors inappropriate in setting rates for natural gas already committed to the interstate market. The use of non-cost factors is a subtle method of recognizing the significance of the intrastate market, which

101. Order No. 455, 48 F.P.C. 218 (1972). The theory behind the procedure was upheld in *Moss v. FPC*, 502 F.2d 461 (1974), *rev'd on other grounds*, 96 S.Ct. 1003 (1976).

102. *Moody, 1974—The Gathering Storm*, 26 OIL & GAS INST. 1, 4 (Matthew Bender 1975). [hereinafter cited as *Moody*].

103. *Belco Petroleum Corp.*, 49 F.P.C. 1154 (1973).

104. 417 U.S. 283 (1974).

105. *Id.* at 309.

106. *Consumers Union v. FPC*, 510 F.2d 656 (D.C. Cir. 1974).

107. *Id.* at 660.

absorbs almost all newly discovered reserves.¹⁰⁸ Unfortunately, the availability of such supplies has been blocked by an out-moded definition of just and reasonable.

The FPC is simultaneously using several other approaches. Since 1970, the Commission has permitted short-term emergency sales to be made at rates indirectly regulated through certification procedures.¹⁰⁹ These certificates are valid for 60 days and can only be granted if the pipeline is unable to meet firm commitments to its customers. In an effort to enable the regulated pipelines to compete in the intrastate market, the FPC has extended the validity of these certificates to 180 days.¹¹⁰

Even though the question had been rendered moot by the FPC's subsequent reversion to the former 60-day plan,¹¹¹ the D.C. Circuit Court of Appeals granted review of the 180-day procedure.¹¹² The court found the 180-day emergency policy was equal to deregulation and an avoidance of the FPC's responsibility to maintain the just and

108.

Year	LOWER 48 STATE NET RESERVE ADDITIONS INTERSTATE VS. INTRASTATE				
	Total Net AGA Reserve Additions Tcf	Net Interstate Reserve Additions (Form 15)		Inferred Intrastate Reserve Additions (1)	
		Tcf	Percent	Tcf	Percent
1964	20.1	10.7	53	9.4	47
1965	21.2	13.3	63	7.9	37
1966	19.2	14.1	73	5.1	27
1967	21.1	14.8	70	6.3	30
1968	12.0	9.5	79	2.5	21
1969	8.3	6.0	72	2.3	28
1970	11.1	0.1	1	11.0	99
1971	9.4	1.9	20	7.5	80
1972	9.4	(0.2)	0	9.6	100
1973	6.5	1.2	18	5.3	82

(1) Derived by assuming that intrastate reserve additions are equal to the difference between total AGA reserve additions and the reserve additions committed to the interstate market.

Moody, *supra* note 102, chart 47.

109. Order No. 418, 44 F.P.C. 1574 (1970). See generally Moody, *supra* note 102, at 27.

110. Order No. 491, 50 F.P.C. 742 (1973), as amended by Order No. 491-a, 50 F.P.C. 848 (1973), Order No. 491-b, 50 F.P.C. 1463 (1973) and Order No. 491-c, 50 F.P.C. 1634 (1973).

111. FPC Order No. 491-d. In June, 1974, even these 60 day sales were repudiated in FPC Opinion No. 699. This lasted until September, 1974 when FPC Opinion No. 699-b was issued. Both limited term and 60 day emergency sales were again authorized under sharply restricted circumstances. See Moody, *supra* note 102, at 27.

112. Consumer Fed'n v. FPC, 515 F.2d 347 (D.C. Cir.), cert. denied, 423 U.S. 906 (1975).

reasonable standard.¹¹³ The court also showed hostility toward the FPC by placing the decision in a historical context:

Throughout the years in controversies such as Phillips and CATCO, the FPC has sought to justify inaction at the level of producer rates on the ground that the pressures built up by producer rate increases could somehow be contained at the pipeline level by invoking a regulatory agency's authority to disallow excessive costs. And throughout the years, the Court has found this professed substitute inadequate.¹¹⁴

This reaffirmation of the responsibility to maintain the just and reasonable standard left the FPC with few options to increase supply.

One method being pursued to lure supplies from the intrastate market to interstate customers has been the encouragement of direct sales. Contrary to the logic used by the Supreme Court to justify the indirect regulation of direct sales,¹¹⁵ the FPC is now urging interstate customers to purchase gas directly from producers.¹¹⁶ The Commission has reasoned that since direct sales are not subject to FPC rate jurisdiction, interstate customers can purchase gas at any rate acceptable to the producer.¹¹⁷ Even so, the method appears vulnerable to attack. While the applicability of the just and reasonable standard to direct sales has not been litigated, it is likely that the standard would be held to limit the certification of direct sales.¹¹⁸

The most dramatic attempt to encourage the increase of natural gas supplies came in 1974 when the FPC discarded the area rate making

113. The court stated: "As a reviewing Court, we must grant the Commission broad latitude in devising methods of regulation 'in this time of acute energy shortage.' But, although we are receptive to 'novel' approaches, we cannot neglect our duty to 'assure fidelity to the functions assigned to the regulatory agencies by Congress.'" 515 F.2d at 360 (footnotes omitted).

114. *Id.* at 357-58.

115. *See* FPC v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1 (1961).

116. Order No. 533, [1975] 6 FED. POWER SERV. at 5-803.

117. Direct sales are

a way for high priority industrial and commercial customers to obtain supplies of natural gas and thus prevent, or at least mitigate, the threatened adverse consequences of deepening levels of pipeline curtailments. . . . Because such direct sales would not be subject to our rate jurisdiction, high priority customers could compete with the producer's intrastate customers for gas supplies not otherwise available to the interstate market.

Id.

118. Under the logic of FPC v. Texaco, Inc., 417 U.S. 380 (1974), the just and reasonable standard should be applicable to direct sales. Whether the direct sales policy violates the standard is another question. Certainly this policy could not meet the standard certified in Mobil Oil Corp. v. FPC, 417 U.S. 283 (1974), because the direct sale policy does not encourage new supplies to be dedicated to the interstate market. In fact, the Commission is supplying an incentive, higher prices to producers, for new supplies to be kept in the intrastate market.

procedure and adopted a uniform national rate base.¹¹⁹ Surprisingly, the Commission's action was sustained by the Fifth Circuit Court of Appeals in *Shell Oil Co. v. FPC (the National Rate Case)*¹²⁰ as a proper exercise of rate making authority. According to the court, it gave "heightened deference to the Commission's expertise" because of the innovative nature of the new approach. This result was influenced by two factors. First, the FPC couched its rate making procedure in public utility terms.¹²¹ More significantly, those attacking the rate urged an alternative more radical than that adopted by the FPC, arguing that the FPC should acknowledge the commodity value of natural gas and let its prices rise to the market level. Thus the opinion was more a refutation of the petitioners' argument than a validation of the FPC's action.¹²²

In validating the order, the court articulated the tests which a just and reasonable rate must satisfy: "the long-standing 'total effect' test of *FPC v. Hope Natural Gas* . . . and . . . a 'zone of reasonableness' to compensate for the necessarily imprecise nature of cost determinations and the inherent difficulty of the regulatory undertaking."¹²³ As these tests suggest, the *National Rate Case* can be characterized as a cautious move by both the FPC and the court. The FPC had been careful to base the rate on established cost factor estimates. Even though validating the FPC's approach, the court significantly assumed that the just and reasonable standard was incompatible with a rate based on commodity market value.

119. Opinion No. 699, [1974] 1 FED. POWER SERV. at 5-307. Opinion No. 699 set a maximum rate of 42 cents per mcf on all gas produced after January 1, 1973 and all new gas dedicated to the interstate market. Existing contracts were not changed.

120. *Shell Oil Co. v. FPC*, 520 F.2d 1061 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976).

121. In fact, the FPC did not use non-cost factors to reach the price.

The overall cost determination was based on an evaluation of the following components: (1) Successful Well Cost, (2) Dry Hole Cost, (3) Lease Acquisition Cost, (4) Cost of Other Production Facilities, (5) Other Exploration Cost, (6) Exploration Overhead, (7) Production Operating Expense, (8) Net Liquid Credit (subtracted from costs), (9) Royalty Expense, (10) Recompletion and Deeper Drilling Cost (stipulated), (11) Regulatory Expense (stipulated), (12) Return on Production Investment, and (13) Return on Working Capital.

Id. at 1067.

122. *See id.* at 1084:

To accept this free market "commodity value" would be to eschew the congressionally mandated responsibility of rate regulation which is devised to reach a "just and reasonable" rate. Fixing a "just and reasonable" rate for a product sold in any inherently uncompetitive market *requires more than mere subservience to national and international market forces.*

(emphasis added).

123. *Id.* at 1071 (citation omitted), quoting *Placid Oil Co. v. FPC*, 483 F.2d 880, 889 (5th Cir. 1973), *aff'd sub nom.*, *Mobil Oil Corp. v. FPC*, 417 U.S. 283 (1974).

The rejection of the commodity value standard in the *National Rate Case* will be felt by the FPC in its latest effort to increase supply. In Opinion No. 770, which increased the uniform national rate by 270%, the FPC adopted the position advocated by the petitioners in the *National Rate Case*, and included non-cost factors in the rate determination process.¹²⁴ While other traditional cost factors were cited, the unmistakable goal of the opinion is the dedication of new reserves to the interstate market by making the price of interstate gas competitive with intrastate gas and other forms of energy.¹²⁵ With the adoption of Opinion No. 770, the full gambit of rate regulation has been run; the FPC's rate making procedure has shifted from an individual determination, focusing on the profits of producers, to an industry-wide approach intended to increase the supply of natural gas.

Consistent with public reaction to Opinion 770,¹²⁶ the courts will probably not maintain the deferential attitude exhibited in the *National Rate Case*. Application of the just and reasonable standard in past decisions would seem to force reviewing courts to overturn the increase. Despite the Commission's lip service to past formulations, the FPC's departure from them is clear. Non-cost factors are to be considered along with the traditional cost analysis factors, and are not to be determinative.¹²⁷

Although supported by past judicial applications of the just and reasonable standard, the impact of a decision overturning Opinion 770 would be adverse to the present and future needs of consumers. By maintaining low prices, it is inevitable that the interstate market of gas

124. Opinion No. 770, 41 Fed. Reg. 33,364 (1976).

125. See *id.* at 33,390, (exhibit 27) noting recent average prices for intrastate natural gas (1st Half, 1975—125.9; 2d Half, 1975—128.9; 1st Quarter, 1976—154.8). The FPC also noted that the fuel oil equivalent for natural gas was selling at between 1.28-1.57 mcf equivalent. The Federal Energy Administration's \$11.40 per barrel upper tier price was equal to 1.67 per mcf at 85% BTU parity value. See *id.* at 33,391.

126. Rep. John E. Moss (D. Calif.) threatened to impeach the three Commissioners (Chairman Dunham, James Watt, and John Holloman, III) who voted for the increase, [1976] EN. USERS REP. (BNA), No. 161, at A-6. On October 2, 1976, the House Subcommittee on Oversight and Investigations stated:

[The FPC] takes cellar position because of its overt disregard of its congressional mandate. Specifically, it has refused to maintain a program of "just and reasonable" natural gas prices consistent with its governing statutes and applicable court decisions. It has acted without sound evidence. It has not enforced the delivery of natural gas supplies to consumers. The Federal Power Commission has displayed a conscious indifference to the public beyond comparison with any other regulatory agency. The Subcommittee believes that this agency is in line for a major overhaul by the Congress.

FOSTER NATURAL GAS REP., Oct. 7, 1976, at 9 (emphasis added).

127. See *Mobil Oil Corp. v. FPC*, 417 U.S. 283 (1974); text accompanying note 104 *supra*.

will continue to contract, limiting gas supplies in nonproducing areas, while unregulated intrastate markets grow. Therefore, an adverse decision would hurt the very consumers that the Natural Gas Act was passed to protect. A low price is an admirable objective only if there is gas available; the consumer is not benefited by a low price if there is no gas to be supplied.

III. RESOLVING THE CONFLICT

Several approaches could be taken to resolve the legal problems incumbent in the application of the just and reasonable standard. Most methods would solve the problem by cutting the Gordian knot, doing away with producer rate regulation or judicial review of such regulation. Because these solutions leave the judiciary with no role in the rate making process, they involve consequences undesirable in light of the legislative intent behind the Natural Gas Act. The standard that must be considered when evaluating the following proposals is whether the economic results engendered by the solution would be in the consumer's interests, as well as whether the legal conflict between the FPC and the courts would be solved.

A. JUDICIAL CONTRACTION OF THE FPC'S JURISDICTION

The Supreme Court can alter its past role by reversing the 1954 *Phillips* case and holding that regulation of producers by the FPC is no longer required by the National Gas Act. This action would end the legal conflict between the FPC and the courts, because the Commission would no longer have any power over the production segment of the industry.

Judicial contraction of the FPC's jurisdiction would deny the assumption underlying the *Phillips* case that the Natural Gas Act was passed primarily for the protection of the consumer. The impact of producer sales on consumer prices is the same today as it was in 1954. The fact that the present form of regulation might not be in the public interest does not necessarily mean that nonregulation would be in the best interest of the consumer. Changing the goals of natural gas regulation should be the function of the legislature.¹²⁸

Exclusion of natural gas producers from FPC jurisdiction ignores the consequences this action may entail. There is a real possibility

128. *FPC v. Texaco, Inc.*, 417 U.S. 380, 400-01 (1974).

that in the future the consumer could be held hostage by an unregulated gas industry. Also, the economics of a depleting resource cannot be ignored. The supply of natural gas is finite and continued production will inevitably exhaust present reserves.¹²⁹ When the supply becomes inelastic, no matter how high it is priced there will be no additional supply.¹³⁰ If the natural gas industry is not subject to regulation when the point of inelastic supply is reached, the consumer will literally be at the mercy of the producers.

Court ordered deregulation would also have an adverse effect on interstate relations. If the federal government withdraws from the field of regulation, producer states, no longer restrained by the preemption doctrine, will be free to pass legislation adverse to the interests of consumers in nonproducing states. Even though some of this legislation is likely to be held violative of the commerce clause, significant harm may result before a definitive ruling on these statutes is issued.¹³¹

129. See *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 628, 629 (1944) (Jackson, J., dissenting):

The heart of this problem is the elusive, exhaustible, and irreplaceable nature of natural gas itself. Given sufficient money, we can produce any desired amount of railroad, bus, or steamship transportation, or communications facilities, or capacity for generation of electric energy, or for the manufacture of gas of a kind. In the service of such utilities one customer has little concern with the amount taken by another, one's waste will not deprive another, a volume of service can be created equal to demand, and today's demands will not exhaust or lessen capacity to serve tomorrow. But the wealth of Midas and wit of man cannot produce or reproduce a natural gas field.

130. This situation has already occurred in the early part of this century. The Appalachian natural gas region, which included West Virginia, western Pennsylvania and southern Ohio, was highly productive from 1882-1917. After its reserves peaked, the price of gas in the area doubled but the supply of gas steadily decreased. Kitch, *supra* note 32, at 248-49.

131. While producer states cannot unilaterally withhold gas from interstate commerce, see *Pennsylvania v. West Virginia*, 262 U.S. 553 (1924), they could take other constitutional measures that would adversely affect consumer states. The Supreme Court has held that state legislation that sets a minimum price for natural gas sold in the producing state does not violate the commerce clause, even though it affects interstate rates, if its purpose is to curb the waste of natural resources, protect the owners of mineral rights, or shield the state's economy. *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179 (1950); *Phillips Petroleum Co. v. Oklahoma*, 340 U.S. 190 (1950). Even though such rate regulation was subsequently held invalid in light of the expansion of the Natural Gas Act's scope to include independent producers, *Natural Gas Pipeline Co. v. Panoma Corp.*, 349 U.S. 44 (1955) (*per curiam*), it is clear that its invalidity was based on the preemption doctrine, rather than the commerce clause. *Northern Natural Gas Co. v. State Corp. Comm'n*, 372 U.S. 84, 91 (1963) ("[T]he federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas . . . or for state regulation which would indirectly achieve the same result."). Thus if the Natural Gas Act rate regulation were suspended, *Cities Service* would again be valid. See generally Dutton, *The Supreme Court's Natural Gas Act: Northern Natural Gas Co. v. Kansas Completes Judicial Legislation*, 1 TULSA L.J. 31 (1964); Meyers, *Federal Preemption and State Conservation in Northern Natural Gas*, 77 HARV. L. REV. 689 (1964).

B. JUDICIAL ABDICATION OF THE DUTY TO REVIEW

A similar alternative is for the Supreme Court to subtly abandon the just and reasonable standard by acceding to the FPC's expertise in rate making, thereby rubber stamping any rate determination even though it is based on fictional cost analysis. This approach invests the FPC with the sole responsibility for determining just and reasonable rates. The legal conflict is resolved, but a host of other problems takes its place.

First, as noted by Justice Jackson in *Hope*, if the Court were to "hold that a given rate is reasonable just because the Commission has said it was reasonable, review becomes a costly, time consuming pageant of no practical value to anyone."¹³² Besides making a mockery of the concept of judicial review, the door is left open for a future Commission to become entirely business oriented.¹³³ Given free rein by a deferential judiciary, the FPC can ignore those consumer interests which were the primary reason for its creation. Even though a business oriented Commission can be controlled by the threat of congressional impeachment, the need to define the just and reasonable standard is still present.

C. CONGRESSIONAL DEREGULATION

Deregulation can be accomplished if Congress specifically exempts producers from rate regulation. This alternative has almost become a reality on several occasions.¹³⁴ While Congressional deregulation would eliminate the conflict over what is a just and reasonable rate, this solution has major drawbacks.

Besides creating the problems previously discussed in regard to judicial contraction of the FPC's jurisdiction, Congress would also discourage the development of an energy program using all primary fuels and abandon all questions of supply to the free market. This effect would be unfortunate, as the answers dictated by the market place

132. 320 U.S. at 645.

133. The captured regulatory agency theory is explored in Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MANG. SCI. 1 (1971).

134. In 1950, Congress exempted independent producers, S. 1498, 81st Cong., 1st Sess., 96 CONG. REC. 4365 (1950), but President Truman vetoed it, H.R. Doc. No. 555, 81st Cong., 2d Sess. (1950). In 1955, Congress again exempted independent producers, H.R. 6645, 84th Cong., 1st Sess. (1955) and President Eisenhower vetoed the legislation because it was procured by improper lobbying techniques, Kitch, *supra* note 32, at 256. In 1976, by a four vote margin, the House rejected deregulation through an amendment to H.R. 9464, 94th Cong., 2d Sess. (1976). [1976] EN. USERS REP. (BNA), No. 131, at A-8.

many times fail to take into account non-economic goals. For example, allocation by the market place ignores the fact that natural gas is a clean-burning, environmentally desirable fuel.¹³⁵ Because the environmental value of natural gas is greater to a region with severe air pollution than to an area without it, the free market allocation in such instances fails to find the most efficient use for available gas. Along the same lines, the need for gas in the long run may outweigh its present value. A free market can cause early consumption of this valuable resource that is needed for future generations. By deregulating natural gas prices Congress would strip the FPC of a needed tool in the establishment of an overall energy policy for the benefit of consumers.

D. ADAPTING THE JUST AND REASONABLE STANDARD TO MEET CHANGED CIRCUMSTANCES

The present rate controversy presents a unique opportunity to reinterpret the just and reasonable standard. The interaction of the courts and the Commission has created a body of common law that has come to be equated with the just and reasonable standard. This body of common law is now forcing a rigid approach to rate setting that was never contemplated by the drafters of the Natural Gas Act. Under this rigid approach, the Commission is now diverted by the procedural questions of rate determination, rather than concentrating on the overall effect of proposed rate increases. The *Hope* decision clearly found there was no specific formula identified with the duty to insure just and reasonable rates. Justice Douglas interpreted this lack of specificity as an indication of an intention to give the FPC the administrative flexibility to attain the end result of consumer protection.

There are no constitutional or statutory barriers that preclude the further evolution of the standard to reflect the Natural Gas Act's twin goals of providing fair consumer rates and adequate service. The FPC's

135. See [1976] EN. USERS REP. (BNA), No. 155, at A-11, A-12:

Three California state authorities are urging the Federal Power Commission to adopt a new policy that would allow Southern California counties to directly purchase intrastate natural gas for boiler fuel during severe pollution emergencies. While the California agencies are only seeking permission for two parts of the state if adopted, the proposed policy statement could possibly apply nation-wide.

.....
The *petitioners* noted the Order 533 was adopted to relieve economic crises for curtailed customers, and claimed that a similar policy for alleviating environmental crises also is needed. "The economic costs of such environmental crisis in terms of ill health, lost work hours, and production should be considered by this commission in its policy determination."
(emphasis in original).

original adoption of the traditional public utility approach of regulation is not controlling today. While consumer protection may have been adequately achieved through strict control of the natural gas industry's profits in the past, changed circumstances now dictate a different approach to insure a continued adequate supply of natural gas.¹³⁶ To this end, reviewing courts must realize that the just and reasonable standard has never been a fixed principle of law, and acknowledge that the public interest would best be served by pursuing the end result of encouraging the maximum amount of return over the longest period of time.

This end result orientation would allow the FPC to change its focus from controlling the costs and profits of the natural gas industry to meeting present and future consumer supply problems. This would solve the present legal conflict by making what is economically wise also legally permissible. With greater administrative flexibility, the FPC would no longer be forced to fulfill the requirements of the now largely irrelevant public utility model and could deal with the natural gas crisis directly through rate determinations.

An end result approach would avoid the problems inherent in other possible resolutions of the conflict over application of the just and reasonable standard. First, it permits an effective recognition of the commodity characteristics of the natural gas industry, emphasizing supply considerations so that proper service to appropriate consumers¹³⁷ is insured. At the same time, continued regulation recognizes the importance of energy and permits the injection of non-economic values into energy control and allocation. Under an end result orientation, residential and commercial consumers would not be forced into a wildly fluctuating commodity market, where they would have little bargaining power, and made to bear the burden of excessive prices that are not related to the policy of increasing supply. Thus, the FPC could face the future of regulating a depleting resource with the power to both maintain supply and equitably distribute natural gas.

136. The amount of profit made by natural gas producers could be controlled through taxes. Taxes would be apportioned on a company by company level in order to account for the variance between the size and the profits of the different corporations. Such a scheme of taxation would be more equitable than the uniform national rate, presently used for the same purpose, which is based on an average cost analysis.

137. The determination of who is an appropriate consumer is a major controversy in itself. The fact that there is but a limited supply of natural gas will force the decision to be made. Whether it is to be supplied to the highest bidder, the most productive sectors of the economy or the consumers with the greatest need, the FPC, either through acquiescence or direct control, will make an allocation decision. See note 90 *supra*.

CONCLUSION

By giving the FPC the ability to better control supply and allowing it to directly confront allocation problems, a redefined just and reasonable standard would supply the Commission with a valuable additional method with which to execute a national energy policy. Using the reformed standard, factors of regional demand and environmental necessity, as well as the existence of alternate energy sources, could be considered in rate making. While a new just and reasonable standard would not provide a complete solution to either the natural gas shortage or the energy crisis, it is a step in the right direction.

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