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New Approaches By the FPC / Scope of Judicial Review

Charles E. McCallum

Joel Porter

NOTES

New Approaches By the FPC to the Regulation of Natural Gas Producers: an Evaluation

Since 1954 the independent producers of natural gas have been regulated by the Federal Power Commission, operating under the Natural Gas Act[1] as construed by the Supreme Court in the *Phillips* case.[2] The results of this regulatory activity have been frustration and delay.[3] Recently the Commission has taken steps to relieve some of its miseries. It has instituted a new approach to producer regulation, area pricing, and it has by regulation outlawed the use of certain contract provisions, indefinite price adjustment clauses, deemed especially harmful to the public interest.

The probable practicality and legality of the area pricing plan have been discussed elsewhere.[4] However, little attention has been given in legal literature to the important question of whether this approach is appropriate to the underlying economic problems involved in the nation's utilization of its natural gas resources. It is the purpose of this note to examine the economic consequences of both area pricing and the abolition of indefinite price adjustment clauses, drawing on the results of recent scholarship in the field of economics.

I. The Natural Gas Industry

"Natural gas" is a mixture of light hydrocarbons which exist in a gaseous state at atmospheric pressure.[5] It is found, either alone or in association with oil, in underground reservoirs, or "traps" (layers of porous gas-bearing rock sealed off by layers of nonporous rock).[6] Commonly a number of reservoirs are found in the same general vicini-

1. 52 Stat. 821 (1938), as amended, 15 U.S.C. §§ 717-17w (1958).
2. Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954).
3. For example, at the end of calendar year 1959 there were 3065 producer rate increase suspensions pending, involving 154 million dollars annually; in 1958 the figures were 2034 suspensions and 89 million dollars; in 1957, 1040 suspensions and 50 million dollars. 1960 Proceedings of ABA Section of Mineral and Natural Resources Law 50.
4. *E.g.*, Orn, *Area Pricing of Natural Gas by the Federal Power Commission*, in Oil and Gas Operations: Legal Considerations in the Tidelands and on Land 371 (Slovenko ed. 1963) [hereinafter cited as Oil and Gas Operations]; Note, *FPC Regulation of Independent Producers of Natural Gas*, 75 Harv. L. Rev. 549 (1962). The second of these is especially valuable.
5. Stockton, Henshaw & Graves, Economics of Natural Gas in Texas 10-12 (1952) [hereinafter cited as Economics of Natural Gas].
6. *Id.* at 5-8.

ty, constituting a "field." A valuable raw material for industrial chemical processes,[7] natural gas is chiefly important as a fuel.[8] Clean-burning, easily ignited, and readily controlled thermostatically, it is desirable for industrial as well as domestic and commercial fuel purposes.[9] Its optimal social use is thought to be in the home—for space heating, water heating, cooking, and refrigerating.[10]

Every oil well contains natural gas, either dissolved in the oil or lying in a distinct layer above it in the reservoir ("associated gas").[11] The high pressure of gas in a reservoir is used to drive oil to the surface. Thus, whenever oil is produced, gas is produced as a necessary by-product.[12] Such by-product gas is known as "casinghead gas." The increased demand for natural gas since World War II has led to the exploitation of reservoirs containing only gas;[13] such gas is called "dry" or "non-associated" gas.

Natural gas was first produced commercially in the United States during the latter part of the nineteenth century in the Appalachian regions of Pennsylvania and New York.[14] By the end of World War I the supply in this area had begun to fail. However, in 1925, incidental to the search for oil, immense reserves of gas were discovered in the southwestern United States.[15] To finance the construction of costly transmission lines powerful holding companies were formed.[16] These companies developed vertically integrated gas systems, which engaged in production, transportation, and distribution of natural gas.

In the early days of the industry in the Southwest gas was a glut on the market.[17] The integrated gas systems could supply most of their

7. In the past the principal use has been in the manufacture of carbon black. See *id.* at 27-35. In recent years, however, the growth of the synthetic chemical industry has opened up thousands of new uses. *Id.* at 66-85.

8. "It is very generally recognized that the fuel with the best performance characteristic is a clean, dry gas of uniform and stable composition. If the common specifications of utilization—cleanliness, freedom from impurities, concentrated heating value, susceptibility to temperature control, completeness of combustion, efficiency, ease of handling, and uniformity—are considered, it is obvious that natural gas has marked physical advantages over competing fuels." *Id.* at 254.

9. In industrial uses natural gas is a preferred fuel in many metallurgical and ceramic heating operations. It is also used to develop steam and electricity. *Id.* at 13.

10. FPC v. Hope Natural Gas Co., 320 U.S. 591, 634-35 (1944) (Jackson, J., dissenting).

11. ECONOMICS OF NATURAL GAS 5.

12. *Id.* at 8.

13. Such gas comprises the bulk of total United States reserves. ECONOMICS OF NATURAL GAS 5.

14. FPC v. Hope Natural Gas Co., *supra* note 10, at 632-33 (Jackson, J., dissenting).

15. Hardwicke, *Some Consequences of Fears by Independent Producers of Gas of Federal Regulation*, 19 LAW & CONTEMP. PROB. 342, 348 (1954).

16. Atkinson, *Federal Regulation of Natural Gas—The Independent Producers' Status*, 13 SW. L.J. 425, 426 (1959). See also BLACHLY & OATMAN, NATURAL GAS IN THE PUBLIC INTEREST 55-56 (1947).

17. In 1940 the average field price for gas was only 4.5 cents per mcf. McKIE, THE REGULATION OF NATURAL GAS 12 (1957) [hereinafter cited as McKIE].

needs from their own reserves. Furthermore, as a result of the rapid growth of the oil industry large amounts of casinghead gas were produced. Owners of non-associated gas reserves were forced to sell to the integrated systems at very low prices under long-term contracts.[18] Around 1935, consumers began to complain of exploitation by the pipelines; as a result the Federal Trade Commission conducted an investigation into the natural gas industry. The FTC's 1936 report to Congress[19] included proposals for legislation regulating the sale of gas in interstate commerce.[20] The Natural Gas Act was passed without opposition in 1938.

After World War II the gas industry went into a period of unusual growth.[21] Advances in technology made long-distance high-pressure transmission lines feasible, and extensive pipeline construction took place. Early in this period the ratemaking practices of the Federal Power Commission (which had been charged with the administration of the Natural Gas Act) made it relatively unprofitable for regulated pipelines to own gas production facilities.[22] Thus the independent natural gas producer became a major force in the industry.[23]

At the present day the natural gas industry has three fairly distinct branches: production, transmission, and distribution. Most gas production is in the hands of independent producers who sell to interstate pipelines.[24] Because of the great cost of pipeline construction, usually financed through long-term bonded indebtedness,[25] and because of the gas consumer's need to be assured of a continuous supply of gas for a considerable period,[26] gas is purchased under long-term contracts (usually twenty years).

The long term of the gas sale contract has led to problems. The producer, anxious to be able to share in any future increases in the general price level of gas, hesitates to commit himself for twenty years at what may later appear to be too low a price.[27] To meet this

18. The usual term of the gas sale contract is fifteen to twenty years. MACAVOY, PRICE FORMATION IN NATURAL GAS FIELDS 30 (1962) [hereinafter cited as MACAVOY].

19. S. DOC. No. 92, pt. 84-A, 74th Cong., 2d Sess. (1936).

20. *Id.* at 616.

21. Hardwicke, *supra* note 15, at 349. A big factor in sparking this growth was the conversion of the Big Inch and Little Inch pipelines for the carrying of natural gas. *Ibid.*

22. Note, 75 HARV. L. REV. 549, 550 (1962). The particular practice involved was the application of rate base regulation to producing properties owned by pipelines. See note 118 *infra* and accompanying text.

23. In 1962, 90.6 per cent of the nation's supply of natural gas was produced by independent producers. PUB. UTIL. FORT., Oct. 10, 1963, p. 80.

24. See note 23 *supra*. Many independent producers sell to intrastate pipelines also.

25. Note, 75 HARV. L. REV. 549, 550 (1962).

26. To protect consumers, the FPC will not certify sales for a term of less than twenty years. *Ibid.*

27. This is especially so in light of the experience of many producers who sold during the early days of the industry in the Southwest.

problem, price adjustment clauses have been used in most recent contracts. These clauses are of two kinds, definite and indefinite. A definite price adjustment clause provides for increases in the contract price of stated amounts at stated intervals. Use of such a clause represents an attempt by the producer to predict market behavior over the next twenty years.[28] Indefinite price adjustment clauses, on the other hand, provide for price increases keyed in both timing and amount to current market behavior. The following types of indefinite pricing provisions are in common usage:[29] (1) two-party favored nation clauses—automatic increase of the contract price to match any price the buyer (the pipeline) pays at any time in the future for gas bought in the same area; (2) third-party favored nation clauses—automatic increase of the contract price to match any price paid at any time in the future by any buyer purchasing gas in the same area; (3) renegotiation clauses—provision for renegotiation (often with arbitration provisions) of the contract price at certain fixed or determinable times; (4) spiral escalation clauses—automatic increase of contract price whenever the buyer gets an increased price for its resale of the gas; and (5) price index clauses—automatic increase of contract price in response to increases in overall price index.

When a pipeline carries its full operating load of gas, the fixed costs of pipeline operation are spread over the largest possible number of units.[30] When the line carries less than a full load, the unit cost of gas rises. The domestic demand, consisting in large part of requirements for space heating, varies widely from season to season. To take up the slack during the off-season of domestic usage, the practice of interruptible industrial sale has been developed. Gas is sold at a low cost for certain industrial uses, on the condition that the flow may be cut off from those uses when the gas is needed to satisfy domestic consumer demand.[31]

II. Economics of The Natural Gas Industry

During the 1930's, in the early days of the industry in the Southwest,[32] prices dropped to an unbelievably low level.[33] This was due to a number of factors: unavailability of transmission facilities; production of vast amounts of casinghead gas; existence of integrated gas

28. McKie 35.

29. Cokenboo, Competition in the Field Market for Natural Gas 110-12 (Rice Institute Pamphlet vol. 44, No. 4, 1958) [hereinafter cited as Cokenboo].

30. Economics of Natural Gas 177-81.

31. *Id.* at 175-76.

32. See text accompanying notes 14-23 *supra.*

33. See note 17 *supra.*

systems;[34] monopoly position of the few pipelines.[35] After World War II, mushrooming consumer demand[36] caused prices to skyrocket upwards.[37] This price rise had two principal results. First, it alarmed consumer groups and caused them to take vigorous action to check further increases. Second, it made producers wary of contracting on a long-term basis without making some provision for increased prices as the market continued to rise.[38] The growth of the natural gas industry, and the vagaries of federal regulation thereof, must always be read in the light of this price history.

A. *Concentration*

When an industry is competitive, its regulation may lead to undesirable results.[39] If prices are set artificially low, the demand for what is being sold will outreach supply, and some sort of rationing scheme must be devised. When prices are set artificially high, over-production will result. On the other hand, in the absence of regulation, competition will in the short run set prices at the point of equality between the supply of and the demand for the product.[40] Over the long run, an industry in which a competitive market exists will attract capital, given increase in consumer demand and increase in profit margins.

Almost no market is perfectly competitive. However, a market price mechanism will perform its function of allocating the limited supply of goods among consumers in a socially desirable fashion so long as a state of "workable competition" is present.[41] This necessitates the satisfaction of a number of conditions:[42] (1) The market must consist of a large number of sellers. (2) No one seller or buyer may be so large as to dominate the industry. (3) Entry into the market must be relatively easy so that existing firms face not only actual competition from their own ranks but also the threat of potential new competition should prices rise to such an extent that abnormal profits are earned. (4) The several firms in the industry must operate inde-

34. The integrated systems could supply most of their demands from their own supplies; thus the market for natural gas was quite restricted.

35. See note 68 *infra* and accompanying text.

36. Between 1952 and 1962 the number of domestic consumers rose from 23.9 million to 31.9 million. PUB. UTIL. FORT., June 20, 1963, p. 46.

37. In 1950 the average wellhead price of gas was 6.5 cents per mcf (thousand cubic feet); in 1961 it was 15.1 cents. PUB. UTIL. FORT., Oct. 10, 1963, p. 80.

38. Hence the widespread use of indefinite pricing provisions. See notes 27-29 *supra* and accompanying text.

39. "Should other than economic considerations prevail and a competitive industry be regulated . . . [most] economists . . . would warn us of the inevitable economic price which must be paid." COKENBOO 2.

40. SAMUELSON, ECONOMICS 380 (4th ed. 1958).

41. COKENBOO 11. See SAMUELSON, *op. cit. supra* note 40, at 486-90, for a discussion of the "evils" of imperfect competition.

42. *Ibid.*

pendently of each other with neither tacit nor overt collusion. (5) There must be some knowledge to buyers and sellers of market prices for a number of transactions. Of these conditions, the first two are considered most important.[43] Where there are many alternative sources of supply with no firm dominant, competitive performance can be expected to exist. The number of alternative sources of supply, and their relative size, is studied by economists through the use of the concept of "concentration."[44] The percentage of the industry accounted for by the top four, or eight, or twenty, firms is computed and examined; the lower the percentage figures the less "concentrated" the industry is.

Recent economic studies have confirmed older findings that the concentration of the natural gas production industry is quite low—lower, in fact, than about three-quarters of manufacturing industries in the United States.[45] One author presents the following table of the percentage of natural gas sales to interstate pipelines:[46]

	Sales under all contracts	*Sales under contracts executed 1951-1955*
Top 4 firms	23%	20%
" 8 "	35%	33%
" 12 "	44%	41%
" 16 "	49%	48%
" 20 "	54%	53%

Similar figures resulted when examination was restricted to sales in a single producing area, and the percentages were only slightly higher when consideration was narrowed to sales to the top fifteen buyers within a single area.[47] The author of that study concludes:

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43. *Ibid.*

44. *Id.* at 41.

45. COKENBOO 79.

46. *Id.* at 62.

47. When consideration was restricted to sales in the Gulf Coast area, the figures were:

	All contract dates	*1951-1955 contracts*
Top 4 firms	26%	27%
" 8 "	42%	42%
" 12 "	52%	53%
" 16 "	60%	61%
" 20 "	67%	67%

Ibid. And restricting consideration to sales to the top fifteen buyers in the Gulf Coast region, the results were:

	1946-1950 contracts	*1951-1955 contracts*
Top 4 firms	34%	27%
" 8 "	53%	42%
" 12 "	65%	53%
" 16 "	73%	61%
" 20 "	78%	67%

Id. at 66.

> The field market for natural gas is one of low concentration. No one firm is large relative to the market, and none is considerably larger than its competitors. . . . The leading firms change from time to time. Concentration has decreased since World War II. And the future market will probably be widely distributed among the various sellers.[48]

Most economists agree that the natural gas industry is one of extremely low concentration.[49] Furthermore, entry into the market is relatively easy.[50] The average initial fixed cost for a productive gas well is about 181,000 dollars. Moreover, "ease of entry has been shown directly in the changing names and positions of the leading sellers in the concentration tables for different time periods."[51]

Economists have for some time, relying on concentration figures, insisted that the price of natural gas in the field is set competitively.[52] However, consumer groups have argued that special features of the gas industry result in non-competitive behavior in spite of low concentration.[53] In light of recent economic analysis, these arguments seem highly questionable.

(1) *The "garden-hose" argument.*[54] A pipeline, it is said, is not movable like a garden hose. Thus, once it is built it is at the mercy of the producers whose properties it touches. This argument ignores the fact that the bulk of the supplies for a line are contracted on a twenty-year basis before construction is begun (otherwise neither financing nor Commission approval would be available).[55] In addition, this argument assumes that supplies bought after the line is laid are bought under monopolistic conditions. But this would be true only if the line is unable to achieve connection with more than a few sellers—which is almost never the case[56]—or if there is collusion among many sellers—which is possible, but has never been suggested.

(2) *"Fixed supply."*[57] The theory behind this argument is that additions to gas reserves are a by-product of drilling for oil, and so unrelated to the price of gas. Thus, it is thought, price increases will not bring increased output, only abnormal profits. Such a suggestion is a

48. *Id.* at 121.
49. ADELMAN, THE SUPPLY AND PRICE OF NATURAL GAS 39 (1962) [hereinafter cited as ADELMAN]; MCKIE 29; Boatwright, *Reasonable Market Prices*, in 1957 PROCEEDINGS OF ABA SECTION OF MINERAL AND NATURAL RESOURCES LAW 4.
50. COKENBOO 121.
51. *Ibid.*
52. "There is . . . no question but that the field price of gas in the United States is competitively determined." ADELMAN 39.
53. See, *e.g.*, Douglas, *The Case for the Consumer of Natural Gas*, 44 GEO. L.J. 566 (1956).
54. COKENBOO 42.
55. See notes 25 & 26 *supra* and accompanying text.
56. MCKIE 30.
57. COKENBOO 83-92.

contradiction of the economic theory of joint products.[58] More significantly, available data indicates that, with ever higher percentages of gas reserves being found in the non-associated form, the price of gas is determinative of supply.[59]

(3) *The "captive consumer."*[60] This argument is that once a consumer installs gas equipment he is a "captive" of the producers. That is, he will more readily pay increases in the price of gas than he will junk his gas appliances and buy new ones using a different fuel. But the so-called "captive consumer" is not at all an unusual situation. The driver of a car is a "captive" of the gasoline manufacturers—he must buy gasoline. More analogously, the owner of a home with wood siding is a "captive" of the paint producers. He will surely pay a higher price for paint more readily than he will change his home, or put up brick facing. What is important, however, is whether or not the industry is monopolistic—*i.e.*, whether there are a number of competing sellers who will, motivated by the desire for profit, keep prices down.

(4) *Soft bargaining.*[61] The criticism here is that the principal interstate buyers do not bargain vigorously, since whatever they pay for gas goes into their cost of service when their rates are set by the FPC. Although the merit of such a charge is difficult to determine, there are several factors making it difficult to believe:[62] (a) Some pipelines deal directly in the ultimate market in unregulated direct sales. (b) Even a small price increase may affect the pipeline's overall profits. (c) The pipelines have a bargaining advantage in most areas.[63]

(5) *Abnormal profits.*[64] It is suggested that profits are abnormally high in the natural gas industry. It has been shown that this charge is not justified. The average rate of return on the investment in a successful well is twelve per cent.[65] A survey by *Fortune* magazine in 1956 showed that the nation's five hundred largest industrial concerns earned, on the average, a fourteen per cent return on net worth.[66]

58. Whenever one product cannot be produced without at the same time producing the other the two are called joint products. ADELMAN 25. The total revenue for the two products determines total activity, and gas revenues are not an insignificant part of the total. Thus it is incorrect to assert that gas prices do not affect the supply of gas. COKENBOO 84-85. *But see* ADELMAN 29, 30 ("[W]e would not expect, and do not find, any perceptible relation between the price of gas and the discoveries of 'casinghead' gas.").

59. ADELMAN 60; COKENBOO 89.

60. *Id.* at 93-96.

61. *Id.* at 96-101.

62. *Ibid.*; Lindahl, *Federal Regulation of Natural Gas Producers and Gatherers*, 46 AM. ECON. REV. 532 (May, 1956).

63. See notes 78-81 *infra* and accompanying text.

64. COKENBOO 103-10.

65. *Id.* at 108.

66. Fortune, July 1956, p. 88.

Working from studies of concentration, researchers have constructed an economic history of natural gas production in the southwestern United States.[67] In early years there was a buyers' monopoly ("monopsony"), due to (1) the unpredictable nature of discovery, such that deposits would be found beyond the reach of existing pipelines, and (2) substantial economies of scale in pipeline transmission. Even today, "as a gas area opens, the first pipeline to begin building will, at least for some time and perhaps permanently, be the only buyer."[68] However, as an area develops, monopsony tends to give way.[69] One indication of the giving way of monopsony is a sharp upward bounce of price. This price bounce, actually indicative of the advent of competition, has been seized upon by consumer groups as evidence of monopoly. According to one analyst: "It is characteristic of the topsy-turveydom of some present-day thinking in the United States that this price bounce is viewed as a sign of a sellers' monopoly. In fact it signals the deterioration of a buyers' monopoly. If there is any price bounce left in an area, there is still some monopsony."[70]

B. *Pricing*

A recent study[71] has corroborated the earlier findings of the concentration studies that prices are set competitively in the field market for natural gas.[72] In this study the author does not examine concentration or other indicia of the structure of the market. Instead, he compares the pattern of purchase prices with theoretical models based on competitive, monopolistic, and monopsomistic markets. When there is competition, "price levels should be uniform for all purchasers. There should be distinct price variation with contract volume, the location of the trap, and the term-length of production . . . ."[73] Under monopolistic or monopsonistic market conditions there should be variation from this pattern.[74]

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67. ADELMAN 44-47; COKENBOO 67-72; MCKIE 28-29.

68. ADELMAN 45.

69. This is evidenced by two effects. First, oil companies report to shareholders that they are moving into an area "inadequately served." Second, there is a sharp upward bounce of prices when a new line enters. *Id.* at 45-46.

70. *Id.* at 46.

71. MACAVOY.

72. "The general conclusions of this economic analysis . . . are that field markets in the 1950's were centers of highly competitive pricing, or were characterized generally by movement away from monopsony (buyer's monopoly) toward competition." *Id.* at vii.

73. *Id.* at 82.

74. "When there is such concentrated ownership of uncommitted reserves that a producer has monopoly power, prices should be set individually for each purchaser. Higher prices should be paid for all new reserves by pipelines with the more inelastic field demands. This should disrupt any variation in prices according to conditions of

For purposes of analysis, the nation's gas supplies are arranged in three groupings: "Gulf Coast,"[75] "Mid-Continent,"[76] and "West Texas-New Mexico."[77] In the West Texas-New Mexico market in the 1950's the prevailing structure was one of monopsony (buyer's monopoly), and in general prices were lower than might have been expected had the market been competitive.[78] In the Gulf Coast market competition emerged from a prior condition of monopsony during the period between 1950 and 1954, and systematic competition prevailed from 1955 to 1960.[79] The Mid-Continent region showed, from a pricing viewpoint, both competitive and monopsonistic behavior.[80] The author concludes:

> Price formation in the West Texas, Gulf Coast, and Mid-Continent regions would seem to have followed at times from monopsony, at times from competition, in the sale of new reserves. Monopsony prevailed in each of the three producing regions at some time, but pricing was generally becoming more competitive in the late 1950's.[81]

C. *Indefinite Pricing Provisions*

Indefinite pricing clauses[82] are not unknown in other industries.[83] In the natural gas industry, they have probably served to bring buyers and sellers together during times of uncertainty as to market behavior.[84] Their purpose is, in general terms, to shift the risk of future market increases from the producer to the pipeline and ultimately to the consumer; thus the consumer groups have opposed their use. The real evil is the long term of the gas sale contract, necessitated by considerations of financing and public protection.[85] Definite price adjustment clauses help to alleviate the problems caused by the long-term

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field locations, the volume of uncommitted reserves, or some other aspect of a particular type of contract." *Ibid.* "When there is one buyer in the relevant region, monopsony prices should be set lower than the competitive level and should exhibit little or no variation from contract to contract. . . . Actual prices should be so uniform as to indicate a *lack* of a pattern similar to that expected from competition." *Id.* at 82-83.

75. This includes Louisiana, adjacent areas of Texas, and the region along the Texas Gulf Coast. *Id.* at 93-94.

76. Oklahoma, Kansas, and north Texas, including the Panhandle and Hugoton fields. *Ibid.*

77. This includes two basins, the Permian Basin in southwestern Texas and southeastern New Mexico, and the San Juan Basin, in northwestern New Mexico and southwestern Colorado. *Ibid.*

78. *Id.* at 121, 126-27, 145.

79. *Id.* at 186, 210-11.

80. *Id.* at 212.

81. *Id.* at 243.

82. See notes 27-29 *supra* and accompanying text for discussion of indefinite pricing clauses.

83. ADELMAN 42-43.

84. *Id.* at 43.

85. COKENBOO 115.

contract, and are probably unobjectionable to consumers,[86] but producers have not been willing to settle for them.[87]

There is disagreement among economists as to both effect and desirability of indefinite pricing provisions.[88] There seems to be agreement, however, that insofar as such clauses are one-way streets, *i.e.*, provide for price increases but not for price reductions, they are defective.[89] There is also agreement that certain types of clauses—spiral, third-party favored nation, and price index—are not justifiable. The index of prices generally is an extraneous consideration in the pricing of a commodity.[90] Likewise, that a pipeline has received a higher price for the gas it sells should not enter into the pricing of the gas it buys—at least, not automatically under a contract provision.[91] Finally, under the third-party favored nation clause the purchaser loses control of the price he pays for gas. The price is not a price he has "bargained" for.[92] One imprudent small purchase by a buyer in a hurry can trigger price increases under such a clause for all pipelines buying in the area.[93]

Contrariwise, it has been suggested that renegotiation and two-party favored nation clauses tend to minimize noncompetitive aspects of natural gas pricing.[94] Furthermore, it has been pointed out that in the absence of such provisions the average price for pipeline gas would be kept abnormally low, thus continuing to call forth excessive demand.[95] In any case, it seems fairly clear now that the inclusion of such a

86. At least, consumers have not yet raised any objections to them. And it is difficult to see how there could be any objection. The buyer under such a clause knows exactly what price he will have to pay over the life of the contract.

87. Largely because of their earlier bitter experience with the unforeseeable boom in the natural gas industry. See note 38 *supra* and accompanying text.

88. As to effect, *compare* ADELMAN 43 ("To the extent—and it may have been substantial—that contingent clauses for a time held prices below the market level . . . they must be regarded as unfortunate."), *with* MACAVOY 264 (stating that initial prices for contracts with coutingent clauses showed no tendency to be lower than those in contracts without such clauses). As to desirability, *compare* ADELMAN 43 *and* MACAVOY 265, *with* COKENBOO 117 ("The tendency toward price uniformity created by the indefinite pricing clauses is, therefore, not ouly in the direction of competitive pricing . . . it should also achieve more or less competitive price levels, unless there should be considerable defects in the wording of the clauses.")

89. *E.g.*, COKENBOO 117; Lindahl, *supra* note 62, at 542. In a falling market the pricing will be non-competitive, since prices will be pegged at the highest point reached.

90. Lindahl, *supra* note 62, at 542. The market for gas should determine the price, not the market for other commodities.

91. MCKIE 38; Lindahl, *supra* note 62, at 542. A higher resale price, based perhaps on higher transport cost, is another extraneous factor.

92. Lindahl, *supra* note 62, at 542. "Where price adjustments depend on prices agreed to by outside parties . . . new price bargains are arrived at without any actual bargaining . . . ." *Ibid.*

93. MCKIE 37; COKENBOO 113.

94. COKENBOO 117; see note 88 *supra*.

95. "If demand continues to increase, the prices for new supply will continue to be

clause in a gas sale contract does not cause the original contract price to be lower than it would have been in the absence of such a provision.[96] Arguing against the use of two-party favored nation clauses, one author noted that they caused relocation of buyers.[97] Older buyers don't purchase in established areas when new purchases would give rise to higher prices on their old contracts. "With the clauses having little 'contingency' value in current markets and resulting in the economic cost of pipeline relocation, there would seem to be some advantage from voiding them."[98]

III. Regulation Under the Natural Gas Act

A. *The Natural Gas Act*

The Natural Gas Act[99] is designed to apply to companies engaging in the "transportation of natural gas in interstate commerce" or in "the sale in interstate commerce of natural gas for resale for ultimate public consumption."[100] Such companies are defined in the Act to be "natural gas companies." The Act exempts intrastate transportation and sale,[101] direct sales to consumers, and the production or gathering of gas.[102]

The operative provisions of the Natural Gas Act with respect to price regulation are sections 4, 5, 7, and 16. Section 7[103] provides that no natural gas company shall engage in the sale or transportation of natural gas subject to the jurisdiction of the Federal Power Commission, or construct facilities therefor, without obtaining first a certificate of public convenience and necessity from the Commission. Such a certificate can only be issued after a hearing of which all interested parties are given notice. In issuing a certificate, the Commission may insert any conditions that it deems required by the public convenience and necessity.[104] Section 7 further provides that no natural gas com-

bid up. If the prices on 'old' supply are arbitrarily kept down to lower levels and the lower cost is passed through as a lower average price to consumers, then demand will increase all the more and prices for new supply will go up all the faster, which will pull up the average price." McKie 36.

96. MacAvoy 264. MacAvoy's study is supported by impressive data.

97. *Id.* at 264-65.

98. *Id.* at 265.

99. 52 Stat. 821 (1938), as amended, 15 U.S.C. §§ 717-17w (1958).

100. Natural Gas Act § 1(b), 52 Stat. 821 (1938), as amended, 15 U.S.C. § 717(b) (1958).

101. Natural Gas Act § 1(c), 52 Stat. 821 (1938), as amended, 15 U.S.C. § 717(c) (1958).

102. The provisions of the act cover transportation or sale for resale in interstate commerce, but do "not apply to any other transportation or sale of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas." Natural Gas Act § 1(b), 52 Stat. 821 (1938), as amended, 15 U.S.C. § 717(b) (1958).

103. Natural Gas Act § 7, 52 Stat. 824 (1938), 15 U.S.C. § 717f (1958).

104. Including a condition as to price. Atlantic Ref. Co. v. Public Serv. Comm'n, 360 U.S. 378 (1959).

pany shall abandon any service subject to Commission jurisdiction without first obtaining permission from the Commission.

Section 4[105] governs changes in rates. Rates and charges that are not "just and reasonable"[106] are declared unlawful, and no change in rates is allowed except after thirty days' notice to the Commission. Upon the filing of a new rate schedule, the Commission may, either upon complaint of an interested party or on its own motion, initiate an inquiry into the lawfulness of the proposed charges. Pending the hearing, the Commission may suspend the new schedule for up to five months. After that time the company may put the new rates into effect, but the Commission may require the furnishing of a bond to refund any receipts attributable to an increase later declared to be unlawful. At the hearing, of which all interested parties are to be given notice, the burden of proof on the issue of the justness and reasonableness of the proposed change rests upon the party seeking the change.

Section 5[107] has seen little use.[108] It empowers the Commission, acting upon complaint or on its own motion, to inquire whether an existing rate schedule of a natural gas company is just and reasonable. If it finds that the schedule is not, the Commission may order the rates decreased to the "lowest reasonable" level. Section 16[109] gives the Commission power to make and enforce any orders, rules, and regulations which it may find necessary to the performance of its duties under the Act.

B. *Pre-1954 Regulation*

Before the momentous *Phillips*[110] decision in 1954, it was widely believed that independent producers of natural gas were not reached by the provisions of the Natural Gas Act.[111] The Commission waivered,[112] but tended to take this view itself.[113] Thus attention during

105. Natural Gas Act § 4, 52 Stat. 822 (1938), 15 U.S.C. § 717c (1958).

106. The term "just and reasonable" is nowhere defined in the Natural Gas Act. FPC v. Hope Natural Gas Co., 320 U.S. 591, 600-01 (1944). The words are "words of art in public utility law, carrying a well-defined and accepted meaning," but "do not necessarily have the same meaning when used in connection with producer prices . . . ." Orn, *Area Pricing of Natural Gas by the Federal Power Commission*, in OIL AND GAS OPERATIONS 371, 372.

107. Natural Gas Act § 5, 52 Stat. 823 (1938), 15 U.S.C. § 717d (1958).

108. Atlantic Ref. Co. v. FPC, 316 F.2d 677, 678 n.8 (D.C. Cir. 1963).

109. Natural Gas Act § 16, 52 Stat. 830 (1938), 15 U.S.C. § 717*o* (1958).

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

111. See, *e.g.*, Crenshaw, *The Regulation of Natural Gas*, 19 LAW & CONTEMP. PROB. 325, 338 (1954).

112. See 1949 PROCEEDINGS OF ABA SECTION OF MINERAL LAW 71, discussing the position of the Commission with respect to a bill which would have exempted independent producers.

113. See, *e.g.*, Columbian Fuel Corp., 2 F.P.C. 200 (1940).

the period 1938-1954 was centered on the pipelines. A pipeline has many characteristics of a traditional utility.[114] Its high fixed cost and its monopoly position vis-a-vis the areas it serves provide the basis for traditional utility regulation. Thus, the Commission has regulated pipeline prices by use of the rate base cost-of-service approach.[115] Under this method, rates are fixed so as to return to the company its cost of service plus a return on the investment in it (the "rate base").

Few serious problems arose during this period of federal regulation. One case of importance to the subsequent development of the law, however, involved an integrated producer-pipeline.[116] The pipeline sought to include in its cost of service the value of the gas it produced from its own properties. This value would be ascertained by reference to the going price in the general production area (the "field price"). Correlatively, the value of producing properties would be excluded from the rate base. The FPC decided, however, and was sustained by the courts,[117] that the field price method could not be used and that the producer-pipelines had to include their production facilities in their rate bases.[118]

Another controversy prior to the *Phillips* decision involved the valuation of pipeline properties. The underlying problem was that pipelines had acquired at low cost vast tracts of gas-producing property prior to the discovery of gas on it. The lines' cost-basis for this property was low, although the land was currently invaluable. The pipelines urged that these and their other properties should be included in the rate base at current replacement cost; the FPC adopted instead the figure of original cost less depreciation.[119] In the case of *Federal Power Commission v. Hope Natural Gas Co.*,[120] the Supreme Court upheld the Commission on this point. In so doing, the Court laid down the famous "end result" test: "Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling."[121]

Mr. Justice Jackson, dissenting in the *Hope* case,[122] raised the obvious question as to the Court's "end result" test: If the method employed by the Commission is not to be considered, how is one to tell whether or not a rate is "just and reasonable"?[123] Confessing dismay,

114. McKie 15.
115. See, *e.g.*, FPC v. Natural Gas Pipeline Co., 315 U.S. 575 (1942).
116. Colorado Interstate Gas Co. v. FPC, 324 U.S. 581 (1945).
117. *Ibid.*
118. *Id.* at 600. This is still the law. Panhandle Eastern Pipe Line Co. v. FPC, 305 F.2d 763 (D.C. Cir. 1962).
119. Hope Natural Gas Co., 3 F.P.C. 150 (1942).
120. 320 U.S. 591 (1944).
121. *Id.* at 602.
122. *Id.* at 628.
123. *Id.* at 645.

he went on to give a now-classic analysis of the gas industry. The integrated pipeline-producer, he said, operates in two spheres: as a pipeline it is a public utility, amenable to traditional utility regulation; as a producer, however, it operates in an area where rate base cost-of-service regulation makes no sense.[124] This technique of rate regulation was designed to be used where a utility's monopoly position meant that no market price was available for its services. But natural gas is a commodity for which there is a competitive market, and so utility regulation is not needed. A more fruitful line of inquiry in fixing the price of natural gas, he suggested, would include the following questions: How far is the field price "established by arm's length bargaining and how far . . . influenced by agreements in restraint of trade or monopolistic influences?"[125] If a company should get more or less than field price for its own product, how much and why? What is gas worth in terms of the fuels it displaces? Is the price fixed an incentive to continue to exploit unoperated reserves and to explore for new reserves?[126]

C. *Regulation Between 1954 and the Policy Statement*

In 1954 the United States Supreme Court cast a new light on the whole natural gas arena, deciding in the case of *Phillips Petroleum Co. v. Wisconsin*[127] that independent producers of natural gas were natural gas companies subject to the provisions of the Natural Gas Act, and that their sales of natural gas to interstate pipelines did not fall within the Act's exemption for "production and gathering."[128] The Commission responded to the *Phillips* decision by issuing a series of orders setting up the mechanics of regulation of independent producers.[129] For its trouble, the Commission was immediately buried under an

124. A traditional utility supplied a "service," and to value it the rate base method was developed. This method was needed since the utility, a monopoly, did not sell its services in a competitive market. But gas turns this topsy-turvy. Gas is tangible and has a price in the field. On the other hand, the value of its rate base is more elusive than the value of the gas itself. *Id.* at 647-49.

125. *Id.* at 654.

126. *Id.* at 654-55.

127. 347 U.S. 672 (1954).

128. If Congress had intended the Natural Gas Act to cover only interstate pipelines, said the Court, then the language "or sale for resale" in § 1 would be superfluous. *Id.* at 681-82. Justices Douglas and Clark dissented, pointing out the legislative history. *Id.* at 688, 691.

129. The *Phillips* decision was handed down in June 1954. The Commission promptly began to issue its "174" series of orders governing independent producers. Order No. 174, 13 F.P.C. 1195 (1954), was issued on July 16. In November 1954, the Commission initiated a hearing to determine principles to govern producer cases. Hillyer, *A Primer on Producer Price Regulation*, in OIL AND GAS OPERATIONS 345, 357-58.

avalanche of certificate and rate filings;[130] not until 1960 did it take forthright action to revive itself.

Mr. Justice Jackson had pointed out in *Hope* that it was doubtful that the rate base cost-of-service type of regulation should be applied to the production facilities of integrated pipeline-producers.[131] A fortiori, it was even more questionably applied to independent producers. Furthermore, logic aside, a rate base cost-of-service hearing is a time-consuming procedure.[132] However, this method was all the Commission had, and a mandate for its use was soon forthcoming from the courts.

The case of *City of Detroit v. Federal Power Commission*[133] involved an integrated pipeline producer. Reversing its previous stand,[134] the Commission had computed a "field price" for gas, looking to the prices established by federally unregulated bargaining for similar gas in the field. It then gave the pipeline applicant, Panhandle Eastern, as part of its cost of service, the value of the gas produced from its own properties, computed on the basis of the field price.[135] On appeal, the Court of Appeals for the District of Columbia stated that the Commission was not bound to use only the traditional rate base method, even though it might lead to lower rates than the field price determination gave.[136] Nevertheless, said the court, "it is essential in such a case as this that it [the rate base method] be used as a basis of comparison."[137] Remanding the case for the Commission's failure to take cost evidence, the court added that if the Commission intends "to abandon the treatment historically accorded pipeline-produced gas in rate making on the ground that the ultimate public interest will be better served thereby, the Commission should justify it on the record."[138]

Reading the *City of Detroit* case to require cost evidence in producer cases, the Commission began to dismiss applications for rate

130. In the two years after the *Phillips* decision there were 4,431 rate increase applications and 7,738 certificate applications filed. 1957 PROCEEDINGS OF ABA SECTION OF MINERAL AND NATURAL RESOURCES LAW 75.

131. FPC v. Hope Natural Gas Co., 320 U.S. 591, 647-48 (1944) (Jackson, J., dissenting).

132. In a recent case seven years elapsed between the date of the rate filing and the close of review proceedings. The case is discussed in FPC v. Texaco, Inc., 32 U.S.L. WEEK 4370, 4373 n.13 (U.S. April 20, 1964).

133. 230 F.2d 810 (D.C. Cir. 1955), *cert. denied*, 352 U.S. 829 (1956).

134. In the case of Colorado Interstate Gas Co. v. FPC, 324 U.S. 581 (1945), the Commission had successfully resisted an attempt by a producing pipeline to force it to use the field price method.

135. The field price was the weighted average of prices achieved in federally unregulated bargaining in the field.

136. 230 F.2d 814-15.

137. *Id.* at 818.

138. *Ibid.*

increases when such evidence was not produced.[139] In hearing after hearing, however, gas was shown to be underpriced;[140] in addition an enormous backlog of filings was steadily accumulating.[141] Thus the Commission again began to consider abandoning rate base cost-of-service regulation. In doing this, it did not have a clear and consistent line of judicial directives within which it could maneuver. The *Hope*[142] case on the one hand had left the door open for considerable variation in regulatory technique, but *City of Detroit* on the other hand seemed to require the use of the rate base method at some stage in almost every proceeding.

The Commission used two approaches to bypass rate base regulation in section 4 rate filings. First, in some cases a token bow was made in the direction of cost evidence, followed by a decision based on a field price approach.[143] Second, the Commission began to use its discretion in deciding whether or not to suspend and investigate proposed rate increases.[144] Orders vacating prior suspensions were used to whittle down the backlog of pending cases. Several grounds were used to justify vacation: (1) that a higher rate than that requested had been previously certificated in the area;[145] (2) that the applicant had agreed to eliminate indefinite pricing clauses;[146] (3) that only a small amount was involved;[147] or (4) that some other form of settlement had been reached.[148] The first of these is an obvious bypass of the *City of Detroit* requirement.

139. The Commission adopted rate base regulation for independent producers in Union Oil Co., 16 F.P.C. 100 (1956), *aff'd sub nom.*, Bel Oil Corp. v. FPC, 225 F.2d 548 (5th Cir. 1958). In a number of subsequent cases the Commission denied requested increases because the producers did not submit rate base evidence. *E.g.*, Sun Oil Co., 17 F.P.C. 174, 194-95 (1957); see Note, 75 HARV. L. REV. 549, 555 (1962).

140. *Ibid.*

141. See note 3 *supra.*

142. FPC v. Hope Natural Gas Co., *supra* note 131.

143. See Pan American Petroleum Corp., 19 F.P.C. 463 (1958), where very little cost evidence was introduced. "In this case ten of the eleven rate proponents . . . are engaged in extensive . . . operations throughout the country, so that these proceedings represent only a fragmentary portion of the operations of any one company. . . . To require rate base evidenee in a case of this kind would necessitate . . . a complete examination of their entire plant and operations in order to regulate only a fraction of their sales. Such a procedure would involve an extensive taking of evidence that would delay the fixing of rates for years to the public detriment and would be a wholly infeasible administrative procedure." *Id.* at 467.

144. See Note, 75 HARV. L. REV. 549, 556 & nn. 71-72 (1962).

145. See, *e.g.*, Reef Fields Gasoline Corp., 19 F.P.C. 351 (1958). This and the other developments are noted in the Report of the Committee on Natural Gas in the 1960 PROCEEDINGS OF ABA SECTION OF MINERAL AND NATURAL RESOURCES LAW 71-72.

146. This has been a leading factor. Note, 75 HARV. L. REV. 549, 557 (1962).

147. See 1960 PROCEEDINGS OF ABA SECTION OF MINERAL AND NATURAL RESOURCES LAW 71-72.

148. The settlement technique was extensively used. Note, 75 HARV. L. REV. 549, 556 (1962).

In another line of development, rate considerations began to play a part in section 7 certification proceedings. Once certificated, an initial rate cannot be suspended while its lawfulness is being determined.[149] In order to exercise some influence on initial prices, the Commission at first assumed the power to condition certification upon the applicant's acceptance of a decreased initial price.[150] Later, however, it abandoned this position, feeling that the safeguard of a section 4 hearing should be provided in any Commission rate regulation.[151] In the well-known *Catco* case,[152] however, the Supreme Court remanded a certification proceeding to the Commission, stating that:

> where the proposed price is not in keeping with the public interest because its approval might result in a triggering of general price rises or an increase in the applicant's existing rates by reason of "favored nation" clauses or otherwise, the Commission in the exercise of its discretion might attach such conditions as it believes necessary.[153]

Pointing to the inadequacy of a section 5 proceeding in providing complete consumer protection, the Court said that the Commission must "hold the line awaiting adjudication of a just and reasonable rate."[154] Subsequent decisions have refined the "holding of the line" doctrine,[155] but it has been kept essentially in its original form, using principally a field price method of price control.[156]

D. *Stirrings in the Legislative Branch*

Seven years before the *Phillips* decision was rendered, legislation was introduced into Congress to exempt independent producers from Commission jurisdiction.[157] Since that time similar legislation has been proposed almost every year.[158] On two occasions both houses of

149. Transcontinental Gas Pipe Line Corp., 20 F.P.C. 264, 273 (1958).

150. Signal Oil & Gas Co., 14 F.P.C. 134 (1955), *aff'd*, 238 F.2d 771 (3d Cir. 1956), *cert. denied*, 353 U.S. 923 (1957).

151. Seaboard Oil Co., 19 F.P.C. 416 (1958).

152. Atlantic Ref. Co. v. Public Serv. Comm'n, 360 U.S. 378 (1959).

153. *Id.* at 391.

154. *Id.* at 392.

155. For example, in establishing the price line the Commission may not rely on other prices which are under review in pending court or Commission proceedings; such prices are under a "cloud." Texaco Seaboard Inc., 47 P.U.R.3d 470 (FPC 1963). Where a substantial number of prices in an area are under review, like prices in the same area are also suspect and may not be relied on. United Gas Improvement Co. v. FPC, 283 F.2d 817, 824 (9th Cir. 1960). And the prices relied on must come from the same or a similar area as that under scrutiny. *Id.* at 823. Furthermore, prices determined in a hearing in which petitioner was denied the right to intervene may not, so long as the denial is under review, be relied upon. *Id.* at 825.

156. See, *e.g.*, California Oil Co. v. FPC, 315 F.2d 652 (10th Cir. 1963).

157. H.R. 2185, 83d Cong., 2d Sess. (1954).

158. See the annual reports of the ABA Section of Mineral and Natural Resources for a summary of each year's legislative efforts. The history of these attempts is given in Heard, *Pending Legislation To Amend the Natural Gas Act*, in OIL AND GAS OPERATIONS 406-15.

Congress have passed bills to this effect;[159] in both instances the President vetoed them.[160] Approaches other than exemption have been tried; none have succeeded. Bills have been introduced which would: restrict Commission authority to a determination of whether a "reasonable market price" had been achieved;[161] outlaw the use of certain types of indefinite pricing clauses;[162] exempt "small" producers from Commission jurisdiction;[163] or give the Commission the job of ascertaining that prices in each gas-producing area are set competitively.[164]

IV. NEW APPROACHES

A. *Area Pricing*

By the time the *Phillips* case got back to the Commission,[165] the burden of producer regulation had become intolerable. On the other hand, the Commission's venture into field pricing in vacating suspension orders had proven profitable.[166] Furthermore, the Supreme Court's mandate in *Catco* to "hold the line" and to consider existing area price lines in the conditioning of certificates indicated that the Court might look with favor upon the more general application of such a technique. On September 28, 1960, the Commission attempted a generalization of the field price approach when it announced in the *Phillips* decision,[167] and in the accompanying Statement of General Policy No. 61-1 [hereinafter referred to simply as the Policy Statement], a new area pricing plan.

1. *The Policy Statement.*—The appendix to the Policy Statement set out two rates for the gas produced in each of twenty-three areas—the first price is to apply to contracts executed after the date of the Policy Statement, and is in most cases higher than the second price,

159. The Kerr-Harris Bill, H.R. 1758, 81st Cong., 2d Sess. (1950), and the Harris-Fulbright Bill, H.R. 6645, 84th Cong., 1st Sess. (1955).

160. Heard, *supra* note 158, at 412-14. President Eisenhower's veto was reluctant, and he specifically indicated that such legislation was necessary. *Id.* at 413.

161. Harris-Fulbright Bill, H.R. 6645, 84th Cong., 1st Sess. (1955).

162. H.R. 6211, 84th Cong., 1st Sess. (1955).

163. S. 1926, 84th Cong., 1st Sess. (1955).

164. H.R. 3940, 84th Cong., 1st Sess. (1955). This bill would have amended § 1(b) of the Act by inserting an exemption for arm's length sales of gas by independent producers. It would further have added a § 1(d), to read in part as follows: "It shall be the duty of the Commission to assemble and keep current pertinent information relevant to determination of whether, by reason of lack of effective competition among producers or gatherers of natural gas, the flow of natural gas into interstate commerce is being or will be unduly retarded or interfered with or the price of natural gas sold in interstate commerce for resale is being or will be unduly affected." Upon so finding, the Commission would report to the President and to Congress.

165. The same case, Docket G-1148, which the Supreme Court remanded in its 1954 decision ordering the Commission to regulate independent producers.

166. See text accompanying notes 143-48 *supra.*

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

which is to apply to rate increases in existing contracts.[168] The rate standards are to serve, the Commission stated, "as a guide . . . in determining whether proposed initial rates should be certificated without a price condition and whether proposed rate changes should be accepted or suspended."[169] Thus these first area prices were intended solely for the guidance of the Commission in (a) "holding the line" in section 7 proceedings and (b) deciding whether or not to suspend in section 4 proceedings. The use of these standards will not, said the Commission, "deprive any party of substantive rights or fix the ultimate justness and reasonableness of any rate level."[170]

If a proposed price exceeds the tentative standards of the Policy Statement, and is therefore conditioned or suspended, a hearing must be held to determine what is a just and reasonable price for gas in the area concerned.[171] This determination is to be "in the nature of setting a price for the gas itself from any source questioned and not necessarily a price applicable solely to the party proposing some other price."[172] All interested parties are to be invited to join in any proceeding connected with an area rate determination.

The Commission acknowledged not ouly that the prices set out in the Policy Statement were tentative, but also that the geographic areas used might need to be redefined at some later date.[173] Although the Commission gave no specific direction for the determining of an area price, it did list the factors considered in setting the tentative Policy Statement prices:[174] (1) cost information from all pending and decided cases; (2) existing and historical price structures; (3) volumes of production; (4) trends in production; (5) price trends; (6) exploration and development trends; (7) trends in demand; and (8) the available markets for the gas. Since that time the Commission has confirmed that these factors are the relevant considerations in setting area prices.[175]

2. *Subsequent Developments.*—Two area rate proceedings have been initiated.[176] The participants in the first quickly sought instruc-

168. 24 F.P.C. 818, 820 (1960), codified in 18 C.F.R. § 2.56(a) (1961). "Initial prices in new contracts are, and in many cases by virtue of economic factors, must be higher than the prices contained in old contracts. . . . It is anticipated that these differences in price levels will be reduced and eventually eliminated as subsequent experience brings about revisions in the prices in the various areas." *Id.* at 819.

169. 24 F.P.C. 819, codified in 18 C.F.R. § 2.56(a) (1961).

170. 24 F.P.C. 820, codified in 18 C.F.R. § 2.56(a) (1961).

171. *Ibid.*

172. *Ibid.*

173. 24 F.P.C. 819, codified in 18 C.F.R. § 2.56(a) (1961).

174. *Ibid.*

175. Area Rate Proceeding AR61-1, 26 F.P.C. 247 (1961).

176. Area Rate Proceeding AR61-1, 24 F.P.C. 1121 (1960), involving the Permian Basin, in which some 400 cases involving 350 independent producers were consolidated, and Area Rate Proceeding AR61-2, 25 F.P.C. 942 (1961), involving the southern

tions from the Commission on exactly what sort of cost evidence was required.[177] The Commission responded that rate base cost-of-service studies could not be introduced in area rate proceedings, regardless of whether these studies pertained to one producer or to groups of producers.[178] This does not mean, however, that all cost data is barred; indeed, said the Commission, measuring the financial requirements of the industry requires the consideration of many items of cost that are included in traditional cost of service.[179] But to be useful in an area rate proceeding, cost data must be "consistently and uniformly developed on a group basis";[180] it "should encompass industry-wide data or data for a substantial segment of a group of similar producers";[181] and it "must be compiled . . . so as to set forth costs pertaining to" the area in question.[182]

Cost data forms have been developed for use in area rate hearings,[183] and steps have been taken to streamline the proceedings.[184] Furthermore, the Commission has given some indication how it plans to proceed after an area hearing has been concluded. In the course of one hearing, a producer moved to be allowed, after the area rates were determined, to demonstrate the reasonableness of his own rates.[185] The Commission stated that "it would appear that such presentations subsequent to the issuance of a general rate order would vitiate the purpose of the hearing."[186] Thus it is clear that the Commission intends to fix prices; after they are fixed individual producers will not be allowed to raise the confiscation issue.

3. *Judicial Comment.*—The area pricing plan has not yet been tested in the courts. However, judicial dicta on regulation under the Policy

Louisiana area. Recently the Commission voted to begin two other area proceedings. Wall Street Journal, Dec. 2, 1963, p. 7, cols. 1 & 2.

177. Area Rate Proceeding AR61-1, CCH FED. UTIL. L. REP. ¶ 10122 (FPC 1961).

178. *Id.* at 14525.

179. *Ibid.*

180. *Ibid.*

181. *Ibid.*

182. *Ibid. Cf.* Area Rate Proceeding AR61-1, 26 F.P.C. 247, 248 (1961), where the Commission ordered that cost data be included in the record on *all* producers in the area.

183. See Area Rate Proceeding AR61-2, 27 F.P.C. 1038 (1962); Area Rate Proceeding AR61-1, 27 F.P.C. 20 (1962).

184. Prebearing conferences are to be used. Area Rate Proceeding AR61-1, 24 F.P.C. 1121 (1960). Direct oral testimony is disallowed; all exhibits and testimony are to be written. Area Rate Proceeding AR61-2, 29 F.P.C. 981 (1963). Simplified presentation of data is permitted for small (less than ten million mcf annual production) producers. Area Rate Proceeding AR61-2, 28 F.P.C. 1001 (1962). Cumulative presentations are disallowed. Area Rate Proceeding AR61-2, 29 F.P.C. 981, 982 (1963). Appeals made during the course of an area hearing will not be entertained by the FPC except in extraordinary circumstances. Area Rate Proceeding AR61-1, 29 F.P.C. 1101 (1963).

185. Area Rate Proceeding AR61-1, 26 F.P.C. 247, 248 (1961).

186. *Ibid.* However the Commission stated also that a ruling on this motion would be premature.

Statement reflect general uncertainty as to both the operation and the legality of the plan.[187]

Most courts seem ready to allow the Commission to experiment. In a certificate case, the Court of Appeals for the Fifth Circuit said that the Commission would never be able "to process certificates on an individualized basis. The hopes for a practical solution must rest in generalized area-pricing or similar resourceful adaption of law and life."[188] And in the case of *Atlantic Refining Co. v. Federal Power Commission*,[189] the Court of Appeals for the District of Columbia agreed that the Commission should be given "some latitude" in proceeding on an area basis.[190] But, cautioned the court, "if area pricing degenerates into mere acceptance of the contract price in the producing area, then will be time enough to stay the commission's hand."[191] Thus, in the eyes of some members of the District of Columbia Circuit,[192] some shadow of *City of Detroit* lives on. The court's caution, motivated by concern for consumer interests, can be read to mean that a form of area pricing which has reference only to competitively set contract prices will be unacceptable. To the same effect is a dictum of the Seventh Circuit, which said that "promulgation of policy and area ceiling prices does not conclusively establish the proposed rates as applicable in any particular case."[193] The thrust here, however, is toward protection of the producer against confiscation. On the other hand, some judges of the District of Columbia Circuit have indicated that regulation under the Policy Statement could rely principally on a competitively set market price:[194]

> Almost the whole of the economics of merchandising differs from the economics of public utility service. Are the just and reasonable prices of such a merchandiser limited to fair return on his own investment and prices paid by him (and, if so, what investment and what prices), or are those prices reasonably measured by the fair prices for the product as measured by the open competitive market for the product, evaluated by Commission expertise and data on the whole of the market operation? Either criterion is a method of regulation. It seems to us that the choice must lie with the Commission.[195]

187. See Note, 75 HARV. L. REV. 549 (1962), for an articulate statement of the doubts as to the plan's legality and operational feasibility.

188. Hunt v. FPC, 306 F.2d 334, 343 (5th Cir. 1962), *rev'd on other grounds*, 376 U.S. 515 (1964). (Footnote omitted.)

189. 316 F.2d 677 (D.C. Cir. 1963).

190. *Id.* at 680.

191. *Ibid.*

192. Judges Wright, Bastian, and Fahy rendered the decision in the *Atlantic Refining* case.

193. Pure Oil Co. v. FPC, 292 F.2d 350, 353 (7th Cir. 1961).

194. Wisconsin v. FPC, 303 F.2d 380 (D.C. Cir. 1961), *aff'd*, 373 U.S. 294 (1963). Judges Prettyman and Danaher wrote the majority opinion.

195. *Id.* at 388.

And the Tenth Circuit has similarly indicated that the spirit of the area rate principle involves exclusion of cost evidence.[196]

The Supreme Court, reviewing the decision on remand of the famous *Phillips* case, has also expressed some views on area pricing.[197] Noting carefully that the validity of regulation under the Policy Statement was not before it,[198] the Court began by reiterating the *Hope* rule that the Commission is not restricted to a single method of rate regulation.[199] The Court then said:

> To whatever extent the matter of costs may be a requisite element in rate regulation, we have no indication that the area method will fall short of statutory or constitutional standards. . . . Surely, we cannot say that the rates to be developed in these proceedings will in all likelihood be so high as to deprive consumers or so low as to deprive producers, of their right to a just and reasonable rate.[200]

In a significant footnote, the Court stated that it did not consider the *City of Detroit* case to require the use of the individual company cost of service method of rate regulation for independent producers of natural gas.[201]

The dissenters[202] disagreed sharply with the majority, both as to the wisdom of expressing an opinion about area pricing,[203] and as to what it saw to be the majority's conclusion.[204] The dissent began by pointing out that area pricing might fail to provide adequate consumer protection.[205] It then went on to point out that application of the plan might result in unconstitutional confiscation; whatever price is set will inevitably be either lower than that required by the high cost producer or higher than that needed by the low cost producer, and, if an average is used, it will be both.[206] Thus, the dissenters concluded,

> the cold truth is that, after all of its area pricing investigation and the fixing of a rate pursuant thereto, the producer aggrieved at that rate may demand and be entitled to a full hearing on his cost. The result is additional delay, delay and delay until the inevitable day when there is no more gas to regulate.[207]

196. California Oil Co. v. FPC, 315 F.2d 652 (10th Cir. 1963).
197. Wisconsin v. FPC, 373 U.S. 294 (1963).
198. *Id.* at 307-08.
199. *Id.* at 309-10.
200. *Ibid.* (Footnote omitted.)
201. *Id.* at 310 n.16.
202. Justices Clark, Black, and Brennan, together with the Chief Justice.
203. *Id.* at 326-27.
204. "I notice the court proceeds to discuss the Statement and strongly implies a view as to its validity." *Id.* at 326.
205. "It can hardly be denied that the Commission's action will leave producers for a number of years . . . without effective regulation and will result in irreparable injury to the consumer of gas." *Id.* at 327.
206. *Id.* at 328.
207. *Ibid.*

Citing the experience of the NLRB and the Wage and Hour Administration, the dissent pointed out that other agencies have solved congestion problems by exempting inconsequential cases.[208] The clear implication of this suggestion is that, in addition to the area plan's illegality, there is further imperfection in the suggestion that regulation under the Policy Statement is the Commission's only hope.

B. *Abolition of Indefinite Pricing Clauses*

Widespread use of indefinite pricing clauses has compounded the regulatory ills of the natural gas industry. A single new gas sale contract with price higher than any previously set in the area can, under two-party and third-party favored nation clauses, trigger a flurry of rate increase filings.[209] Legislation aimed at abolishing the use of such clauses has failed of passage.[210] In 1961, in the case of *Pure Oil Co.*,[211] and accompanying Order No. 232,[212] the Commission decided to take such action on its own.[213]

1. *The Regulations.*—Section 154.93 of the Commission's current regulations provides that, with certain exceptions, provisions for the change of the price in a gas sale contract executed after the date of the order shall be inoperative.[214] The provisions permitted by the regulations are: (a) a provision that changes price to reimburse the seller for increases in taxes on production, selling, or gathering; (b) a provision that changes price to a specific amount at a definite date; and (c) a provision that allows, once in a five year contract period when there has been no operation of a provision as described in (b) above, a price change at a fixed date by renegotiation (the renegotiated price must be based upon and not higher than rates of producers in the same area subject to FPC jurisdiction which are not in issue in a certificate or suspension proceeding). The section provides further that any contract executed after April 2, 1962, containing other than permissible price change clauses shall be summarily rejected.[215]

2. *Legality.*—The principal objection raised to the Commission's regulations outlawing the use of indefinite pricing clauses was that they deprived natural gas companies of their statutory right to a

208. *Id.* at 329.

209. Superior Oil Co. v. FPC, 322 F.2d 601, 619-20 (9th Cir. 1963).

210. *E.g.*, H.R. 6211, 84th Cong., 1st Sess. (1955).

211. 25 F.P.C. 383 (1961).

212. 26 Fed. Reg. 2850 (1961), as amended, 27 Fed. Reg. 1357 (1962), codified in 18 C.F.R. § 154.93 (Supp. 1964).

213. The history of the Commission's treatment of indefinite pricing is given in Superior Oil Co. v. FPC, *supra* note 209, at 605-08.

214. 18 C.F.R. § 154.93 (Supp. 1964).

215. *Ibid.*

hearing.[216] On this ground, the Tenth Circuit Court of Appeals set aside a Commission order rejecting a certificate filing in which the proposed contract contained a forbidden price change clause:[217]

> The summary rejection of applications based on contracts containing price-changing clauses, of which the commission does not approve, deprives the natural gas companies of their statutory right to a hearing, ignores the statutory standards, and precludes the possibility of any effective judicial review.[218]

In the Ninth Circuit, on the other hand, a similar order was upheld,[219] the court specifically mentioning the flood of filings which may result in an area where indefinite pricing clauses are in common use.[220]

The conflict between the circuits has recently been authoritatively settled. In the case of *Federal Power Commission v. Texaco, Inc.*,[221] the Supreme Court reversed the Tenth Circuit and held that the Commission could enforce the ban on indefinite pricing clauses. The Court held that the case was governed by established administrative law principles,[222] under which section 7's hearing requirement did "not preclude the Commission from particularizing statutory standards through the rule-making process and barring at the threshold those who neither measure up to them nor show reasons why in the public interest the rule should be waived."[223] There is a procedure whereby an applicant can seek a waiver of Commission rules,[224] but in this case that procedure was not used. To the gas companies' contention that the terms of their contract had to be passed on in an adversary proceeding, the Court replied that the regulations in question were conditions "that relate to the ability of applicants to serve the consumer interest . . . ."[225] Furthermore, added the Court,

216. The theory was that certificate applicants are entitled under section 7 to a hearing on their applications. Summary rejection of applications was said to deprive producers of their statutory right to present evidence in an adversary proceeding showing the reasonableness of the contract.

217. Texaco, Inc. v. FPC, 317 F.2d 796 (10th Cir. 1963), *rev'd*, 32 U.S.L. WEEK 4370 (U.S. April 20, 1964).

218. *Id.* at 807.

219. Superior Oil Co. v. FPC, *supra* note 209.

220. *Id.* at 619-20.

221. 32 U.S.L. WEEK 4370 (U.S. April 20, 1964).

222. The Court held that the case was governed by the principle of United States v. Storer Broadcasting Co., 351 U.S. 192 (1956). In that case the FCC had promulgated a rule limiting permissible multiple ownership of radio and television stations. Affirming the denial of a hearing based on this rule, the Court said that the rule was reasonable since there was in the FCC's regulations a provision whereby any rule could be waived upon a showing of exceptional circumstances.

223. 32 U.S.L. WEEK 4372.

224. 18 C.F.R. § 1.7(b) (Supp. 1964).

225. 32 U.S.L. WEEK 4372. "They are kin to the kind of capital structure that an applicant has and to his ability by reason of the rate structure to serve the public

to require the Commission to proceed on a case-by-case basis would be to require the needless formality of repeating, in hearing after hearing, the conclusions that condemn all indefinite pricing clauses.[226]

V. Evaluation of the Area Pricing Plan

Experience with area pricing is limited.[227] The Commission has indicated an intention to use cost evidence in setting area rates[228] and to set an area price for all producers in an area, regardless of individual costs.[229] But these statements of intention are far from settled rules. Thus, most of what can be said about area pricing must of necessity be conjectural and theoretical. With these reservations in mind, the objections that have been raised to area pricing will now be examined.

A. *Practicality*

It has been questioned whether the area pricing plan will, in its practical operation, be any more satisfactory than the old rate base method.[230] Difficulties inherent in the area approach and problems arising because of lack of experience and of a blueprint for action make an affirmative answer doubtful.

Individual producer rate and certificate cases proved to be time-consuming affairs.[231] Area rate cases seem destined to be even more so.[232] Each area proceeding is the consolidation of hundreds of individual cases; to receive evidence from and allow cross-examination by such a large number of participants must take time. The Commission has taken some steps to speed up area hearings,[233] and, of course,

interest." *Ibid.* "Natural gas companies that seek to enter the field with prearranged escalator clauses and the like have a built-in device for ready manipulation of rates upwards. Protection of the consumer interests against that device may be best achieved if it is done at the very threshold of the enterprise." *Id.* at 4372-73.

226. *Id.* at 4373.

227. To date, only two area proceedings have been undertaken, note 178 *supra*, and neither has reached the decision stage.

228. See notes 177-82 *supra* and accompanying text.

229. See notes 185-86 *supra* and accompanying text.

230. See Note, 75 Harv. L. Rev. 549, 561-64 (1962), for a full discussion. Orn, *Area Pricing of Natural Gas by the Federal Power Commission*, in Oil and Gas Operations 371, expounds the thesis that to base the area pricing method upon rate-base methods would be unworkable. *Id.* at 378-98.

231. See note 132 *supra*.

232. The first proceeding, begun in 1961, has not yet reached the stage of decision by the Commission. The hearing before the examiner lasted two and one-half years and produced more than thirty thousand pages of testimony and 337 exhibits. Wall Street Journal, Dec. 2, 1963, p. 7, cols. 1 & 2. Commissioner Charles R. Ross dissented from the Commission's decision to institute new area proceedings. *Ibid.* "The actual period of time consumed in deciding, applying, and reviewing the most important area cases will certainly be far longer than four years." Reply Brief of Long Island Lighting Co., Philadelphia Elec. Co., and United Gas Improvement Co., Wisconsin v. FPC, 373 U.S. 294 (1963), p. 25.

233. See note 184 *supra*.

experience will lead to further expediting of procedures. Perhaps imposition on producers of a uniform system of accounting, such as that already required of pipelines,[234] would simplify data collection.

There are presently twenty-three areas designated by the Commission. Only two area rate proceedings have been started. By the time the twenty-third is accomplished, it is not at all unlikely that the participants in the first ten to twenty will have been clamoring for some time that changing conditions make a new determination necessary. The Commission has not indicated how frequently it will compute an area price. However, without a tremendous expansion in the size of its staff, it is hard to see how the Commission can keep from falling ever further behind in its regulatory task. Consequently, the rates of individual producers will be frozen for extended periods at old area levels while new proceedings are pending.[235]

A problem of rate base regulation that will remain as a thorn in the side of every area proceeding is that of allocation.[236] Since gas and oil are explored for and often produced jointly,[237] the costs of their joint production must be allocated between them. To date, no satisfactory method of allocation has been found;[238] it has been suggested that none exists.[239] In addition to oil-gas allocation, some provision will have to be made for the fact that many producers operate in more than one area.[240]

For the first years of regulation, area proceedings will go forward under a cloud of doubt as to final judicial approval of area principles and techniques. Of course, the *Hope* doctrine may again be used by the courts to abdicate their responsibility in the regulatory process.[241] Assuming that the judiciary plays its proper role, however, there will be inevitable delay both in getting approval for the broad aims of area pricing and in clarifying on a case-by-case basis the detailed workings of the program.

The details of area pricing cannot be worked out, of course, until its

234. 18 C.F.R. Parts 201, 204, 205 (1961). "The thousands of independent producers, making up the largest single group within the Commission's jurisdiction, have not been subjected to a comprehensive uniform system of accounts and records even though the Commission recognizes the necessity of this for effective regulation." Brief for State of California and Public Utilities Commission of the State of California, Wisconsin v. FPC, 373 U.S. 294 (1963), p. 27.

235. MACAVOY 255. The tentative Policy Statement ceilings, at which prices in all twenty-three areas are still frozen, are based on the price structure of September 1960. Wisconsin v. FPC, *supra* note 232, at 316 (dissenting opinion).

236. See Orn, *supra* note 230, at 379-87.

237. *Id.* at 379.

238. *Id.* at 381-82; ADELMAN 28-29.

239. Orn calls the problem "inherently insolvable." Orn, *supra* note 230, at 378. See ADELMAN 28-29.

240. Note, 75 HARV. L. REV. 549, 563 (1962).

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

broad aim is known. The Commission has listed the factors it will consider in setting an area price;[242] however, it has not stated exactly how these factors will be put together to arrive at a result. Possibly the Commission intends to find an average cost figure, but the indications are otherwise. The signs, unfortunately, point to the conclusion that the Commission intends to tediously compile a mass of statistical evidence of obscure relevance, and then with the magic touch of "expertise" draw forth a price.[243]

242. See note 174 *supra* and accompanying text.

243. The Commission's instructions with respect to cost data can only be described as vague. See notes 177-82 *supra* and accompanying text. And the Commission has never attempted to state how an area price will be arrived at. The Commission staff, however, has spoken of the use of "economic analysis" to achieve "the measured answers which economic theory and an enormous amount of data afford." ABA Utility Section Newsletter, Jan. 1, 1964, p. 2. To collect this data the Commission has sent 114 natural gas producers questionnaires consisting of 428 data sheets and weighing ten pounds. It is estimated that to complete one of these forms would require 17,000 accountant man-hours and 85,000 dollars in salary costs. Editorial, Wall Street Journal, Jan. 27, 1964, p. 8, cols. 1 & 2.

The litigants in Wisconsin v. FPC, 373 U.S. 294 (1963), had something to say on this point. "Neither the Commission's original statement nor any of its pronouncements since have indicated how all of these various factors were weighed or evaluated one as against the other." Brief for Petitioners State of Wisconsin, Public Service Commission of Wisconsin, and Public Service Commission of the State of New York, Wisconsin v. FPC, 373 U.S. 294 (1963), p. 30. "The Policy Statement acts like a programmed computer. Feed rate schedules into the machine, put certificate applications into the right slot—and out come the approvals or the rejects. Where is the judgment? Where is the expertise? Form and policy have been stored in the computer, but do facts, evidence and argument play any role in determining whether the schedule or application is stamped 'approved' or 'rejected'? The answer is NO." Petition for Rehearing by the People of the State of California and the Public Utility Commission of the State of California, Wisconsin v. FPC, 373 U.S. 294 (1963), p. 7.

The following excerpts from oral argument are also illuminating:

"MR JUSTICE CLARK: . . .

"I wonder if you would tell me just how the Commission then goes in, we will say, to the Permian Basin—how they arrive at an area price . . . .

"MR. SOLOMON: We have got all the contracts there. We have got all the information from all the producers there—cost information as well as economic information of their nation-wide exploration and development activities, and their nation-wide production activities. We have got all the information there as to their operations in the Permian Basin itself. And we are attempting, by looking at the cost and economic information for the nation—because part of this problem is a nation-wide problem—and for the specific area, to determine a price of gas to be sold from there which will be as low as possible because that, of course, is our statutory obligation, but still be sufficiently high to bring gas to the interstate market, which, of course, would be sufficiently high to pay for the exploration and development activities of the gas companies and bring this gas to the existing market.

"I do want to make clear here, Mr. Justice Clark, that the suggestion that going to area pricing is junking cost considerations is completely untrue.

"MR. JUSTICE CLARK: What weight do they give the going price? Every field, I suppose, or every contract has a going price in it. So what weight do you give that? You say they take the costs of development and everything like that.

"MR. SOLOMON: The weight, if any, which the so-called area price, field price, existing field price, will be given by the Commission in the Permian Basin case, or the other area cases, still is to be determined, but, if there is one thing that is clear, it is

B. *Legality*[244]

The Natural Gas Act does not spell out the method of regulation that the FPC is to use. However, its provisions are drafted on the assumption that regulation will be carried out on an individual basis. Thus, section 4 places on the individual applicant the burden of showing that a requested rate increase is just and reasonable.[245] Provision is made for an individual hearing. Under area pricing, however, this individual treatment would not be afforded,[246] or would become a mere formality, if the area price had previously been set. It has been suggested that the Act's "policy of individualization"[247] is not completely nullified by the use of area pricing—that in cases of confiscation or other special circumstances the individual producer may seek a variance from the area price, and that any producer may seek to show that a rate is unjust and unreasonable because area conditions do not justify it.[248] This exception, if allowed, would likely swallow the rule. Almost every high-cost producer would argue that his special circumstances—*e.g.*, poor luck in exploration—justified a higher price for his gas than the area rate. To allow any producer to raise individually the objection that area conditions do not justify the area rate would result in a hundred rehearings of every area case.

On the other hand, the area price will probably exceed a fair return

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that the Commission has no intention of fixing area prices on the basis of field prices, the price which is actually being bargained for." Bound Transcript of Oral Argument, Wisconsin v. FPC, 373 U.S. 294, Jan. 9, 1963, pp. 48-49.

"MR. SOLOMON: We are starting out to get the underlying costs and to apply these underlying costs to the problem of fixing fair prices.

"MR. JUSTICE BRENNAN: I have heard you say that but you haven't told me how you are going to do it.

"MR. SOLOMON: We have, for example, in the Permian Basin case—now I am going to talk about the staff presentation because other people have different ideas—we put into the Permian Basin what the staff has determined, on the basis of extensive questionnaires and information that it received, is a cost for exploration development.

"Now, this I indicate is a national cost. I don't know what this figure is, but let us say it is 3¢. A cost which experience in the industry shows that they are spending per Mcf, whatever that means, of gas to do sufficient exploration to find new gas. That is one basic cost in this. There are other costs. The operating costs of lifting gas and drilling in this particular case. We have derived in effect a composite cost of service for the Permian Basin." *Id.* at 56-57.

244. See Wisconsin v. FPC, *supra* note 232, at 326-28 (dissenting opinion); Orn, *supra* note 230, at 388-90; Note, 75 HARV. L. REV. 549, 564-68 (1962).

245. Natural Gas Act § 4(e), 52 Stat. 822 (1938), as amended, 15 U.S.C. § 717c(e) (1958).

246. See note 186 *supra* and accompanying text.

247. Note, 75 HARV. L. REV. 549, 566 (1962).

248. *Id.* at 567. In oral argument the Commission's counsel said that "obviously, we are going to have to set up a procedure whereby a man who believes that there is confiscation can bring his claim. . . ." Bound Transcript of Oral Argument, Wisconsin v. FPC, 373 U.S. 294, Jan. 9, 1963, p. 52.

to the low-cost producers in an area.[249] To the extent that prices are set higher than necessary for any individual producer, consumer interests will charge that such a producer is making windfall profits and thus that the principal aim of the Natural Gas Act, consumer protection, is not served.

The Natural Gas Act was designed to regulate pipelines, which are traditional utilities.[250] Thus it is not surprising that the Act was drafted on the assumption that rate base cost-of-service regulation would be used.[251] However, since the *Phillips* case independent producers have been regulated under the Natural Gas Act. Although rate base regulation is unsuited to the setting of rates for independent producers,[252] the Commission was caught in a bind. It responded by trying to fit the square peg into the round hole and regulating producers by the rate base method.[253] Area pricing is an attempt to machine a square hole, and in so doing it will be necessary for the Commission to disregard portions of the Act keyed to rate base regulation. The Commission may not refuse to exercise some form of regulation of independent producers; *Phillips* settled that point. But should it have stuck to the rate base method and kept up the losing fight against the backlog of filings, or was it right to go ahead and shape a new procedural frame for regulation? The answer is not easily found. It may be thought, however, that in this situation the administrative body should not be allowed to alter the framework within which it operates. Decisions as to what interests are to be protected in ratemaking are politically charged, and should be made by a legislative body.

In addition to the problem of squaring area pricing with the Natural Gas Act, constitutional problems are involved in its use. A producer must be allowed a rate sufficient to enable him to recover his costs.[254] Since costs vary so widely from producer to producer and, for the small producer especially, are so dependent on luck in

249. "If the rate is set by the 'financial requirements' of the higher cost producer it will be higher than that necessary to make it just and reasonable to the lower cost producer, thus resulting in a windfall to the latter. If the 'financial requirements' of the lower cost producer are used it will result in a rate that will confiscate the gas of the higher cost producer. If the higher and lower costs are averaged, as the Commission indicates it intends to do, then the higher cost producer will still not recover his costs and the rate will be confiscatory. On the other hand the lower cost producer will receive a windfall." Wisconsin v. FPC, *supra* note 232, at 328 (dissenting opinion).

250. McKie 15.

251. Thus, the term "just and reasonable"—well defined in utility regulation—was used without definition in the Natural Gas Act. See note 206 *supra*.

252. See note 124 *supra* and accompanying text.

253. See note 139 *supra* and accompanying text.

254. FPC v. Natural Gas Pipeline Co., 315 U.S. 575, 589 (1942); *but see id.* at 599, 601 (dissenting opinion).

exploration,[255] there will always be, in each area, a number of producers for whom the area price will be confiscatory, unless it is set at the highest level. As suggested previously, exception could be made from the general rule in such cases, and prices for these producers set on an individual basis.[256] It would seem, however, that to make such an exception would seriously hamper the operation of the Commission. For a mere claim of confiscation would require that individual producer cost evidence be taken in order to determine whether or not there was in fact confiscation. And a series of individual producer hearings at which cost evidence is to be taken was the very evil the area pricing plan was designed to remove.

C. *Responsiveness to the Basic Economic Problem*

Economic research has shown that the field market for natural gas in the United States today is generally competitive, and can be expected to remain so.[257] Thus, rate base cost-of-service type regulation makes no sense for this industry; economists and alert legal commentators have so stated.[258] What about area pricing?

A competitive market price mechanism will automatically fulfill the function of allocating a commodity among potential consumers.[259] When supply, as in the case of natural gas, is relatively fixed, upward movement of price is the only way to keep demand in equilibrium with supply.[260] The probable effect of area pricing, however, will be to freeze prices.[261] With prices held constant, demand will exceed supply. And "if for political or social reasons market price is not to be permitted to rise high enough to bring demand down to the level of supply, the only solution . . . lies in outright coupon or point rationing."[262] But ordinary rationing will not work for natural gas.

255. See MCKIE 7.

256. Note, 75 HARV. L. REV. 549, 567 (1962).

257. See notes 40 & 72 *supra.*

258. *E.g.*, FPC v. Hope Natural Gas Co., 320 U.S. 591, 648 (1944) (Jackson, J., dissenting); COKENBOO *passim;* MACAVOY 252-53, 265; MCKIE 47; Orn, *supra* note 230.

259. SAMUELSON, ECONOMICS 386 (4th ed. 1958).

260. *Id.* at 380.

261. MACAVOY 255. "These guides freeze into permanence the 1959-60 price levels . . . ." Brief for Petitioners State of Wisconsin, Public Service Commission of Wisconsin, and Public Service Commission of the State of New York, Wisconsin v. FPC, 373 U.S. 294 (1963), p. 17. In its brief the FPC presents statistics purporting to show that the price rise had in fact been alleviated since area pricing had been initiated. Brief for Respondent FPC, Wisconsin v. FPC, 373 U.S. 294 (1963), pp. 33-34. "The fact is that since the Commission's decision in this case the rate of increase in natural gas prices has fallen off sharply." *Id.* at 33. It is striking how the Commission here takes lower prices as an end in itself. The prior steady increase in gas prices, even under regulation, reflected increasing demand. The area price seems, by the Commission's admission and intent, to be a price-freezing device.

262. SAMUELSON, *op cit. supra* note 259, at 395.

A provision that each consumer may get two-thirds of his annual need for gas simply will not do. Instead, some consuming areas will have to be allowed to purchase their requirements of "cheap" gas, while other potential consuming areas will have to be excluded.[263] While the group receiving the cheap gas profits from the freezing of the price, the group totally deprived of gas must use alternative fuels, possibly much more expensive.[264]

The demerits of even a systematic program of rationing are readily apparent. One leading economics text compares rationing with insanity.[265] But there is at present no scheme or system at all for the rationing of natural gas. Presumably a "first come, first served" basis would be followed; although this seems hardly an intelligent approach to the problem.

Another unfortunate aspect of area pricing will be its effect on the amount of new gas reserves. "In simplest terms, the expectation of higher future prices provides incentive for larger exploration investments. Given a priori probability of success in finding dry-gas reserves, the larger investment results in larger discovery."[266] The freezing of the price will remove this incentive to exploratory effort.[267] Still further, the freezing of prices which will result from use of the area plan will impede the trend toward systematic competition in those producing areas previously characterized by monopsony pricing.[268]

The consumer's chief complaint is that the natural gas producer is making wrongful profits as a result of the tremendous increase in the demand for natural gas.[269] But this is a problem of income distribution,[270] and it should not (indeed, cannot) be solved by tinkering with the market price mechanism. If there is a legitimate complaint about producers' profits, the proper remedy is taxation.[271] However, one may wonder whether consumer groups are really concerned about undeserved producer profits, or whether, in fact, they are merely

263. MACAVOY 255-56.
264. *Id.* at 258.
265. SAMUELSON, *op cit. supra* note 259, at 395.
266. MACAVOY 259.
267. *Id.* at 260-61.
268. *Id.* at 255.
269. See COKENBOO 103.
270. That is, the complaint logically is not that prices are too high, but that the producers are getting more than their fair share of the nation's income by virtue of their ownership of national energy resources. This problem is better solved by taking the excessive profits away from the producers. Lindahl, *Federal Regulation of Natural Gas Producers and Gatherers*, 46 AM. ECON. REV. 532, 543 (1956).
271. *Ibid.* There would be disagreement from those economists who feel that the burden of a tax falls largely upon the consumer. But economists are not in agreement as to what is the incidence of a tax. SAMUELSON, *op. cit. supra* note 259, at 138. Samuelson says that "a tax will raise the price to the consumer and will lower the price received by the producer, the difference going to the government." *Id.* at 391.

concerned to continue buying gas at a low price. Along this line it should be noted that present consumers of natural gas employ articulate spokesmen to advance their case; the potential consumers whom a price freeze would exclude have no voice.

D. *Conclusion*

There are serious operational and legal drawbacks to the use of area pricing. More important, however, than these is the failure of area pricing to make good economic sense. In the absence of regulation natural gas prices would be set by a competitive market price mechanism. There would be no necessity for a rationing program. Regulation under the area pricing plan seems destined to freeze prices, and will inevitably lead to some form of rationing. Since there is no machinery available for the implementation of a systematic rationing scheme, this rationing will probably be carried out on a "first come, first served" basis.

While there may be a legitimate complaint that producers are making windfall profits at the expense of consumers, this is a problem in income distribution. It is not indicative of any defect in the market. The income distribution problem should be met by increased taxation of producers, not by tinkering with the market price mechanism.

VI. EVALUATION OF THE ABOLITION OF INDEFINITE PRICING

Indefinite pricing clauses came into widespread use as a defense against loss of profits by a producer who, in a rising market, tied up his gas for a long period of time.[272] Some of the clauses that were developed are completely indefensible on economic grounds. Spiral and price index clauses work against the free operation of the market price mechanism.[273] The same is true of third-party favored nation clauses, which tend to negate the important element of bargaining.[274] Two-party favored nation clauses, on the other hand, may have some beneficial economic effects.[275] However, the buyer relocation that their use tends to produce is an effective argument against them.[276]

Renegotiation clauses, on the other hand, merely serve to reopen bargaining at some later date. Thus they do not interfere with competitive price determination. Furthermore, since their use is already limited in the regulations, renegotiation clauses will not add appreciably to the regulatory burden of the Commission. (Of course,

272. See notes 25 & 26 *supra* and accompanying text.
273. See notes 90 & 91 *supra* and accompanying text.
274. See note 92 *supra* and accompanying text.
275. See notes 93 & 94 *supra* and accompanying text.
276. See notes 97 & 98 *supra* and accompanying text.

definite price adjustment clauses will add nothing at all, since they are approved when the original contract is approved.)

The number of rate increase filings caused by the operation of indefinite pricing clauses is substantial.[277] To ban them as the Commission has done by regulation will relieve its regulatory ills to a considerable degree. Furthermore, except for renegotiation clauses, which are permitted, such provisions are not economically desirable. The legality of the Commission's action has been established.[278] And the courts have indicated that they are not insensitive to the practical need for such relief.[279] It is submitted that, unlike area pricing, the abolition of indefinite pricing clauses makes practical, legal, and economic good sense.

VII. Summary and Proposals

In the early 1960's the Federal Power Commission launched a two-fold attack on the problem of regulating independent natural gas producers. One branch of this attack, the abolition of indefinite pricing clauses, was economically sound, and has been sustained by the Supreme Court. The other branch, the area pricing plan, has not been tested by the courts. However, it does not make good economic sense, and it promises to run into both practical and legal difficulties as well.

If area pricing is condemned by the courts, the Commission may feel bound to return to the use of the rate base cost-of-service method, a public utility regulation technique. Application of the rate base method to producers makes as little sense as the use of area pricing. However, the Court has instructed the Commission that it must exercise some degree of regulatory authority over natural gas producers. What, then, is the Commission to do? The answer is not entirely clear. One alternative would be for Congress to exempt independent producers from the Natural Gas Act. But reliance cannot be had upon such a solution.[280]

Another alternative that has been suggested could be adopted by the Commission on its own initiative. It has been shown that, by and large, prices are set competitively in the field market for natural gas.

277. See Texaco, Inc., 27 F.P.C. 339, 340 (1962).

278. See notes 221-26 *supra* and accompanying text.

279. *E.g.*, in the Texaco case the Supreme Court noted the burden placed on the Commission by the widespread use of indefinite pricing clauses. FPC v. Texaco, Inc., 32 U.S.L. Week 4370, 4373 n.12 (U.S. April 20, 1964).

280. See notes 157-64 *supra* and accompanying text. However, with a President from the leading producing state the results of legislative effort might be different. While he was still a Senator, President Johnson wrote an article denouncing the *Phillips* decision. See Johnson, *The Phillips Case Decision and the Public Interest*, 54 Pub. Util. Fort. 473 (1954).

Regulation of *price*[281] is unnecessary except in those segments of the market in which prices are not set competitively. The Commission's function should be to determine in which segments of the market, if any, prices are not set competitively.[282] Since market conditions vary with time, this watchdog role would be a continuing duty of the Commission.[283] To determine whether or not pricing in any part of the market was subject to monopolistic influences, the Commission's investigatory staff would have recourse to concentration figures, theoretical pricing models (such as that developed by MacAvoy), and other economic tools.

In any area in which the Commission determines that prices are set competitively, the Commission should approve any contract arrived at through arm's length bargaining. In areas in which pricing is non-competitive, the Commission should set prices, having recourse to the prevailing competitive market price.

It will be objected to this proposal that the purpose of the Natural Gas Act is to underwrite just and reasonable gas rates for consumers.[284] But, first, an arm's length bargain in a competitive market could certainly fall under the label "just and reasonable." And, second, the word "consumers" should be read to mean "the consuming public" and not merely "those presently buying gas."[285] While an artificially low price will certainly be more desirable to present consumers of natural gas, it produces rationing.[286] Without rhyme or reason, numbers of potential consumers are deprived of gas altogether. Perhaps a more intelligent scheme of allocating the nation's gas resources than by use of the market price mechanism can be devised. If so, it should be considered. But in the absence of such a scheme, resort to the competitive market would seem to be the most sensible way to resolve the problem.

CHARLES E. MCCALLUM*

* Associate, Warner, Norcross & Judd, Grand Rapids, Michigan.

281. To avoid a windfall to producers, regulation of *profits* may be desirable. See notes 270-271 *supra* and accompanying text.

282. MCKIE 47. McKie says that to exempt the field price from regulation is politically unfeasible. But, he suggests, the FPG can deal with those special situations where there are substantial monopolistic influences. And, "there appears to be no decisive reason why market competition cannot generally regulate the field price of natural gas in the public interest." *Ibid.*

283. Compare H.R. 3940, 84th Cong., 1st Sess. (1955), where a similar proposal was introduced. See note 164 *supra* for a portion of the text of the bill.

284. Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672, 685 (1954).

285. See Lovejoy, *Gas Conservation and Public Utility Regulation in Our National Fuels Policy*, 1 NATURAL RESOURCES J. 257 (1961). The author states: "The 'public' seems to be only the current gas consuming group, or expectant consumers waiting for service. Present and potential users of other fuels, gas producers, other fuel producers, and potential gas customers, present and future, appear to get little or no attention." *Id.* at 259.

286. See notes 261-64 *supra* and accompanying text.

Scope of Judicial Review in Urban Renewal Litigation

I. Introduction

A. *Background*

The problem of urban decay and blight has become increasingly recognized as a widespread national problem.[1] The initial federal legislation[2] aimed at eliminating urban decay authorized capital grants to local public agencies for the acquisition and clearance of slum areas which were breeding places for crime and disease and the construction thereon of low rent public housing. The Housing Act of 1949[3] authorized federal aid to local projects for the acquisition and clearance of "blighted, deteriorated, or deteriorating" areas and the redevelopment of such areas by private enterprise to as large a degree as possible. State enabling acts were passed which authorized the establishment of local agencies to administer projects and the contribution of matching funds by municipalities. The courts unanimously upheld the constitutionality of the state slum clearance enabling statutes as a valid exercise of the police power pursuant to which public funds might be expended and the power of eminent domain used.[4] The state urban renewal statutes passed pursuant to the Housing Act of 1949 presented a considerably more difficult problem since they were not confined to the clearance of slums and erection of housing, but extended to the condemnation and redevelopment of property for commercial and industrial uses. Also the contemplated use of eminent domain to acquire private property for resale to private developers created a problem. The high courts of three states held that the statutes which authorized the taking of private property for redevelopment by private developers were an unconstitutional attempt to use the power of eminent domain for a private purpose.[5] Only one of these decisions still stands,[6] although

1. For a discussion of the degree of blight in the United States in 1950, see 1 U.S. Census of Housing, pt. 1, pp. xxii, xxiii (1950), and Dewhurst and Associates, America's Needs and Resources 221-22 (1955).

2. 50 Stat. 888 (1937), 42 U.S.C. §§ 1401-36 (1958).

3. 63 Stat. 413 (1949), 42 U.S.C. §§ 1441, 1451-60 (1958).

4. See, *e.g.*, City of Cleveland v. United States, 323 U.S. 329 (1945); Allydonn Realty Corp. v. Holyoke Housing Authority, 304 Mass. 288, 23 N.E.2d 665 (1939); New York City Housing Authority v. Muller, 270 N.Y. 333, 1 N.E.2d 153 (1936); Annot., 130 A.L.R. 1069 (1941).

5. Adams v. Housing Authority, 60 So. 2d 663 (Fla. 1952); Housing Authority v. Johnson, 209 Ga. 560, 74 S.E.2d 891 (1953); Edens v. City of Columbia, 228 S.C. 563, 91 S.E.2d 280 (1956).

6. The Adams case, *supra* note 5, seems to have been impliedly overruled in Grubstein v. Urban Reuewal Agency, 115 So. 2d 745 (Fla. 1959), which held urban renewal constitutional at least to the extent that it contemplated the elimination of slums, as distinguished from blighted areas. The *Johnson* case was overruled by a constitutional amendment.

constitutional amendments were deemed necessary to validate these statutes in six states prior to any judicial scrutiny.[7] The great majority of the courts held the statutes valid on a theory which stretched somewhat the traditional concept of public use.[8] Public use had been generally taken to mean the future use by the public of the property acquired.[9] The courts reasoned that the acquisition itself was a public purpose since the acquisition and clearance eliminated slums and blight and that the intended future use by private developers was merely incidental to the achievement of that public purpose. The Supreme Court of the United States upheld the validity of the District of Columbia's enabling act in an opinion which indicated that economic re-development alone is a public use under the United States Constitution.[10] Whatever may have been the merits of these constitutional objections to the statutes on their faces, they have been put at rest. There remains largely unsettled, however, the problem of the scope of judicial limitations, constitutional or otherwise, on the administration of these acts.

B. *Outline of Administrative Procedure*

The typical urban renewal project[11] is initiated by the local public agency which prepares a project plan[12] after a study of the selected area. The plan will include maps classifying existing structures in the area as standard or substandard and designating which of the parcels should be acquired. The plan will also contain maps setting out the proposed re-use of the property to be acquired. The proposed project

7. CAL. CONST. art. XIII, § 19; GA. CONST. art. XVI; MD. CONST. art XI-B; MO. CONST. art. VI, § 21; N.J. CONST. art 8, § 3; N.Y. CONST. art. 18, §§ 1,2.

8. See, *e.g.*, Schneider v. District of Columbia, 117 F. Supp. 705 (D.D.C. 1953), *aff'd sub nom.*, Berman v. Parker, 348 U.S. 26 (1954); Grubstein v. Urban Renewal Agency, *supra* note 6; Zurn v. City of Chicago, 389 Ill. 114, 59 N.E.2d 18 (1945); Crommett v. City of Portland, 150 Me. 217, 107 A.2d 841 (1954); Murray v. La Guardia, 291 N.Y. 320, 52 N.E.2d 884 (1943), *cert. denied*, 321 U.S. 771 (1944). See also cases cited in Annot., 44 A.L.R.2d 1414 (1955), and Miller v. City of Tacoma, 61 Wash. 2d 374, 394 n.6, 378 P.2d 464, 476 n.6 (1963).

9. Schneider v. District of Columbia, *supra* note 8, at 716, discusses this evolution of the public use concept.

10. Berman v. Parker, *supra* note 8, *affirming sub nom.* Schneider v. District of Columbia, *supra* note 8. The court said, "It is within the power of the legislature to determine that the community should be beautiful as well as healthy, spacious as well as clean, well-balanced as well as carefully patrolled. In the present case, the Congress and its authorized agencies have made determinations that take into account a wide variety of values. It is not for us to reappraise them. If those who govern the District of Columbia decide that the Nation's Capital should be beautiful as well as sanitary, there is nothing in the Fifth Amendment that stands in the way." 348 U.S. at 33.

11. 63 Stat. 420 (1949), 42 U.S.C. § 1460(c) (1958).

12. 63 Stat. 420 (1949), 42 U.S.C. § 1455(a) (1958). For the elements of a plan, see HHFA, LOCAL PUBLIC AGENCY MANUAL Pt. 2, ch. 5, § 2 (1955).

must be approved by the governing body of the municipality[13] and there must be a public hearing on the merits of the proposal.[14] If approved, the local agency submits the plan to the Federal Urban Renewal Administrator along with an application for a capital grant and loan. The capital grant usually comprises two-thirds of the total project cost except in cases where neither the existing use nor the proposed re-use is predominantly residential.[15] The only administrative remedy available to a dissatisfied property owner or citizen is the right to be heard at the public hearing.

II. Areas of Judicial Control

A. *Character of the Project Area*

The most frequent objection which has been raised in the courts as to the validity of a project is that the project area is not in fact "blighted, deteriorated, or deteriorating" within the meaning of the statute.[16] There are considerably divergent views both as to the meaning of "blight" and as to the extent to which the administrative declaration of blight shall be conclusive on the courts. The differing interpretations of "blight" are primarily due to the lack of a clear, or in some cases any, definition of the term in most enabling acts. Most state courts have construed this term as denoting an area which is detrimental to the health, safety, morals, or welfare of the community, *i.e.*, an area which differs only in degree from a slum.[17] But in *Berman v. Parker*,[18] the Supreme Court indicated that a blighted area could be an area which, in the opinion of the administrators, is an economic or aesthetic detriment to the community. Apparently no state court has defined the term this broadly.

Decisions as to the conclusiveness of the administrative finding of blight range all the way from an apparent holding that judicial re-

13. 63 Stat. 416 (1949), 42 U.S.C. § 1455(a) (1958).

14. 63 Stat. 416 (1949), 42 U.S.C. § 1455(d) (1958).

15. 63 Stat. 414 (1949), 42 U.S.C. § 1452(a) (1958). It is provided in 63 Stat. 420 (1949), as amended, 42 U.S.C. § 1460(c) (Supp. IV, 1962), that if a project area is neither at present "clearly predominantly residential" nor will be redeveloped for predominantly residential uses under the plan, then the capital grant cannot exceed 30% of the maximum grant allowable under § 1452(a).

16. The statute provides: "'Urban renewal area' means a slum area or a blighted, deteriorated, or deteriorating area in the locality involved which the Administrator approves as appropriate for an urban renewal project." These terms are nowhere defined in the federal act. The term "blight" is frequently used to include "blighted, deteriorated, or deteriorating conditions" and shall be so used hereinafter. 63 Stat. 420 (1949), 42 U.S.C. § 1460(a) (1958).

17. See, *e.g.*, Crommett v. City of Portland, *supra* note 8; Murray v. LaGuardia, *supra* note 8.

18. *Supra* note 8.

view should be de novo[19] to one that the findings are conclusive.[20] Most courts have characterized these findings as legislative in nature and thus entitled to considerable weight.[21] These courts have frequently stated the test to be that if the evidence is such that men of training and experience might differ, then the court will not substitute its judgement for that of the local agency.[22] It is frequently said that the findings of the local agency must be arbitrary, unreasonable, or in bad faith before they will be set aside.[23] A few courts have held that the only evidence which may be considered is that which was before the agency at the public hearing and that in order to be reversed the findings must appear unreasonable or arbitrary on the basis of this evidence.[24] However, the prevailing view seems to be that all relevant evidence is admissable[25] and that if, on the basis of this evidence, it appears that men of training and experience might

19. Bristol Redevelopment and Housing Authority v. Denton, 198 Va. 171, 93 S.E.2d 288 (1956). The court reasoned as follows: "Thus, the condition of an area is the very basis of the jurisdiction and power of a redevelopment authority to acquire property located therein by eminent domain. Code, § 36-50. Unless the area meets this definition the authority has no power to acquire it and the council has no basis for the approval of such taking. In this situation, the court has the right to determine whether the area is in fact 'blighted or deteriorated' as defined in the statute. Code, § 36-49(1)." *Id.* at 178, 93 S.E.2d at 293.

20. Allen v. City Council, 215 Ga. 778, 113 S.E.2d 621 (1960). The Georgia court had originally held the enabling act unconstitutional, but the decision was overruled by a constitutional amendment. The court indicated that the amendment had completely withdrawn from the court the power to review saying, "however much as individuals we may deplore the surrender by the people of their rights, as Justices of this Court we unhesitatingly follow and apply the law as the people have written it." *Id.* at 782, 113 S.E.2d at 624.

21. *E.g.*, Bahr Corp. v. O'Brion, 146 Coun. 237, 149 A.2d 691 (1959); City of Chicago v. R. Zwick Co., 27 Ill. 2d 128, 188 N.E.2d 489 (1963); Bowker v. City of Worcester, 334 Mass. 422, 136 N.E.2d 208 (1956); Miller v. City of Tacoma, *supra* note 8.

22. See Kaskel v. Impellitteri, 306 N.Y. 73, 115 N.E.2d 659 (1953), *cert. denied*, 347 U.S. 934 (1954); Boro Hall Corp. v. Impellitteri, 128 N.Y.S.2d 804, *aff'd*, 283 App. Div. 889, 130 N.Y.S.2d 6, *motion for rehearing denied*, 283 App. Div. 951, 130 N.Y.S.2d 887, *appeal denied*, 307 N.Y. 672, 120 N.E.2d 847 (1954). In the *Boro Hall* case, the court said: "Nothing has been presented to this court which would do more than indicate that perhaps men of training and experience might honestly differ on this question. In such cases the Legislature has undoubtedly given the local authorities power to make that determination." 128 N.Y.S.2d at 806. The court also said that the exclusion of several parcels logically included does not run afoul of the "area as a whole" concept.

23. State *ex rel.* Dalton v. Land Clearanee for Redevelopment Authority, 364 Mo. 974, 270 S.W.2d 44 (1954); Kaskel v. Impellitteri, *supra* note 22; Miller v. City of Tacoma, *supra* note 8.

24. Bowker v. City of Worcester, *supra* note 21; Urban Renewal Agency v. Iacometti, 379 P.2d 466 (Nev. 1963).

25. *In re* Bunker Hill Urban Renewal Project 1B, 37 Cal. Rptr. 74, 389 P.2d 538 (1964) (evidence of prior findings by city health department held admissible); Bahr Corp. v. O'Brion, *supra* note 21; Offen v. City of Topeka, 186 Kan. 389, 350 P.2d 33 (1960); Bristol Redevelopment and Housing Authority v. Denton, *supra* note 19. The *Bahr* case is discussed in Note, 69 YALE L.J. 321 (1959).

reasonably characterize the area as blighted, then the administrative determination will not be disturbed.

The courts have generally been quite reluctant to set aside an urban renewal project on this basis. In only one reported case has a court set aside a project solely on the basis that it did not meet the statutory requirement concerning the character of the area.[26] The courts have generally been reluctant to substitute their judgement for the objective judgement of a group of city planning experts to whom this function has been delegated by the legislature. In addition to this, it is frequently said that the required public hearing affords each property owner an adequate administrative remedy. However, the position that there should be stricter review is not without foundation. The nature of the urban renewal structure makes it very difficult in many cases for the local public agency to make entirely objective determinations. The existence and continued operation of a local agency depends upon findings that conditions of slum and blight exist in the community. The adoption of each project means another sizable federal grant to a municipality. Frequently, there is strong public sentiment for or against a particular project due to the proposed re-use of the property. All of these outside pressures may affect the objectivity of the local agency from the time the study of an area is begun.[27] In addition to these outside pressures, there is usually a large expenditure of time and money on the part of the local agency in the study of an area and the preparation of a plan. Consequently, by the time the public hearing is held, in many cases the members of the local agency are committed to the adoption of the plan.[28] In fact, it would be strange indeed if the architects of a plan should not take pride in it and advocate its ratification. A court of law is more immune to these factors which militate against objectivity.

B. *Real Purpose of the Project*

Another objection which has frequently been raised before the courts is that the real purpose[29] for undertaking a particular project

26. Bristol Redevelopment and Housing Authority v. Denton, *supra* note 19. The court heard testimony as to the character of each piece of property in the entire project area and determined that substandard structures comprised less than 50% of the total structures in the project area. In Bahr Corp. v. O'Brion, *supra* note 21, and in Offen v. City of Topeka, *supra* note 25, allegations in the pleadings were held sufficient to show determinations of blight were unreasonable and arbitrary in the respective areas involved.

27. For a discussion of the various pressure groups usually interested in urban renewal programs, see Johnstone, *The Federal Urban Renewal Program*, 25 U. CHI. L. REV. 301, 313-15 (1958).

28. For a discussion of local agency determination prior to the public hearing, see Note, *supra* note 25, at 328. See also Sullivan, *Administrative Procedure and the Advocatory Process in Urban Redevelopment*, 45 CALIF. L. REV. 134, 144 (1957).

29. It is not clear from the cases which consider "real purpose" whether the

is either private or ultra vires. In order to determine the scope of this limitation, it is first necessary to determine the purpose or purposes of the urban renewal statutes. In considering the constitutionality of the enabling acts most courts found it necessary to determine the statuatory purposes; however these decisions are not entirely in harmony. Since statutes are given a constitutional meaning whenever possible, it is likely that the determinations of statutory purpose were influenced by each court's effort to give the enabling act a constitutional meaning. As pointed out above, most of the courts held that the primary purpose of the statutes is the elimination of blight, not redevelopment.[30] There are at least two other minority views. In *Berman v. Parker*,[31] the District of Columbia enabling act was interpreted to have the dual purpose of blight elimination and economic redevelopment, neither of which was considered dominant. Another interpretation has been that the elimination of blight is the primary purpose, but that redevelopment so as to prevent their recurrence is a continuing part of that purpose.[32]

The subject of this section is the extent to which the courts will consider an allegation that the real or dominant purposes is not in fact the elimination of slums or blight, but some other purpose, whether public or private. This objection may be upon either of two bases. First and most frequent is that the real purpose is a private one and it is unconstitutional to spend tax money or to use the power of eminent domain for a private purpose. Second, a project may be attacked on the theory that the real purpose is some purpose other than the statuatory purpose of elimination of slums or blight and thus is ultra vires. This second objection would be valid even where the real purpose was a public purpose. There is authority for both of these approaches. These decisions are not based upon allegations of an evil or corrupt purpose, but upon the theory that there has been an honest misconception of the proper purpose or function of urban renewal on the part of a local agency. *In Re Opinion of the Justices*,[33] is a leading decision on real purpose being an unconstitutional one, though it is not an urban renewal case. The legislature of Massachusetts had declared an area occupied by an old railroad yard to be blighted and subject to redevelopment. It appeared that the land was so situated as to be ideally suited for economic re-

actual subjective intent of members of a local agency is relevant or whether the improper motivating purpose must be shown only by evidence of objective circumstances showing that an undertaking will not reasonably accomplish a proper purpose.

30. It is not clear from these cases whether redevelopment is an incidental purpose of the statute or merely a power incidental to, but necessary to carry out, the statuatory purpose.

31. *Supra* note 8.

32. Velishka v. City of Nashua, 99 N.H. 161, 106 A.2d 571 (1954).

33. 332 Mass. 769, 126 N.E.2d 795 (1955).

development. The court looked behind the legislative declaration of blight and concluded that the "primary design" of the project was redevelopment and not the elimination of blight.[34] The court looked at all the circumstances including the present character of the area as compared with other areas in the city of Boston and the proposed re-use and determined that this area would not have been selected had it not been so attractive for redevelopment.[35] Decisions from other jurisdictions which do not consider redevelopment a public purpose seem to be in accord with the Massachusetts court.[36]

The constitutional objection would not pertain where the real purpose was not the elimination of blight, but was some other public purpose such as the acquisition of land for a public hospital or school. In such a case, the problem would be whether such a purpose was ultra vires. The view that any motivating purpose other than the elimination of blight is ultra vires is very clearly set out in *Kaskel v. Impellitteri*.[37] This theory appeared in a strong dissenting opinion with which the majority agreed to the extent of the applicable rules of law. In the *Kaskel* case, the urban renewal plan contemplated the re-use of the property acquired for a municipal stadium, a public purpose. The rule was laid down that if the real purpose was other than the elimination of blight, then such purpose is ultra vires irrespective of how commendable it may be.[38] The majority of the court concluded from all the evidence that the declared purpose, *i.e.*, the elimination of blight, was the real reason for undertaking the project.

34. The court concluded: "It seems plain that the primary design of the bill is to provide for the acquisition of the area by the use, at the outset at least, of substantial sums of public money and later of comparatively small sums, to formulate a plan for development, including the devoting of some portions of the area to truly public uses, and the return of the remainder to private ownership to be rented or sold for private profit, with the expectation that adjacent areas and the city as a whole will benefit through the increase of taxable property and of values. But this kind of indirect public benefit has never been deemed to render a project one for a public purpose." *Id.* at 783, 126 N.E.2d at 803.

35. The court stated, "the main difference between the area we are now considering and such other tracts seems to be that the location of this tract makes it more prominent than many others, and this is hardly a difference in principle." *Ibid.*

36. See, *e.g.*, City of San Francisco v. Ross, 44 Cal. 2d 52, 279 P.2d 529 (1955); Denihan Enterprises v. O'Dwyer, 302 N.Y. 451, 99 N.E.2d 235 (1951); Hogue v. Port of Seattle, 54 Wash. 2d 799, 341 P.2d 171 (1959).

37. *Supra* note 22.

38. The court expressed the rule as follows: "If the main purpose of combining these two areas is not slum clearance, but merely to lend color to the acquisition of land for a coliseum under the guise of a slum clearance project, then the combined project is not authorized by statute, and a taxpayer's action can be maintained to restrain it under section 51 of the General Municipal Law, Denihan Enterprises v. O'Dwyer, 302 N.Y. 451, 99 N.E.2d 235. In that event, the courts would not be invading the administrative province, but performing their duty in limiting administrative officials, capable and public spirited as they may be, to spending public money for purposes authorized by law." *Id.* at 83, 115 N.E.2d at 664.

There is no clear holding that a project may be invalidated even where it is not unreasonable to characterize the area as blighted because it appears that the real purpose is unconstitutional or ultra vires. In the cases where it has been found that the primary purpose was improper, there has also been some question as to the character of the area. The character of the area is always evidence of the real purpose. Theoretically it would not seem to make any difference whether the area is in fact blighted when the issue of motivating purpose is being considered. But a questionable determination of blight would always be a circumstance to consider in determining real purpose. An incidental proper purpose should not validate a project where the dominating purpose is improper.

C. *Particular Parcels within the Area*

Another related problem is the selection of the area boundaries and the parcels to be acquired. Property owners have frequently objected to the taking of their property on the theory that their particular property is not substandard. This objection has been unanimously rejected under the "area as a whole" doctrine.[39] The courts reason that the purpose of the statute is to eliminate substandard conditions in an entire area and that certain properties inoffensive in themselves may be taken in order to redevelop the area as a whole in such a manner as to prevent the recurrence of blight. It is a common practice for the local agency not to acquire certain standard parcels which are considered in determining the character of the project area but which are not considered necessary for the renewal of the area as a whole. Certain other properties logically within the project area are neither taken nor even included in computing the percentage of substandard structures in the area.[40] It is not clear whether this type of "administrative gerrymandering" is proper. This practice has been assailed in only one reported case in which it was held that the exclusion of a few such parcels did not invalidate the project under the "area as a whole" concept.[41] It would seem that if carried to an extreme, entire cities could be classified as blighted and subject to piecemeal renewal in violation of the "area as a whole" concept.

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39. See, *e.g.*, Berman v. Parker, *supra* note 8; Gohld Realty Co. v. City of Hartford, 141 Conn. 135, 104 A.2d 365 (1954). Cases are collected in Annot., 44 A.L.R.2d 1414, 1439 (1955).

40. These practices are suggested by the Federal Administrator. See the suggested redevelopment plan, *supra* note 12.

41. Boro Hall Corp. v. Impellitteri, *supra* note 22. The court implied that the exclusion of a large number of parcels might require a different result.

IV. Conclusion and Proposals

Though it may be said that there is some meaningful judicial review in the area of urban renewal, so far the courts have been reluctant to set aside a project except in extreme cases. It is understandable that the courts are hesitant to enter this area of administrative judgement in which courts do not profess to be experts. Such interference could certainly cause very costly delay in the execution of proposed projects and would place an added burden on the already crowded dockets. This attitude could not be critized if there were clear and meaningful statutory standards to guide and restrain the local agencies coupled with a reasonable administrative remedy for the correction of errors in administration.

There are indications that in many instances the local agencies have misconceived what is the real purpose of the urban renewal laws. Sometimes the emphasis seems to be on the re-planning and redevelopment of cities rather than the elimination of evils which already exist in the cities. There are several cases on record where local agencies have contracted to sell land to private persons prior to the public hearing or the official approval of the plan.[42] There has been widespread lay criticism of urban renewal as being merely a guise to receive federal grants for private economic development.[43] According to a great majority of the courts, it is not the purpose of the enabling acts to acquire land for needed economic development and if it were, the acts would be unconstitutional.

The federal act requires that the local agencies prepare a "workable program" before undertaking urban renewal in a community,[44] and this requirement has been incorporated into the state enabling acts. This requirement may have been considered by Congress as being roughly comparable to the comprehensive plan requirement of zoning law. In practice, however, it has never been considered more than a condition precedent to a federal grant and has never been strictly enforced by the Federal Urban Renewal Administrator.[45] Nor has it ever been used by a court as a basis for review.

If an analogy may be made to zoning law, which is somewhat similar in nature to urban renewal, it will be seen that the scope of review in urban renewal is considerably narrower. As in zoning,

42. Kintzele v. City of St. Louis, 347 S.W.2d 695 (Mo. 1961); Bleecker Luncheonette v. Wagner, 141 N.Y.S.2d 293, *aff'd*, 143 N.Y.S.2d 628 (1955). In the *Bleecker* case, New York University had also defrayed part of the cost of the study of the project area.

43. See Dowdy, *The Mounting Scandal of Urban Renewal*, Reader's Digest, March 1964, p.51.

44. 63 Stat. 414 (1949), 42 U.S.C. § 1451(c) (1958).

45. See Johnstone, *supra* note 27, for a discussion of the requiremeuts of a workable program and the leniency with which the Administrator approves them.

there is the constitutional limitation that the action of the authorities must not be unreasonable or arbitrary. This constitutional limitation is applied only in extreme cases of abuse of discretion. Also like zoning, an urban renewal project must be in pursuance of a proper purpose. The third major restraint in zoning law, that zoning must be "in accordance with a comprehensive plan,"[46] has no workable counterpart in the urban renewal laws.

There have been some very commendable efforts at self-restraint by the Federal Administrator. In a recent directive to the local agencies, it was made a prerequisite to the receipt of future federal grants that the local agencies formulate a sort of master plan for urban renewal in a particular city.[47] This plan would show all the slums and blighted areas throughout a city. It would designate the priorities of all areas in the renewal scheme presumably based on the degree of blight. It remains to be seen to what extent the Federal Administrator will enforce this requirement. Urban renewal is an area where a master plan requirement could be very valuable.[48] The comprehensive plan requirement of zoning law which has been an effective deterrent in many cases to arbitrary or "spot" zoning would probably not be nearly so effective in urban renewal. Unlike urban renewal, zoning is by nature city wide and comprehensive so that a general plan can frequently be discerned by the courts. It is much more difficult to discern a general scheme in the scattered urban renewal projects in a city. But a master plan showing all blighted areas throughout a city and showing degrees of blight in each area would show a general scheme in the light of which a particular proposed project could be judged. This would largely eliminate the danger of blight being used as an excuse for the acquisition and redevelopment of property rather than the cause for such acquisition and redevelopment. The system of priorities would largely prevent the *ad hoc* development of areas due to the desirability of the location for redevelopment. The cost of urban renewal also dictates such a course. The project area which was held properly classified blighted in *Kaskel v. Impellitteri*,[49] was similar in character to one-third of

46. Courts reviewing zoning matters have frequently employed this statuatory language to test the propriety of actions of zoning authorities. However, it has been argued that this statuatory standard adds nothing to the constitutional standard and that courts would reach the same result applying only the constitutional restraint on unreasonable or arbitrary action. See Haar, *In Accordance With a Comprehensive Plan*, 68 HARV. L. REV. 1154 (1955).

47. HHFA, Local Public Agency Letter No. 276, Aug. 19, 1963.

48. For a definition of a master plan and a criticism of its merits with relation to zoning, see Haar, *The Master Plan: An Impermanent Constitution*, 20 LAW & CONTEMP. PROB. 353 (1955). According to Haar, one of the major effects of a master plan is to minimize arbitrary zoning in a community. *Id.* at 367.

49. *Supra* note 22.

the area of New York City. The cost of urban renewal in New York has averaged 481,000 dollars per acre.[50] Due to this prohibitive cost, urban renewal of necessity must proceed very slowly and it seems only logical that the worst areas of blight should be eliminated first. If a master plan requirement were incorporated into the state enabling acts so as to be readily available as an effective judicial restraint, it would go a long way toward eliminating the danger of misconception of purpose which exists under the present law.

In addition to a master plan requirement, it would be desirable to provide an administrative remedy before an independent forum with no stake in the ratification of a project plan. This forum should be divorced as far as possible from political influence and should be in no way connected with the local administrative agencies. This forum would bear some similarity to planning commissions and should be composed of men possessing some degree of expertise in city planning. This would relieve the courts of some of the burden of reviewing urban renewal projects and wonld afford a hearing before an objective board of experts. Until such meaningful statutory restraints and remedies are provided, it is essential that the courts guard individual rights against abuse by the ever growing urban renewal movement.

It cannot be denied that urban renewal has performed a valuable and needed function in the elimination of ever-increasing areas of blight in American cities. The courts must be careful not to unduly hamper the proper operation of this vital program. But the sanctity of private property is equally as valuable and must not be sacrificed in the process simply because it is more convenient to the administration of the program.

JOEL PORTER

50. H.R. REP. No. 7, 87th Cong., 1st Sess. 37 (1961).