RATEMAKING AS RULEMAKING—THE NEW APPROACH AT THE FPC: AD HOC RULEMAKING IN THE RATE- MAKING PROCESS

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THE ADMINISTRATIVE PROCEDURE ACT

The federal Administrative Procedure Act¹ has been on the statute books for a quarter of a century. However, only now are the compromises agreed upon in order to soften the rigors of adjudicatory procedures being fully exploited by the Federal Power Commission and upheld by the courts. The FPC now deems itself authorized to forsake its long-established pattern of "full evidentiary hearings" in ratemaking cases for a new streamlined procedure based on the compromise procedure of the APA, which exempts ratemaking from adjudication and includes it in rulemaking.² In the course of using the "ratemaking as rulemaking" provision, however, the FPC has taken undue advantage of the fact that interpretive rulemaking, an integral part of formulating a rate model, is exempted from the formal publication requirements of rulemaking.³ Since interpretive rulemaking is normally carried on in an adjudicative proceeding and the rules published in an opinion, interpretive rules were plausibly exempted from such requirements by the draftsmen of the APA. However, in present FPC practice, where there is no adjudicative proceeding but only a rulemaking proceeding, merely the rate *order* and other *orders* associated therewith are promulgated as formal rules. The interpretive rules which go into the formulation and application of a rate model are not proposed or pub-

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1. 5 U.S.C. §§ 551-59, 701-06, 1305, 3105, 3344, 5362, 7521 (1970).

2. See Administrative Procedure Act §§ 5(c), 8(a), 5 U.S.C. §§ 554(d), 557(b) (1970).

3. Administrative Procedure Act § 4(c), 5 U.S.C. § 553(d)(2) (1970). Notice and participation in interpretive rulemaking would not seem exempted since just and reasonable rates, pursuant to section 5 of the Natural Gas Act, 15 U.S.C. § 717d (1970), may be determined only after a hearing, and such rulemaking would be an integral part of the determination.

lished as formal rules and are subject to only indirect attack in the rulemaking proceeding.⁴

There was apparently no intention in Congress to deal with interpretive rulemaking in the compromises which transferred ratemaking from adjudication to rulemaking—in fact, however, the compromises served to relegate this process to marginal protection by the APA in the formulation of such rules, and to protection by only constitutional due process requirements in the rules' application. This result stemmed from the fact that *all* ratemaking, presumably interpretive formulation of the specifics of the just and reasonable rate model as well as the formal promulgation of the rate itself, was removed from adjudication, where it was subject to the protective processes of full evidentiary hearings, and was consigned to the more limited protection afforded the rulemaking process.⁵ Since this shift was an afterthought, made at the behest of those agencies concerned with the overjudicialization of such processes as ratemaking,⁶ initial licensing and corporate reorganization, all of the results of the shift on the structure of the statute may not have received adequate consideration by Congress.

As the majority bill for the APA was originally drafted, "rule" was defined to include "the whole or any part of any agency statement of general applicability designed to implement, interpret, or prescribe law or policy. . . ."⁷ This statement clearly included *formally promulgated* legislative rules prepared pursuant to a power to make substantive rules and regulations to implement a statute as well as *interpretive* rules announced by an agency incident to applying a broadly drafted statute to a specific case; the latter would be the "new rules [which] sometimes come into being . . . through the process of administrative adjudication."⁸ However, this interpretive or "ad hoc"⁹ decisional rulemaking process was specifically exempted

4. Appalachian and Illinois Basin Area Proceeding, 86 P.U.R.3d 16 (FPC 1970). See notes 121-28 *infra* and accompanying text.

5. Administrative Procedure Act § 2(c), 5 U.S.C. § 551(4) (1970).

6. For example, see the testimony of Commissioner Aitchison of the Interstate Commerce Commission, S. Doc. No. 248, 79th Cong., 2d Sess. 100-07 (1946).

7. S. Doc. No. 248, *supra* note 6, at 156.

8. NLRB v. E. & B. Brewing Co., 276 F.2d 594, 598 (6th Cir. 1960). The court also said: "Just as courts generally do not hesitate to announce new rules to govern novel or changed conditions, so administrative boards often lay down new so-called 'interpretive' rules." *Id.*

9. In SEC v. Chenery Corp., 332 U.S. 194, 202 (1947), Justice Murphy used the phrase "ad hoc adjudication to formulate new standards of conduct." The

from the notice and publication requirements of the formal rule-making process, presumably on the theory that the process resulting in interpretive rules would be adequately safeguarded by the procedures laid down for adjudication, where, by definition, interpretive rulemaking would be expected to take place.

But in the legislative compromises exempting "proceedings involving the validity or application of rates . . ." from the judicialization or separation of functions requirements of APA § 5(c)¹⁰ and including them in the definition of "rule,"¹¹ the *entire* ratemaking process was ostensibly transferred, including the *interpretive* rule-making essential to the process, as well as the formal promulgation of rate orders. However, the exemption of interpretive rules from formal publication was not disturbed despite the fact that the draft bill from which the "ratemaking as rulemaking" idea was lifted also included a provision that interpretive rules were to be issued as *rules*.¹²

Prior to the legislature's forsaking the pattern of "full evidentiary hearings" in ratemaking cases, the exemption of interpretive rulemaking from formal publication was not of great moment since the interpretive rulemaking process had gone on in the full light of an adversary adjudication, with ample opportunity for competing experts to make their interpretive proposals on the record, to be subjected to cross-examination thereon, and, if a proposal were not adopted, to attack the opposing interpretive proposal by taking exception thereto on brief before the examiner and on review by the full agency. It was, no doubt, the general acceptance of these adjudicative procedures for the formulation of interpretive rules which prompted the draftsmen of the majority bill to exempt interpretive rules and statements of policy from the formal notice and publication

term "informal rulemaking" is also encountered. See *NLRB v. Wyman-Gordon Co.*, 394 U.S. 759, 772 (1969); Benjamin, *A Lawyer's View of Administrative Procedure*, 26 LAW & CONTEMP. PROB. 203, 228 (1961). See also Peck, *The Atrophied Rule-Making Powers of the National Labor Relations Board*, 70 YALE L.J. 729, 756 (1961) ("ad hoc policy-making process"). While not in common use, the term "ad hoc rulemaking" seems appropriate and acceptable shorthand to describe the process, along with "policy-making" and "informal rulemaking," where, as in the FPC, a welter of accounting and financial rules are being formulated in this way.

10. 5 U.S.C. §§ 554(d) (1970).

11. See Administrative Procedure Act §§ 2(c), 8(a), 5 U.S.C. §§ 551(4), 557(b) (1970).

12. S. Doc. No. 248, *supra* note 6, at 166.

requirements of §4.¹³ The legislators assumed that such rules would be announced in opinions accompanying adjudicative orders and would have been preceded by hearings fully participated in by the original and intervening parties after notice by pleadings as to the issues of law which would be involved in the application of a broadly drawn statute. Thus, in an initial draft of the majority bill, which contemplated that the process would go on in the restricted context of adjudication, interpretive or ad hoc rulemaking could safely be exempted from the protections afforded formal rulemaking.¹⁴ The procedure was left in limbo, however, when ratemaking was transferred from adjudication to formal rulemaking, but, at the same time, interpretive rulemaking, an integral part of ratemaking, was exempted from notice and hearing requirements of formal rulemaking except where required by substantive statute, and was exempted entirely from publication requirements.

As noted, during the formulation of the APA, exemptions from the adjudicatory process were sought for ratemaking, initial licensing, and corporate reorganization, primarily due to concern that these agency responsibilities be freed from the restraints of a rigorous separation of functions so as to maximize the use of agency expertise in the formulation of complex and sophisticated criteria for the determination of controversies and so as to avoid leaving such matters wholly in the hands of a single trial examiner even in initial determinations.¹⁵ Relatively little attention was paid to the fact that freeing these agency responsibilities from adjudicatory restraints would place substantial power in the agencies over the degree of participation to be accorded interested parties in the hearing process. This aspect of the exemptions was to assume importance only at a later date.

A comment by the Solicitor for the Securities and Exchange Commission (SEC) in an early symposium on the APA, well illustrates that the drafters' focus of concern was elsewhere than on the possible submergence of the interpretive ad hoc rulemaking process which would result from the transfer of ratemaking, initial licensing, and corporate reorganization from the full adjudicatory procedures to formal rulemaking. The Solicitor, whose primary concern was safeguarding adequate participation in the proceedings by agency ex-

13. 5 U.S.C. § 553 (1970).

14. S. Doc. No. 248, *supra* note 6, at 157.

15. See 92 CONG. REC. 5651 (1946) (remarks of Representative Walter).

perts, saw the party interests adequately safeguarded by rules of practice which would "postpone until some difference of opinion may arise any determination of whether in the absence of agreement either the letter or spirit of the Administrative Procedure Act may require the following of a particular procedural routine in connection with any particular statutory procedure."¹⁶ The Solicitor noted that the current rules of practice of the SEC made it the duty of the parties to specify as early as possible in the proceeding what procedures they deemed "necessary or appropriate" and made it the "duty of the examiner to see that a clear understanding is reached at an early date as to the procedure which the parties may desire."¹⁷ He observed that, typically, counsel before that Commission evidenced less concern for obtaining procedural due process (presumably provided by the adjudicatory requirements of the APA) and more concern for avoiding an undue amount of procedure which might slow up obtaining a decision of the Commission.¹⁸ He could not have foreseen the development now at hand in which public interest bodies may be deprived of a forum in which to voice questions concerning interpretive ad hoc rules adopted by the FPC except upon the decision by that body that the issues require public illumination.

What "ratemaking as rulemaking" currently means to the FPC is evidenced by a statement made by the District of Columbia Court of Appeals in sustaining the power of the FPC to promulgate a formal rule that pipeline companies price gas produced by them at area prices:

[T]he Commission may conduct, as it did here, a full evidentiary hearing of the type contemplated by Sections 7 and 8 of the Administrative Procedure Act, or may use *any variant* of such procedures. Whatever procedure is utilized, a primary objective is the acquisition of information which will enable the Commission to carry out effectively the provisions of the Natural Gas Act. The ability to choose with relative freedom the procedure it will use to acquire relevant information gives the Commission power to realistically tailor the proceedings to fit the issues before it, the information it needs to illuminate those issues and the manner of pres-

16. Foster, *Application of the Administrative Procedure Act to the Statutes Administered by the Securities and Exchange Commission*, in *THE FEDERAL ADMINISTRATIVE PROCEDURE ACT AND THE ADMINISTRATIVE AGENCIES* 213, 221 (G. Warren, ed. 1947).

17. *Id.* at 221-22.

18. *Id.* at 222-23.

entation which, in its judgment, will bring before it the relevant information in the most efficient manner.¹⁹

The rule in question was formally promulgated as a part of the FPC General Rules as follows:

As a matter of policy in future pipeline rate proceedings, gas produced by pipelines or by their affiliates from leases acquired after the date of this order will be priced for rate making purposes at the just and reasonable area rate applicable to gas of a vintage corresponding to the date of completion of the first well on the lease, otherwise at the "in-line" price, or, if there is no in-line price, on the basis of the guideline price²⁰

The congerie of interpretive rules which underlay the "just and reasonable area rate" referred to in the rule now need not be tested in an adversary setting and published unless the FPC finds it expedient or is ordered to do so. The concern of this article is with this shift in procedure, from formulating and applying subsidiary ratemaking criteria as interpretive rulemaking in an adversary adjudicative setting, to carrying it on in the semi-private, less adversary context of formal rulemaking which the FPC has now espoused. The following pages note the initial Supreme Court participation in the formulation of interpretive ad hoc rules for determining just and reasonable rates for natural gas pipeline companies in the transition from the fair value approach.²¹ The development then proceeds to the rate-making problems precipitated by the extension of FPC jurisdiction to independent producers of natural gas and to the early ad hoc attempts to determine just and reasonable costs and prices for gas produced and distributed, or produced and sold, to independent pipelines. Throughout the discussion, the procedural format in which all of this decision making took place and the complexity of the resulting ad hoc rules are of primary concern. The development notes the utilization of the certification proceeding as the public forum in which interpretive ad hoc rules had first to be formulated in order to control price pending definitive determination on an area basis. From such proceedings emerged the preliminary interpretive rule that a price which was "in line" with prices generally in effect for gas

19. *City of Chicago v. FPC*, 458 F.2d 731, 743-44 (D.C. Cir. 1971) (emphasis added).

20. 18 C.F.R. § 2.66(a) (1970).

21. For an analysis of this transition, see Dakin, *The Changing Nature of Utility Rate Regulation: Just Compensation, Due Process, and Equal Protection*, 36 *TULANE L. REV.* 711 (1962).

produced in a field or area would be the tentative reasonable price for the purpose of certifying sales or transportation of gas pending definitive determination of the "just and reasonable" price for an area.

The exceedingly complex interpretive ad hoc rulemaking and application which was to follow in fixing definitive area rates took place in full public adjudicatory proceedings with maximum participation by all interested parties before a trial examiner charged with the responsibility for recommending a decision. The remainder of the article is devoted to assaying the results of that enterprise at the commission and court levels and to describing the transition now underway from such full public adjudicatory proceedings to an abridged, formal, semi-private rulemaking process deemed permissible under the APA. The thesis developed is that the newly adopted approach unduly submerges the crucially important formulation and application of interpretive ad hoc rules in a manner literally permissible under the APA, but unintended and inadvertently brought about by compromises in the legislative drafting.

THE INTERPRETIVE RULES OF *Hope* AND *Phillips*

When the FPC decided *Cleveland v. Hope Natural Gas Co.*,²² ratemaking "methodology" had already been largely supplied by the Supreme Court through the concurring opinions in *FPC v. Natural Gas Pipeline Co.*;²³ the Commission was free to apply the Brandeis formula of fixing a return which would cover the use of capital, allowance for risk incurred and enough more to attract capital, whatever the nature of the security issued therefor. Thus in *Hope*, the FPC needed only to apply these interpretive rules of the Supreme Court and to find and fix the rate of return at 6½% after taking into account from an adversary record an "abundance of evidence" including

investors' appraisal of the natural gas industry, comparative risk data, interest rates and yields on securities of natural gas and electric utilities, statistics showing the growth and stability of the natural gas industry, the trend of the cost of money and its current cost, . . . the financial history of the Hope Company and the facts about recent financing by its parent Standard Oil Company.²⁴

22. 3 F.P.C. 150 (1942), *rev'd sub nom.* *Hope Natural Gas Co. v. FPC*, 134 F.2d 287 (1943), *rev'd*, 320 U.S. 591 (1944) (FPC order held valid).

23. 315 U.S. 575, 602-03 (1942).

24. 3 F.P.C. at 185-86.

When the Supreme Court appraised the FPC's order, it refined the "methodology" somewhat and restated it in terms of price: rates were "just and reasonable" and therefore in compliance with due process if they enabled the company to (1) operate successfully; (2) maintain financial integrity; (3) attract capital; and (4) compensate investors for the risks assumed.²⁵

Formal accounting requirements already in existence for pipeline companies provided a large part of the data required for the new test model. Data on plant, depreciation, and working capital were already required to be submitted under existing rules, as were financial data on capital structures of utilities.²⁶ Other interpretive rules would be formulated ad hoc for the measurement of such esoteric phenomena as debt-equity ratios and earnings-price ratios, all essential to applying the new Supreme Court guideline rules. Tariff increases would be rejected if existing price tariffs were found to yield revenues for the test period which, when translated into a composite rate of return (constructed from pro rata returns on debt and equity) satisfied, in the agency's view, these Supreme Court criteria. Presumably, such tariffs would contain a minimum of monopoly profit and would permit the utility to "operate successfully" and to "attract capital" because they adequately compensated investors for risks assumed. The revenue statement and the market were to be the source of data for the determination of the rate of return, after scrutiny for inaccuracies and excesses which might redound to the benefit of the venture stock.

A decade after *Hope*, in *Phillips Petroleum Co. v. Wisconsin*,²⁷ the Supreme Court ruled that gas producing companies were natural gas companies along with pipeline and distributor companies. The effect was to expand the price-fixing authority of the FPC from jurisdiction over less than 200 pipeline companies to several thousand independent producers of natural gas. Overwhelmed by the magnitude of the problems precipitated by the decision, the Commission fell back upon competition as the determinant of price, at least where production was combined with the transportation of gas by a pipeline company. Thus, in an adjudication of the reasonable-

25. 320 U.S. at 605 (1944).

26. These requirements are presently contained in various sections of 18 C.F.R. pt. 201 (1972).

27. 347 U.S. 672 (1954).

ness of rates charged by Panhandle Eastern Pipeline Company,²⁸ the FPC substantially modified its *Hope* rate base approach for the company's producing properties by adopting a "field" price rule for gas obtained from these properties based upon the "weighted average arms-length prices" established by federally unregulated bargaining for similar gas in the field. However, upon judicial review, the order was set aside and remanded.²⁹

Defeated by the courts in its attempt to use "field prices" as a determinant for the price of gas to the pipelines, the FPC turned to new experimental ad hoc procedures which would enable it to test the reasonableness of the price of gas by more or less conventional rate base approaches. Thus the examiner's approach in the *Phillips Petroleum Co.* case,³⁰ concluded six years after the momentous jurisdictional decision, was to utilize ad hoc procedures which brought together in one lump sum the cost of producing gas, the cost of purchasing gas, and the cost of gathering the gas. To this figure was added a return on a rate base consisting of production and gathering facilities and working capital. Finally, to this amount was added the alleged actual liability for federal income taxes, producing a total adjusted cost of service translated into a cost of natural gas of 11.3747 cents per thousand cubic feet.

At the time the FPC was reviewing the examiner's decision in *Phillips*, it had already made its decision to move to a new method of fixing natural gas rates by areas, using group costs either on a national or area rate basis in lieu of fixing the cost of gas by companies on an individual rate base method. However, it was necessary to dispose of the *Phillips* proceeding which had been pending since 1954; the Commission determined that the system-wide cost of gas for jurisdictional sales was \$10,000,000 in excess of the applicable jurisdictional revenues and, on the basis of these findings, terminated its inquiry into the reasonableness of the Phillips rates and discharged Phillips' obligation to refund prior charges. Even though the inquiry was not definitive, important ad hoc rulemaking was required principally in solving allocation problems incident to dividing production costs between oil and gas production and allocating exploration costs between oil and gas.³¹

28. Panhandle E. Pipeline Co., 13 F.P.C. 53 (1954).

29. City of Detroit v. FPC, 230 F.2d 810 (D.C. Cir. 1955), cert. denied, 352 U.S. 829 (1956).

30. 24 F.P.C. 537, 590 (1960).

31. *Id.* at 562-63.

INTERIM INTERPRETIVE RULES—THE ROLE OF CERTIFICATION

The FPC's formulation of rules of ratemaking for multiple companies on an area basis, as distinguished from the one company rate base model, and the application of those rules was to be a long and laborious process. For the interim, the authority of the FPC to control sales and transportation of gas through the certification process was to be used to assure protection to the consumer against monopoly profit. In an initial attempt to make reasonable price a term or condition of a certificate, the FPC vacillated, then finally backed down;³² Supreme Court action was required to establish that "reasonable price" was an appropriate term or condition of certification in addition to the other requisites which could be imposed by the FPC. Thus, in *Atlantic Refining Co. v. Public Service Commission of New York*³³ (the *CATCO* case), because no evidence of the reasonableness of price had been introduced by the applicant for certification, the Supreme Court directed the FPC to deny the application; in doing so, the Court articulated guidelines for the determination of a reasonable price, stating:

Where the proposed price is not in keeping with the public interest because it is out of line or 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.³⁴

This statement was the first ad hoc articulation of the "in-line" price concept which was deemed necessary for fulfillment of the Congressional "comprehensive and effective regulatory scheme."³⁵

As a preparatory step prior to the issuance of notice of ratemaking by areas, the FPC used this new-found authority to issue a Statement of General Policy in which, with later amendments, it announced "in-line" prices as the area price levels for natural gas sales by independent producers during the period prior to the establishment of an area reasonable price.³⁶ In the absence of telling evidence warranting other action by the Commission, proposed initial sales of natural gas by independent producers which included rates

32. *Continental Oil Co.*, 17 F.P.C. 563, 732, 880 (1957).

33. 360 U.S. 378 (1959).

34. *Id.* at 391.

35. *Id.* at 392.

36. 24 F.P.C. 818 (1960).

higher than those indicated were to be denied a certificate or certified only upon the condition that lower rates be filed. The Statement was said by the FPC to be based on "our experience gained after six years of regulation of independent producers under the Natural Gas Act."³⁷ It was published in the Federal Register pursuant to APA § 3³⁸ but was not preceded by formal rulemaking hearings, presumably on the theory that neither APA § 4³⁹ nor the Natural Gas Act (NGA) § 16⁴⁰ required them.

The FPC's rule as to "in line" prices was upheld in *United Gas Improvement Co. v. Callery Properties, Inc.*,⁴¹ where the Supreme Court concluded that under NGA § 7(e)⁴² adequate protection to the public interest required "as an interim measure that gas not enter the interstate market at prices higher than existing levels."⁴³ The FPC was not required to canvass any evidence bearing on the question of what would be a just and reasonable price for the gas sought to be certified but could reject the application on the basis of the announced rule. The FPC was said to be well within the thrust of the court's *CATCO* opinion directing the Commission to use its § 7 conditioning power to prevent large jumps in initial contract prices, pending the determination of just and reasonable rates.⁴⁴

THE PERMIAN BASIN AREA RATE PROCEEDINGS—INTERPRETIVE RULES IN AN ADJUDICATIVE SETTING

The new adventure in area ratemaking started quite unpretentiously with a notice and order for institution of a proceeding in which the FPC proposed to determine the just and reasonable rate or rates for the sale of natural gas produced in the Permian Basin area.⁴⁵ All pertinent pending producer rate-suspension proceedings under § 4 and all pertinent applications for certification under § 7 of the NGA were consolidated with the § 5 proceedings to determine just and reasonable rates for the area.⁴⁶ The order delineated boundaries for the area and announced that no contentions

37. *Id.*

38. 5 U.S.C. § 552 (1970).

39. *Id.* § 553.

40. 15 U.S.C. § 717o (1970).

41. 382 U.S. 223 (1965).

42. 15 U.S.C. § 717f(e) (1970).

43. 382 U.S. at 227.

44. 360 U.S. at 391.

45. Area Rate Proceeding, 24 F.P.C. 1121 (1960).

46. See 15 U.S.C. §§ 717c, 717f, 717d (1970).

would be entertained as to inappropriateness of the area for ratemaking purposes nor would any evidence be considered looking toward the fixing of rates for sale of gas outside the boundaries of the area. The appointment of an examiner to preside at the hearings was made in compliance with APA § 7 and § 11,⁴⁷ indicating the FPC's intent to conduct a full "adjudicatory" hearing. A pre-hearing conference was held in order to simplify and delineate the issues and to determine the type of evidence to be adduced, order of presentation, and number of witnesses to be heard on any issue or subject. Persons seeking an opportunity to participate in the hearings were required to file a statement setting out their interests in the proceedings. Four years later the examiner's opinion was published and a year thereafter the final decision and order of the FPC was issued.⁴⁸

In *Phillips*, the FPC had declared that its objective was "to set prices in all producing areas . . . adequate to maintain the gas supplies needed by the consumers of the nation, but at prices that are no higher than are necessary to accomplish that purpose."⁴⁹ The Commission had indicated that it would make use of cost data obtained in the past and that it would acquire and consider cost information in the future. Costs relative to a representative sampling of the industry in any one area were to be accepted as part of the basis for fixing rates for all producers in the areas.

The FPC's experience in the *Phillips* case and others during the six year period of producer regulation had impressed upon it the difficulties which would be encountered in fixing rates for producers on an area basis. The Commission noted particularly the difficulty of formulating rules for the allocation of expenses between production of oil and gas and the difficulty of estimating reserves for gas when qualified experts differed as much as one hundred percent in appraising the quantity of reserves in the same formations. It cautioned that "[w]hen an unrealistic result is reached, the formulae for allocations must be changed, in order to bring about a reasonable result. [Otherwise] [t]he allocation methods . . . become a means of supporting a result *already arrived at*, rather than a means of arriving at a result *which was previously unknown*."⁵⁰ In approach-

47. 5 U.S.C. §§ 556, 3105 (1970).

48. Area Rate Proceeding, 34 F.P.C. 159, 306 (1965).

49. 24 F.P.C. at 547.

50. *Id.* at 544 (emphasis added).

ing its new regulatory task the FPC quoted Justice Jackson's concurring opinion in *Colorado Interstate Gas Co. v. FPC*⁵¹ that

[f]arsighted gas-rate regulation will concern itself with the present and future, rather than with the past, as the rate base formula does. It will take account of conditions and trends at the source of the supply being regulated. It will use price as a tool to bring goods to market—to obtain for the public service the needed amount of gas.⁵²

It expressed confidence that, within the area regulatory pattern, it could fix prices which would provide the incentive producers needed to explore to meet the nation's increasing demand for natural gas and yet would give consumers the protection which the NGA intended.⁵³

INTERPRETIVE DEVELOPMENT OF THE PERMIAN MODEL AND METHODOLOGY—EVOLVING ACCOUNTING RULES IN ADJUDICATION

As previously noted, the primary concern of this article is with the FPC's transition from the employment of the full adjudicatory procedure, at one time deemed to be dictated by NGA § 5, to the procedures authorized by the APA in classifying ratemaking and initial licensing as rulemaking. In particular, the focus of the examination is upon the formulation of rules pursuant to the ad hoc procedures traditionally utilized by the FPC in adjudication and an exposition of the shortcomings of the newly-espoused formal rulemaking procedures. For such an inquiry it is not essential to examine the entire ratemaking process; instead, it is sufficient to note the complexities and choices made in the formulation of area methodology under ad hoc rulemaking in adjudication and to point out the submergence of those complexities and choices when they are made in the context of the formal rulemaking process.

The FPC acknowledged the crucial role of ad hoc formulations of methodology in a tribute to the presiding examiner and to the parties and intervenors in the *Permian* proceeding:

We acknowledge at the outset our indebtedness to Examiner Wenner for his penetrating analysis of the basic economics of the industry and his constructive proposals for a pricing system in har-

51. 324 U.S. 581, 608 (1945).

52. *Id.* at 612.

53. Area Rate Proceeding, 34 F.P.C. 159, 179 (1965).

mony with the realities of the industry and the Commission's responsibilities under the Natural Gas Act. We must acknowledge also the helpful and constructive role of the parties to the proceeding. The cooperation of the respondents and the interveners with the Commission has been instrumental in achieving what the examiner has described as a breakthrough in reaching a workable method of producer regulation.⁵⁴

For pipeline companies, uniform systems of accounts had already been prescribed by the FPC. However, when the *Permian* proceeding was begun, producers had not yet been required to conform their books to uniform systems of accounts. Since there were no statistics based on a uniform set of accounts, the FPC had to resort to the promulgation of a cost questionnaire in order to fill the information gap. In addition, census data and other well-recognized and authoritative industry data were introduced through witnesses and relied upon by the FPC. But, while the questionnaire dictated the data to be submitted and the required detail as to national and area operations, the FPC had still to formulate on an ad hoc basis the methodology to be applied to the data to reduce it to costs in cents per thousand cubic feet of gas produced and ultimately to a price which would provide the needed incentive and at the same time protect the consumer against monopoly profit.

The *Permian* cost model for new gas-well gas, once structured on an ad hoc basis, also required ad hoc or interpretive rules for selection of the data to which the cost model was to be applied in order to yield an area rate for new gas which could be promulgated as a formal rule by the FPC. The determination of unit costs, begun in *Phillips*, emerged as the *Permian* cost model for new gas.⁵⁵

54. *Id.* at 172.

55.

Cost Elements		COST OF NEW GAS-WELL GAS IN CENTS PER MCF	
		Producers' Figures	Commission Determination
Exploration and Development Costs			
(1)	Dry Holes	1.56	1.42
(2)	Other Exploratory Costs	1.56	1.59
(3)	Adjustment for Exploration in Excess of Production	2.15	1.11
	<u>Subtotal</u>	<u>5.27</u>	<u>4.12</u>
(4)	Production Operating Expense	2.62	2.70
(4a)	Adjustment of Net to Marketed Production	1.05	
(5)	Net Liquid Credit	(3.27)	(3.10)
(6)	Regulatory Expense	.14	.14

Each of the cost elements appearing in the model required formulation of ad hoc methodology and adoption of rules for selection of data. Analysis of the choices involved in formulating and unitizing the major cost elements elicits apprehension when one contemplates the present submersion of these vital procedures into a rulemaking process which announces only the final rates, terms and conditions as formal "rules." Apprehension is deepened as one samples the quantitative effect of the choices on the unit cost set out above.

As the *Permian* model indicates, the initial determination was the unit "dry holes cost." Producers proposed a so-called project method which involved capitalizing total investment to acquire a capital asset and providing for a return on that investment over its productive life. Under this method, dry holes cost and other costs associated with unproductive ventures would be capitalized along with the cost of productive ventures⁵⁶ and charged off as depletion, depreciation, and amortization in usual capital recovery fashion, probably with substantial effect on timing of the deductions. The FPC rejected this method as a departure from industry accounting practices and as not adequately supported in the record. In lieu thereof, it adopted the method of determining a national dry holes cost by multiplying the annual or test period dry hole footage by a statistically supported dry holes drilling cost per foot; the resulting total dry hole cost was divided by the average annual reserve additions of gas-well gas to yield a cost of 1.42 cents per Mcf of gas pro-

Depletion, Depreciation, and Amortization
of Production Investment Costs

(7) Successful Well Costs	3.10	2.88
(8) Lease Acquisition Costs	1.24	.76
(9) Cost of Other Production Facilities	.31	.31
(10) Return on Production Investment (at 12 percent)	8.45	5.21
(11) Return on Working Capital		.35
	<u>Subtotal</u>	<u>18.91</u>
		<u>13.37</u>
(12) Production Taxes at 6.1 percent	1.42	1.01
(13) Royalty at 12½ percent of Total	2.91	2.05
	<u>Total</u>	<u>23.24</u>
		<u>16.43</u>

See 34 F.P.C. at 192, 343. As will be evident, "dry holes cost" (Item 1) and "successful well cost" (Item 7) are the basic elements. Items 8 and 9 are derived from Item 7, and Item 2 is derived from Items 1, 7, 8 and 9. Item 3 is derived from Items 1 and 2, and Item 10 is derived from Item 7, 8 and 9. Item 11 is derived from Item 4, the national average for "production operating expense." See Committee, *The Permian Case, the FPC, and Economics*, 77 PUB. UTIL. FORT-NIGHTLY 31 (March 17, 1966).

56. Area Rate Proceeding, 34 F.P.C. 159, 192-93 (1965).

duced.⁵⁷ "Other exploratory costs" consisting of geophysical, lease rentals and overhead costs, added 1.59 cents per Mcf.

The FPC believed it essential that an "allowance for losses" be added in order to encourage a level of exploratory effort which would provide findings of gas in excess of gas production. The method selected to achieve this objective was to take the weighted annual average ratio of *findings* of gas to *production* for a five-year period, amounting to 1.37, and apply it to the dry hole and other exploratory costs already determined. This approach permitted the addition of 1.11 cents per Mcf as an allowance which the examiner called "allowance for growth" and which the FPC called "adjustment for exploration in excess of production."⁵⁸ The examiner, however, based the element not on the relationship between findings and production alone, but rather on the fact that use of this factor would result in increasing reserves to 17.5 times annual production by 1970. Producers urged a reserve to production ratio of 20 to 1, with a commensurate increase in the "allowance for growth."⁵⁹ While the FPC agreed that a strong exploration program which would discover and develop gas reserves in ample time to meet increasing demands for gas was vital, it refused to assume the existence of a direct relationship between any calculated reserves-production ratio and the price of gas, noting that the ratio went down steadily during the periods in which gas prices were staging their most spectacular increases.⁶⁰ Thus the methods finally selected resulted in unit costs of exploration and development of some 4.12 cents per Mcf of production as an annual unit cost of finding necessary volumes of gas rather than the 5.27 cents per Mcf urged by the producers.

In establishing a rate base for an area, the FPC might have proceeded by applying the method used in *Phillips*, aggregating the cost of all the well equipment and reserves for all of the companies in the area. As noted, the producers urged an approach which would have capitalized all of the costs of acquiring capital assets in the area, dry hole cost along with productive leases. This aggregate for the area would then have been depreciated, depleted and amortized, and a return allowed over the years of recovery on what, for

57. *Id.* at 192, 383-84.

58. *Id.* at 193-94.

59. *Id.* at 386.

60. *Id.* at 184.

each asset, would have been a declining rate base. The producers' method would have resulted in a charge for successful well costs of 3.10 cents per Mcf and an associated return on investment of 8.45 cents per Mcf.⁶¹

The FPC chose a method more in keeping with industry practice of expensing exploration and development costs on an annual basis. Questionnaires supplied these data on a national and area basis. The method contemplated that the cost per foot of successful wells would be divided by the estimated reserves added per successful foot; the result would be the "successful well cost" in cents per Mcf as the gas was actually produced. The producers urged that, if this method was to be used, drilling costs per foot and estimated reserves added should at least be those supplied by the industry; the FPC instead used census data and arrived at 2.88 cents per Mcf as "successful well cost."⁶²

As indicated, in making its determination of "return on production investment," the FPC was faced with at least two ad hoc approaches. The producers' proposed method would have produced a return of approximately 8.45 cents per Mcf of gas produced. The alternative method was to take the successful well cost per annum for the area and approximate an investment cost by multiplying this annual cost by the estimated number of years for recovery of the reserves. The FPC chose the latter method on the ground that the data was more reliable. It also chose to use census data instead of selected group data because it was more characteristic of the industry as a whole. The Commission selected 20 years as its model period of recovery, with an average of 10 years plus one as the proper rate base for computing a return (on the assumption that there was a lag of one year between the making of an investment and recovery of revenues thereon). Thus, its rate base calculation consisted of taking the annual total successful well and associated costs of 3.95 cents per Mcf and multiplying that sum by eleven years to obtain a rate base of \$43.45 per Mcf.⁶³

A rate of return was determined on the basis of procedures perfected during prior regulation of pipeline companies. Thus, the FPC examined debt-equity ratios and concluded that the ratio for so-called nonintegrated producers was approximately 15% debt and

61. *Id.* at 354-55.

62. *Id.* at 197-98.

63. *Id.* at 204.

85% equity. The producers argued that 12% debt would have been a more characteristic figure. The producers also argued for an overall incentive return on the order of 16 to 18% in keeping with non-regulated commercial rates and representing a return on common equity, on the basis of the debt-equity ratio noted above, of approximately 20%. The FPC was persuaded by its staff that only a "fair" rate of return was necessary and that the rate need contain no incentive factor. The Commission concluded "after weighing all the evidence" that a return of 12% overall was appropriate.⁶⁴ Such a rate of return applied to the rate base of \$43.45 per Mcf, as determined above, resulted in a cost of 5.21 cents per Mcf. Return on working capital figures, with regard to which alternative calculation procedures were also proposed, increased total return to 5.56 cents per Mcf as compared with the 8.45 cents per Mcf urged by the producers.

In *Permian*, aside from preliminary statements of objectives, the FPC did not discuss "incentive" or non-cost inclusions in the model, treating all items as cost elements. However, it seems clear that incentives were present in exploration and development, in the adjustment for exploration in excess of production and in the return on production investment to the extent return allowed exceeded experienced capital cost. There was also a negative cost element which did not appear in the model but which reduced return by a requirement for "absorbing" price adjustments for less than pipeline quality gas.⁶⁵

SUPREME COURT APPROVAL OF PERMIAN

The Supreme Court noted, in approving the *Permian* order,⁶⁶ that "the parties before this Court have together elected to place in question virtually every detail of the Commission's lengthy proceedings"⁶⁷ but that "a presumption of validity . . . attaches to each exercise of the Commission's expertise, and those who would overturn the Commission's judgment undertake the 'heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences.'"⁶⁸ Citing the *Hope* case,

64. *Id.* at 200-04.

65. *Id.* at 221-25.

66. *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

67. *Id.* at 766.

68. *Id.* at 767.

the Court stated that its statutory review authority was circumscribed by the NGA provision that factual findings of the FPC, if supported by substantial evidence, were to be conclusive.⁶⁹ It thus took a "mixed law and fact" approach and charged itself only with determining whether the "total effect of the rate order cannot be said to be unjust and unreasonable" ⁷⁰ The Court acknowledged that "the Commission is not required by the Constitution or the Natural Gas Act to adopt as just and reasonable any particular rate level; rather, courts are without authority to set aside any rate selected by the Commission which is within a 'zone of reasonableness.'" ⁷¹ *SEC v. Chenery Corp.*⁷² was not cited although the FPC had in an earlier case relied upon the decision to support its ad hoc selection of methodology.⁷³ Rather, the Supreme Court quoted from a pre-*Chenery* case that "legislative discretion implied in the ratemaking power necessarily extends to the entire legislative process, embracing the *method used* in reaching the legislative determination as well as that determination itself."⁷⁴ It saw the issues presented as (1) statutory and constitutional authority to employ area regulation; (2) the validity of the rate structure adopted by the FPC; (3) the accuracy of the cost and other data from which the FPC derived its area maximum prices; and (4) the validity of the refund obligations imposed by the FPC.⁷⁵

All of the arguments adduced by the producers to show that the FPC had exceeded its statutory authority were rejected. Particularly, the Court rejected the argument that the FPC was limited to regulation by individual company rate base determinations,⁷⁶ noting that *Hope* did not establish this proposition nor did dicta in the case of *Bowles v. Willingham*.⁷⁷ It thought that "the ultimate achievement of the Commission's regulatory purposes may easily depend upon the contrivance of more expeditious administrative methods" and that "[w]e cannot, in these circumstances, conclude that Congress has given . . . authority inadequate to achieve with rea-

69. *Id.* at 766-67, citing 320 U.S. at 602.

70. 390 U.S. at 767, citing 320 U.S. at 602.

71. *Id.*

72. 318 U.S. 80 (1943).

73. Phillips Petroleum Co., 24 F.P.C. 537, 549 (1960).

74. 390 U.S. at 776, citing *Los Angeles Gas & Elec. Corp. v. Railroad Comm'n*, 289 U.S. 287, 304 (1933) (emphasis added).

75. 390 U.S. at 767-68.

76. *Id.* at 775.

77. *Id.*, citing 321 U.S. 503 (1944).

sonable effectiveness the purposes for which it has acted.”⁷⁸ The fact that area regulation constituted a new direction by the FPC did not deter the Court: “[A]dministrative authorities must be permitted, consistently with the obligations of due process, to adapt their rules and policies to the demands of changing circumstances.”⁷⁹

The Court set aside competition as a possible substitute for regulation and approved the holding in *Detroit v. FPC*,⁸⁰ although without citation.⁸¹ Summarizing the deficiencies of the market mechanism in the Permian Basin, it noted that these imperfections, despite an essentially monopsonistic environment, had accentuated the consequences of inelastic supply and sharply rising demand. The Court accepted the FPC analysis that the “inelastic supply” applied only as to the oil well gas which could not be separately sought or independently produced because of state limitations on the production of oil. Gas-well gas, on the other hand, could be independently sought, and “[t]he supply . . . is therefore relatively elastic, and its price can meaningfully be employed by the Commission to encourage exploration and production.”⁸²

The Court approved the dual rate system, the rate for old gas based on historic costs and the rate for new gas based on national costs, as within the agency’s authority to adopt. It noted that it could set aside such rates only if they were not within a “zone of reasonableness.”⁸³ Buttressing the FPC’s power to search for more expeditious ratemaking methods, the Court invoked a kind of statutory equivalent of the constitutional “necessary and proper clause” by noting that “if these arrangements are ‘necessary or appropriate to carry out provisions of this Act [NGA],’” the FPC is permitted by the statutory grant of authority to fix just and reasonable rates.⁸⁴ Most far-reaching, perhaps, was the Court’s statement upholding the proscription of new rate filings, that it was “. . . in the absence of compelling evidence that such was Congress’ intention,

78. 390 U.S. at 777.

79. *Id.* at 784.

80. 230 F.2d 810 (D.C. Cir.), *cert. denied*, 352 U.S. 829 (1956).

81. 390 U.S. at 792-95.

82. *Id.* at 796-97.

83. *Id.* at 767. *See also id.* at 803.

84. *Id.* at 797. The Court here relied upon Natural Gas Act § 16, 15 U.S.C. § 717o (1970), which empowers the FPC “to prescribe . . . such . . . rules, and regulations as it may find necessary or appropriate to carry out the provisions of this chapter.”

unwilling to prohibit administrative action imperative for the achievement of an agency's ultimate purposes."⁸⁵

In rejecting producers' attacks on the methodology and data selection in the *Permian* rate model, the Supreme Court relied upon its recent decision in *Chicago & North Western Railway v. Atchison, Topeka & Santa Fe Railway*,⁸⁶ a case involving an ICC rate determination. In approving the ICC decision, the *Chicago & North Western Railway* Court had noted that

presentation and discussion of evidence on cost issues constituted a dominant part of the lengthy administrative hearings and the issues were thoroughly explored and contested before the Commission [I]ts conclusions had reasoned foundation and were within the area of its expert judgment [with respect to] accounting problems . . . relating entirely to . . . special and complex peculiarities. . . .⁸⁷

The FPC's determinations with respect to exploration and development expense were thus left relatively undisturbed by the Court. Likewise, the relatively novel FPC method for arriving at a rate base for the area elicited little more than a recitation, somewhat elliptic, of what the FPC had done. The appropriateness of taking the annual successful well cost per annum and dividing it by the amount of reserves added to get the capital recovery cost per Mcf produced was not questioned by the court. Translating this capital recovery charge per Mcf into a rate base by multiplying it by the average years of recovery was also accepted after only brief comment. The Court summarily rejected the producers' argument that because a declining investment base would obviously result in greater return on investment at the outset of production, diminishing during the life of the reserve, it would have been fairer to them than such an average base. Noting that this was "a question peculiarly within the Commission's discretion," the Court found that the FPC's resolution could not be held to be arbitrary or unreasonable.⁸⁸

85. 390 U.S. at 780.

86. 387 U.S. 326 (1967).

87. *Id.* at 356, quoted in 390 U.S. at 824; cf. *Dobson v. Commissioner*, 320 U.S. 489 (1943).

88. 390 U.S. at 805-06. In the later *Southern Louisiana* proceeding, 80 P.U.R.3d 197 (F.P.C. 1969), a dissenting commissioner noted that accepting the producers' argument that 22 years rather than 20 years should be the normal period of recovery would have made a difference of 10% in the amount of the rate base on which return was calculated. *Id.* at 246-47.

In approving the method selected for determining a rate of return, the Court was on more familiar grounds and, predictably, probed somewhat more deeply. The FPC had determined that a rate of return appropriately could be based in substantial part on return data for non-integrated producers. The significance of the debt-equity ratio was noted by the Court and the selection of 12% as a proper rate of return for gas of pipeline quality was approved. But, as in the case of the allowance for exploration and development expense, the Court did not discuss the appropriateness of any included allowance as incentive for further exploration. It concluded simply with a citation of the *Hope* criteria that the rate was likely to "maintain [the producers'] financial integrity, to attract capital, and to compensate [their] investors for the risks assumed"⁸⁹ The fact that the return of 12% was fixed for gas of pipeline quality only and that gas of lesser quality would result in an adjustment of the return was not deemed to invalidate it, although producers argued that this approach treated as a risk what probably should be treated as a cost. No abuse of discretion was found in the adoption of this procedure.⁹⁰

The producers insisted that the effect of the FPC's methods would be to reduce prevailing field prices and thus jeopardize essential programs of exploration. In response to their argument that the ratio between proved recoverable reserves at current production was dangerously declining, the Court stated that "recent variations in the ratio of reserves to production are of quite limited significance"⁹¹ and "[w]e assume that the Commission will continue to examine both the premises of its regulatory methods and the consequences for the industry's future of its rate making orders. Nothing under the act or the cases of this Court compels the Commission to reduce its regulatory functions to self-fulfilling prophecies."⁹²

89. 390 U.S. at 808, quoting 320 U.S. at 605. The Commission's staff pressed for a return of 9½% as compared with the 12% allowed by the Commission. Area Rate Proceeding, 34 F.P.C. 159, 345. The lower figure was rejected on the ground that it was too closely tied to the returns of pipeline companies with higher debt structures and 10 to 12% returns on equity. However, an allowance of 12% over-all return for producers assumed substantially no debt; the staff figure assumed producer debt of 15%, thus reducing the need for an over-all return of 12% to 9½%. The return allowed by the Commission arguably could be said to contain an "incentive for further exploration" to the extent debt was in fact utilized by producers.

90. 390 U.S. at 808-12.

91. *Id.* at 817.

92. *Id.* at 816 n.99.

The examiner had adopted a method which would have required refunds only to the extent that overall industry revenues in the area exceeded overall industry expenditures in a given year. Guidance for application of the method was not developed further by the examiner than a proposal that amounts to be refunded should be "equitably apportioned among the appropriate sales under the rates subject to refund of the category in which the excess remains."⁹³ The FPC felt that such a method would result in inequities among wholesale customers as well as among individual producers, noting that "[i]f one wholesale customer has been overcharged it is of little comfort to him to know that another customer has received a bargain."⁹⁴ As a result, the FPC rejected this proposal and adopted in lieu thereof a rule requiring refunds as to rates in excess of area rates for all sales after the date of the *Permian* order and for all sales subject to proceedings under NGA § 4(e)⁹⁵ in which rates had been collected "subject to an obligation to refund amounts collected in excess of the just and reasonable rates" to be determined in the *Permian* proceeding.⁹⁶ Upon reviewing this series of proposals, the Supreme Court upheld the FPC's authority to order specific refunds using the area "just and reasonable rate" as a retroactive ceiling. The Court found that the FPC had reasonably rejected the examiner's proposal of a system of refunds conditioned on findings as to aggregate revenues; the FPC was free to conclude that the examiner's proposal would be both inequitable to consumers and difficult to administer effectively.⁹⁷

In sum, the Court maintained that in the adoption of the *Permian* methodology and selection of data, the FPC had given "reasoned consideration to each of the pertinent factors."⁹⁸ Presumably, it had also satisfied the requisites of judicial review which the court had stated at the outset would be fulfilled "if the Commission indicates fully and carefully the methods by which, and the purposes for

93. 34 F.P.C. at 375.

94. *Id.* at 232.

95. 15 U.S.C. § 717c (1970).

96. 34 F.P.C. at 232.

97. 390 U.S. at 825-28. In *Area Rate Proceeding*, 34 F.P.C. 1068, 1073 (1965), the Commission, issuing an opinion and order denying applications for rehearing of *Area Rate Proceeding*, 34 F.P.C. 159 (1965), estimated that the quality adjustments would range from .7 to 1.5 cents per Mcf on new gas well gas but would be affected by liquid credits. Specific allowance of the adjustment as cost would, of course, have expanded the element of incentive in the allowed return.

98. 390 U.S. at 792.

which, it has chosen to act, as well as its assessment of the consequences of its orders for the character and future development of the industry."⁹⁹ The Court did note rather wistfully, however, that ". . . we would expect that the Commission will hereafter indicate more precisely the formulae by which it *intends* to proceed. . . ."¹⁰⁰ Only Justice Douglas dissented from the Court's approval of the FPC's order, finding no compliance therein with the construction given to the NGA by the *Hope* case. While he conceded that group regulation of rates is not novel, he noted that where they had been approved, the rates fixed on the basis of group costs were for *typical* group costs of service, and the individual producer's right to minimum operating expenses and capital charges was protected.¹⁰¹ The profuse use of averages implicit in the FPC's method was thought by Justice Douglas "to take us with Alice [the Commission] into Wonderland."¹⁰²

FORMAL RULEMAKING AND INTERPRETIVE RULEMAKING IN THE SOUTHERN LOUISIANA PROCEEDINGS

A modest state of euphoria prevailed at the FPC when it issued its first order in the Southern Louisiana proceedings,¹⁰³ since the order came only a few months after the Supreme Court had sustained the Commission's *Permian* orders in their entirety. Producers had again adduced the argument that regulation was not necessary because competition prevailed in the area and field prices would adequately protect the consumers. The FPC again rejected the argument on the ground that "there is a concentration of control over the uncommitted reserves in southern Louisiana [which the producers] have made no showing to rebut."¹⁰⁴ The FPC thereupon applied its *Permian* two-price-system model, with historic costs for flowing gas and national costs for new gas. Substantially the same factor was allowed as adjustment for exploration in excess of production, using the same method adopted in *Permian* to arrive at this figure.¹⁰⁵

Producers again had urged that exploration and development

99. *Id.* (emphasis added).

100. *Id.* at 800 (emphasis added).

101. *Id.* at 831-32.

102. *Id.* at 836.

103. Area Rate Proceeding for Southern Louisiana, 79 P.U.R.3d 113 (FPC 1968).

104. *Id.* at 136.

105. *Id.* at 143-44.

expenses should be capitalized and amortized and again the argument was rejected.¹⁰⁶ They also had argued that the *Permian* method of arriving at a rate base by multiplying the successful well cost (depletion, depreciation and amortization expense) per Mcf by average years of recovery plus lag period provided inadequate incentive for exploration and development.¹⁰⁷ Nevertheless, in establishing the appropriate rate of return, the FPC adhered to the *Permian* model. Earnings-book ratios of the integrated producers were deemed to provide data for a return figure which could be adjusted to fit the risks of gas production by non-integrated producers.¹⁰⁸ The use of earnings-price data from the market with adjustments to take account of the difference between stock market prices and book investments, as employed in *Phillips*, was rejected by the FPC in favor of the earnings-book ratios.¹⁰⁹ Insofar as an incentive factor was included in the 12% rate of return finally approved by the FPC, it was not discussed. The staff had urged and introduced data on returns and debt ratios supporting only a 9½% return, but the FPC again allowed a 12% return with no hint that the rate contained an element of incentive for exploration.¹¹⁰ The FPC provided an implicitly conceded incentive for off-shore gas by fixing the price of new gas at 20 cents per Mcf with an adjustment of 1.5 cents per Mcf for the Louisiana severance tax when the tax was in fact 2.3 cents per Mcf.¹¹¹

The institution of the *Southern Louisiana* proceeding as a rule-making proceeding as well as an adjudicatory proceeding seemed in no way to affect the FPC's treatment of its ad hoc rules as they were developed in *Permian*. The rulemaking dimension was added only to insure that the rates announced as rules would be binding not only upon the natural gas producers in the actual proceedings "but [on] all those who are or may become producers in the future in this area."¹¹² Utilization of rulemaking power as a device to control the

106. *Id.* at 138-39.

107. *Id.* at 149-54.

108. *Id.* at 155-59.

109. *Id.* at 156-57. The FPC conceded that the use of such ratios would be "somewhat circular" with respect to traditional utilities but deemed the approach appropriate here. *Id.* at 157. For a discussion of the problems avoided here, see Dakin, *supra* note 21, at 736-41.

110. 79 P.U.R.3d at 157-59.

111. *Id.* at 215.

112. *Id.* at 218.

nature of the proceedings *prior to announcement of a price as a rule* was yet to come.

The FPC had before it a settlement proposal which it rejected on the ground that the rates and rate structure proposed would not be consistent with the just and reasonable rates determined.¹¹³ It particularly noted that the proposal did not limit initial or subsequent rate levels specified in contracts for new gas on new acreage.¹¹⁴ The Commission added that "[t]his is not to say that hard and fast ceilings are to be imposed indefinitely, impervious to change despite inflation or other unforeseeable events in the future," and announced that the rates established "will be modified if a showing is made that unit costs—reflecting amounts spent and reserves found—have increased to such an extent that an increase in area rates is required."¹¹⁵ It responded to the problem of special exemptions for hardship by noting that "certain principles" have been established. Thus "[o]verall high cost of service of an individual producer is not a ground for relief. *[But] the fact that current revenue from a particular well is less than the costs of continuing its production is a ground for relief.* [However] the fact that a producer can obtain a higher price elsewhere is not a ground for relief."¹¹⁶ The Commission noted that, "[i]n determining prices, then care must be taken that exploration and development will be sustained at an adequate level over the long run and that available supplies are not allowed to dwindle to a dangerous level."¹¹⁷ As in *Permian* it rejected the staff argument that lower prices for gas would increase exploration and development.¹¹⁸

JUDICIAL CRITICISM OF THE COMMISSION'S INTERPRETIVE RULEMAKING

Before the *Southern Louisiana* order had been argued on appeal, the FPC instituted new proceedings to reconsider the order.¹¹⁹ When the Court of Appeals for the Fifth Circuit later affirmed the original order, it anticipated that such hearings would result in sub-

113. *Id.* at 206.

114. *Id.*

115. *Id.* at 217-18.

116. *Id.* at 194 (emphasis added).

117. *Id.* at 209.

118. *Id.* at 209-10.

119. Phillips Petroleum Co., No. AR69-1, FPC, Dec. 15, 1969. See 34 Fed. Reg. 19833 (1969).

stantial modification of the rates set.¹²⁰

The first concern of the court of appeals was the fact that in spite of the Commission's optimistic conclusion regarding the adequacy of the rate selected, circumstances intervening since the Commission's decision indicated a substantial possibility that the supply of gas was dangerously low. The court felt that a serious shortage might already have become unavoidable because of conditions rendering any remedial action ineffective in light of the lag time between remedy and result.¹²¹ It criticized the FPC for failure to consider supply in relation to demand, noting that the FPC had assumed without supportive findings that the price would be sufficiently profitable to assure an adequate supply whatever the level of demand. The court characterized this approach as circular pricing—that is, where demand rises and cannot be satisfied out of reservoirs that are easily enough found to allow the entrepreneur his profit, increased demand will not be satisfied. The FPC, the court said, should have confronted the problem in “a semi-quantitative or qualitative way.”¹²²

The court of appeals was particularly critical of the ad hoc procedures used in determining “non-cost elements” in the price fixed and the failure to explain adequately the reasons for their use. “If the Commission approaches these matters forthrightly,” the court said, “it can expect a reviewing court to give great deference to its expertise, even when it ventures into new territory.”¹²³ In discussing the “non-cost elements,” the court noted that the Supreme Court in *Permian* had indicated the FPC was not bound by the sum of cost and return even if it adopted cost as the primary basis of its calculations.¹²⁴ While the court lamented the Commission's lack of precision in explaining such elements, it nonetheless approved the addition of 1.2 cents per Mcf for offshore gas implicit in the rounding of 18.8 cents per Mcf unit “cost” to a 20 cent ceiling and also approved the additional .8 cent per Mcf non-cost element resulting from the treatment of the severance tax as 1.5 cents per Mcf when its actual cost was 2.3 cents per Mcf.¹²⁵ The court did not allude to

120. Southern Louisiana Area Rate Cases, 428 F.2d 407 (5th Cir.), *cert. denied*, 400 U.S. 950 (1970).

121. 428 F.2d at 437.

122. *Id.* at 436. See also *id.* n.91.

123. *Id.* at 441.

124. *Id.* at 426.

125. *Id.* at 425.

the computed incentive "allowance for exploration in excess of production" as a non-cost element. Nor did it discuss under this rubric the incentive allowance presumably contained in the 12% rate of return.

With respect to cost determinations, after examining the FPC's rationale for selecting national cost figures over regional cost figures for pricing new gas, the court of appeals rejected the argument that the use of national costs to fix the price of new gas was not substantial evidence.¹²⁶ Since the cost determinations constituted rulemaking, although ad hoc in character, the court might have contented itself with the rule of *NLRB v. Hearst Publications, Inc.*¹²⁷ requiring only warrant in the record and a reasonable basis in law. The court did consider it disturbing that a dissenting commissioner listed cost determinations involving *choice of method* which, had the choices been different than they were, would have resulted in an increase of about 4 cents per Mcf of gas.¹²⁸

The court reserved its most stinging criticism, however, for the FPC's failure to comply with the *Hope* "end result" test, which required the Commission to find that "the total effect of the rate order cannot be said to be unjust and unreasonable. . . ."¹²⁹ Specifically, the court found that the FPC had refused to make findings as to overall demand for gas and had declined to estimate future supply in its order. Furthermore, the FPC had refused to make findings as to the appropriate "reserves to production ratio" or "findings to production ratio" or to assess the consequences of its orders on these ratios. The court particularly scored the FPC's determination that the rate order would reduce revenues on the order of \$49,000,000, a finding which was supported only by the statement that "[i]n our judgment, the revenues allowed . . . should foster an active exploratory program consistent with both the financial needs of the industry and the protection of the public interest."¹³⁰ The court quoted approvingly from the opinion of Justice Jackson in *Colorado Interstate Gas Co. v. FPC* that

if the supply is not too plentiful and the price is not a sufficient incentive to exploit it and fails to bring forth the quantity needed,

126. *Id.* at 432-33.

127. 322 U.S. 111, 131 (1944).

128. 428 F.2d at 433-34.

129. *Id.* at 435 n.87.

130. *Id.* at 437, quoting 4 Joint Appendix, pt. 1, at 683d (Commission's Opinion).

the price is unwisely low, even if it does square perfectly with somebody's idea of return on a 'rate base.'¹³¹

The court also seemed to be urging the Commission back to econometric studies, for it suggested the FPC should add to its *Permian* cost model additional ad hoc procedures which would include three steps with respect to the industry and its performance: (1) an estimate of the needs of consumer service (in other words, the demand for gas); (2) a determination of the level of service which the FPC intended to provide for, with an explanation of how that level was related to actual demand if demand was not to be fully satisfied; (3) findings made as specific as possible with regard to how the rate set by the FPC would affect the industry's tendency to meet the intended level of service (in other words, an estimate of the gas supply which the rate would bring forth). The court noted that if the FPC set a rate on a cost basis and did not consider these issues, its conclusionary statements that a rate was adequate or that there would probably be no need for changes in the future would amount only to "so much whistling in the dark."¹³²

On this note the court sustained the FPC orders without modification. However, as noted, the court did so because of the existence of new proceedings which were to take into account many of the issues whose absence had concerned the court.¹³³ The court specifically and emphatically rejected a contention of distributors that once the FPC had established rates determined to be just and reasonable, it had no power to set the rates aside when it later had reason to believe its determinations might have been erroneous. When this interpretation of the Commission's authority was questioned on petition for rehearing, the court made it "crystal-clear" that in its view, the power was vested in the FPC to reopen any part of its order as circumstances required. However, to obviate any further question, the court proceeded under the broad remedial powers inhering in a court of equity to make it part of the remedy in the case that the "authority of the Commission to reopen any part of its orders, including those affecting revenues from gas already delivered, is left intact. The Commission can make retrospective adjustments in this case if it finds that it is in the public interest to do so."¹³⁴

131. 324 U.S. 581, 612 (1945).

132. 428 F.2d at 444.

133. *Id.* at 444-45.

134. Southern Louisiana Area Rate Cases, 444 F.2d 125, 126-27 (5th Cir. 1970).

The court chose not to cite any decisional authority, contenting itself with reliance on the powers of the FPC under NGA § 16. Predictably, *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Railway*¹³⁵ had been cited by distributors and consumer representatives for the proposition that any retroactive reopening and modifying of the order was precluded.¹³⁶ However, the *Southern Louisiana* court could have distinguished *Arizona Grocery*, since in that case the ICC had sought in a later and entirely new proceeding to modify a rate it had previously found to be just and reasonable for future application. The Supreme Court had held in *Arizona Grocery* that the ICC could not in such a proceeding change retroactively a rate already legislatively determined. Relying upon principles of stare decisis, the Court had ruled that the ICC was "bound to recognize the validity of the rule of conduct prescribed by it and not to repeal its own enactment with retroactive effect."¹³⁷ In *Southern Louisiana*, however, the court of appeals was reaffirming only the FPC's authority to reopen its original order on the ground that its first determination might have been erroneous. An agency's power to do so, where statutorily authorized, had been upheld by the Supreme Court subsequent to the *Arizona Grocery* case in *Baldwin v. Scott County Milling Co.*¹³⁸ Nonetheless, in the *Southern Louisiana II* proceedings, in which such an original order was being reopened, the FPC relied wholly upon "instructions" from the court of appeals as to its powers under NGA § 16.¹³⁹

THE TRANSITION TO RATEMAKING AS RULEMAKING

In *Permian* the FPC had initiated its 1961 proceedings by issuing a notice and order for hearing under NGA § 5¹⁴⁰ that it proposed to fix just and reasonable rates.¹⁴¹ On the other hand, in reopening the proceeding in *Southern Louisiana II*, the Commission

135. 284 U.S. 370 (1932).

136. *Southern Louisiana Area Rate Proceeding*, CCH UTIL. L. REP. ¶ 11224, at 12801 (FPC 1971).

137. 284 U.S. at 389.

138. 307 U.S. 478 (1939).

139. CCH UTIL. L. REP. ¶ 11224, at 12801, discussing 15 U.S.C. § 717o (1970). The FPC rather gratuitously announced that "[a]s far as we are concerned, in the prescription of just and reasonable rates, Opinion Nos. 546 and 546A [*Southern Louisiana I*] now perform no office." *Id.* But their existence was at least the procedural basis for distinguishing the *Arizona Grocery* rule.

140. 15 U.S.C. § 717d (1970).

141. 24 F.P.C. 1121, 1123 (1961).

promulgated an "order instituting investigation and proposed rule-making."¹⁴² The new proceedings were then consolidated with the 1961 proceedings.¹⁴³

A first articulation of this new rulemaking approach of the FPC is found in the *Appalachian and Illinois Basin* area proceedings.¹⁴⁴ There were no prior NGA § 5 proceedings underway in *Appalachian and Illinois*. The entire proceeding was initiated by publication of a notice of proposed rulemaking (and the proposed rule contemplated) under APA § 4,¹⁴⁵ and a comprehensive report by the FPC staff consisting of a cost analysis of the model used in *Permian and Southern Louisiana* was attached thereto.¹⁴⁶ The procedure was attacked on the ground that it deprived parties of the full adjudicatory hearing to which NGA §§ 4 and 5 were said to entitle them. The FPC responded by noting that its power so to proceed had been clearly established in such cases as *Federal Power Commission v. Texaco, Inc.*,¹⁴⁷ and *United Gas Improvement Co. v. Callery Properties, Inc.*,¹⁴⁸ where it had determined a standard requiring "in-line" price by using rulemaking procedure. The Commission might have relied upon the fact that such certification under NGA § 7 constituted initial licensing and thus was partially exempt from APA § 5¹⁴⁹ along with ratemaking. Without making this point, however, the FPC stated that proceedings under NGA §§ 4 and 5 prescribe rates for the future, a function clearly exempted from adjudication under APA §§ 2(c), 2(d) and 5(c).¹⁵⁰ In light of this exemption of ratemaking from the adjudicatory requirements of the APA, the FPC reasoned that only the hearing requirements of APA § 4(b),¹⁵¹ providing that "when rules are required by statute to be made on the record after opportunity for an agency hearing, sections 556 and 557 [§§ 7 and 8] of this title apply . . .," would be applicable.¹⁵² Since §§ 7 and 8 merely insure that a qualified

142. CCH UTIL. L. REP. ¶ 11224, at 12800.

143. *Id.*

144. 86 P.U.R.3d 16 (FPC 1970). The new procedure was also utilized in Rocky Mountain Area Rate Cases, CCH UTIL. L. REP. ¶ 11222, at 12781 (FPC 1971).

145. 5 U.S.C. § 553 (1970).

146. 86 P.U.R.3d at 21.

147. 377 U.S. 33, 39-45 (1964).

148. 382 U.S. 223, 227-29 (1965).

149. 5 U.S.C. § 554 (1970).

150. *Id.* §§ 551(4), (6)-(7), 554(d).

151. *Id.* § 553(c).

152. 86 P.U.R.3d at 20-21.

examiner will sit on the matter and that an opportunity will be provided for exceptions to be taken to any proposed findings prepared by the staff or examining officers, and since these requirements had been satisfied, the FPC reasoned that there was no need for a full hearing with presentation of witnesses and cross-examination, unless there were substantial factual controversies. Finding none, it ruled that arriving at a proper rate order "without a full blown evidentiary hearing" was appropriate.¹⁵³ Presumably, in light of the exemption of ratemaking from adjudication in the APA, and in the absence of a provision in the NGA requiring that rates be fixed on the basis of a full adjudicatory hearing, the only restraint on the FPC would be the requirements of constitutional due process. In the absence of substantial factual controversies, submission of the staff report to interested parties with an invitation for comments thereon would seem to satisfy due process requirements. In any event the FPC so proceeded, concluding that "we believe the procedure we are following in this case is consistent with statutory and constitutional hearing requirements."¹⁵⁴

153. *Id.* Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. §§ 717c-d (1970), specify merely that "hearings" shall be held. *See also* Natural Gas Act § 15, 15 U.S.C. § 717n (1970).

154. 86 P.U.R.3d at 23. The Commission has been sustained in its use of rulemaking procedure. *City of Chicago v. F.P.C.*, 458 F.2d 731 (D.C. Cir. 1971). However, in *Chicago* the issue was not area prices but rather "the most appropriate pricing method to be applied to natural gas utilized in a pipeline's interstate system which is produced by the pipeline or its affiliated producing company from leases acquired after the date of determination of this issue." *Id.* at 737. "Evidentiary" hearings were held, but in reaching its decision the Commission relied upon extra-record data bearing on gas reserves, a procedure valid in rulemaking. The Commission was sustained by the court of appeals after "some inquiry into the factual predicate for the rules promulgated by the Commission . . ." *Id.* at 743. The court stated that while its inquiry into the "factual predicate" was to be "searching and careful," it would not substitute its judgment for that of the Commission. It thus refused to limit itself merely to the question of whether the rules promulgated bore some rational relationship to the regulatory objectives of the NGA but nonetheless kept within the allowable confines of the "rational basis rule" as enunciated in *NLRB v. Hearst Publications, Inc.*, 322 U.S. 111, 130-31 (1944).

While the *Chicago* proceeding was more limited in scope than would be the promulgation of an area price by rulemaking procedures, the Commission was nonetheless required to reconsider the underlying methodology used in the *Permian* model and to determine the appropriateness of its application to a pipeline producer as distinguished from an independent producer. As a consequence, *Chicago* can be said to approve the procedure in circumstances where the formal rule promulgated is underlaid by ad hoc rules normally arrived at in adjudication. The *Chicago* court presumably avoided constitutional due process attack by noting that "[i]f the pipeline is able to show in a rate proceeding that special circumstances exist which

In *Appalachian and Illinois* the FPC formally promulgated only the area rates as rules. With respect to the many alternative procedures for arriving at costs between which choices had been made in *Permian* to arrive at the final rates, the FPC said only that "the proposed rates are based on a cost analysis of the type used in *Permian* and *Southern Louisiana* for flowing gas."¹⁵⁵ It did not promulgate the *Permian* methodology as formal rules.

The sequence of events was somewhat different in *Southern Louisiana*, but the Commission nonetheless incorporated the new rulemaking approach. Thus, the original *Southern Louisiana I* decision issued on October 1, 1968, was followed by an order proposing new rulemaking proceedings for *Southern Louisiana* which was subsequently amended to provide for reopening the October 1, 1968 order as well.¹⁵⁶ The amendment followed the decision of the Court of Appeals for the Fifth Circuit affirming the October 1, 1968 order on the understanding that the FPC would reexamine its effects on supply and demand.¹⁵⁷ As noted, the court had indicated specifically that the FPC should explain the relationship between the level of service, the demand for service, and the price fixed, concluding that non-cost factors might be used to influence market variables such as supply and demand and to create price stability, but only if they were clearly identified and explained.¹⁵⁸

In this sequence of events moving toward greater use of rulemaking procedure, the *Texas Gulf Coast* area rate order,¹⁵⁹ issued prior to the *Southern Louisiana II* order, became the vehicle for re-examination and rearticulation of the *Permian* approach to area rate-making. In *Texas Gulf Coast*, an examiner's opinion and order had been prepared after a full adjudicatory hearing, but at the time *Southern Louisiana I* was reopened, a final decision had not yet been issued. In order to synchronize with the *Southern Louisiana II* orders both as a matter of administrative convenience and in order to assure that producers in similar circumstances, except for dif-

justify different treatment such a showing should be made by means of a special schedule and supporting evidence filed in addition to the material otherwise required by [the regulations]." 458 F.2d at 758.

155. 86 P.U.R.3d at 18.

156. CCH UTIL. L. REP. ¶ 11224, at 12800.

157. 428 F.2d at 444-45. See notes 119-22, 129-32 *supra* and accompanying text.

158. 428 F.2d at 441.

159. Area Rate Proceeding for Texas Gulf Coast Area, 89 P.U.R.3d 1 (FPC 1971).

ferences in areas, would receive similar treatment, the date of October 1, 1968 was selected as the *nunc pro tunc* effective date for *Texas Gulf Coast*. There was no reliance upon rulemaking procedures except insofar as the final rates ultimately determined were promulgated as rules.

In *Southern Louisiana I*, against a background of full adjudicatory proceedings, the producers' offer of settlement, in keeping with APA § 5(b),¹⁶⁰ had been rejected by the FPC "at most as an additional pleading, albeit one to which many of the conflicting interests would subscribe"¹⁶¹ The court of appeals reviewing *Southern Louisiana I*, however, had viewed the settlement agreement favorably, concluding that it presented incentive plans important to the attainment on an industry-wide basis of specified reserve dedication goals.¹⁶² In their offer of settlement the producers had proposed achieving such goals by increased prices and by ad hoc rules for the ratable forgiveness of refunds as new gas reserves were committed to the jurisdictional market.¹⁶³ While no offer of settlement was before the FPC in *Texas Gulf Coast*, it had in hand the offer for *Southern Louisiana* and, with the admonitions of the court of appeals in mind, was persuaded to rely upon the offer for guidance. Against this background, the FPC proposed to review the cost components for new gas, not with a view to departing from the *Permian* methodology, but "to give more attention to the range [of pricing results] which that methodology permits."¹⁶⁴ In the main, the "range" was to be broadened by examining data open to the "official notice" of the agency.¹⁶⁵ However, the Commission also proposed to examine "divergent methods of computation and varying selection of statistics" implicit in the *Permian* methodology.¹⁶⁶ It did not propose to distinguish between cost and non-cost elements to the full extent that it might have been authorized and urged by the court of appeals in *Southern Louisiana I*, nor did it propose to make the precise supply and demand findings which that court had suggested be made. Instead, the Commission proposed to adopt an approach which would quantify non-cost elements of cost

160. 5 U.S.C. § 554(c)(1) (1970).

161. 79 P.U.R.3d at 206-07.

162. 428 F.2d at 434.

163. See the dissenting opinion of Commissioner Carver, Area Rate Proceeding for Southern Louisiana, 80 P.U.R.3d 197, 241-43 (1969).

164. 89 P.U.R.3d at 16.

165. *Id.* at 17.

166. *Id.* at 29.

as far as possible and thus embrace them within the cost concept.¹⁶⁷ It proposed to search for a "surrogate for cost"¹⁶⁸ where precise costs were unascertainable and to make its selection of methods and data on the "high side" in order to improve the cash flow of producers and enhance the expenditures for exploration.¹⁶⁹ Thus the FPC reexamined the ad hoc rules prescribed as "methodology" in *Permian* and reexamined the selection of data and the effect of using later data in the application of the ad hoc rules of the methodology.

This reexamination generally "revealed" to the FPC a much broader zone of reasonableness within which the "judgmental process" could operate than was apparent from the original *Permian* and *Southern Louisiana I* opinions.¹⁷⁰ The Commission concluded that a credible, "high-side," range was from about 22 to about 26 cents per Mcf and within that range it fixed by rule 24 cents per Mcf

167. *Id.* at 10, 28. To explain why better proof was not made as to the responsiveness of supply to price, the FPC said "... a useful econometric model was impossible of construction given the number of variables and the time lag factors for this complex business." *Id.* at 28.

168. *Id.* at 18.

169. *Id.* at 29. One might have supposed that the FPC would have seized on the previous omission of a provision for a unit of income tax costs as an opportunity to improve the *Permian* methodology. In the *Permian* case producers had argued for the inclusion of 48 percent of the allowed return as an appropriate part of the unit cost per Mcf; the FPC had disallowed the inclusion in the model on the ground that "there will be no Federal income tax liability at any return up to 15 percent." 34 F.P.C. at 206, 388. This proposition is no doubt true since the options of percentage depletion and expensing intangibles are normally relied upon to eliminate tax liability. However, these tax concessions are deliberately made by Congress for the purpose of encouraging exploration, and not to allow provision in the rate for the tax thus saved is to defeat the purpose of the congressional subsidy—it can hardly be a subsidy if the producers are not permitted to collect it from their vendees. It is thus no answer to say that a tax allowance should not be included in the rate provision because there is no liability—the object of the special tax treatment is to relieve funds in the producers' hands from liability after they have been collected, thus making monies available for further exploration. If the FPC was making its selection of "methods and data" on the "high side" in order to improve cash flow and enhance expenditures for exploration, inclusion of a mythical tax factor would seem to have had the congressional blessing. Of course, the allowance for depletion was recently reduced by Congress when the hue and cry for more exploration had already begun, but that may have been only in keeping with the "political realities" of the Tax Reform Act of 1969, 83 Stat. 487 (1969) (codified in scattered sections of INT. REV. CODE OF 1954). The Senate Committee, in proposing reduction of percentage depletion, said that the "rate provided for oil and gas wells is higher at the present time [1969] than is needed to achieve the desired increase in reserves." S. REP. NO. 552, 91st Cong., 1st Sess. 179 (1969). The climate had changed substantially by 1971 when the *Southern Louisiana II* order was handed down.

170. 89 P.U.R.3d at 12-13.

as the just and reasonable rate for new gas. This rate, the FPC said, represented its judgment as to the level necessary to elicit additional supplies from the area.¹⁷¹ The Commission noted its more liberal approach: "Where we have a range of creditable choices within our costing model, we have exercised our judgment by making selections within the range on a cumulatively higher basis."¹⁷² The effect of selections of data from the "high-side" and, by official notice, from later data *dehors* the record,¹⁷³ may be seen in the tabular presentation of the cost model for *Texas Gulf Coast*.¹⁷⁴

171. *Id.* at 30. The Commission, in further observing that their rate determination took into account the relationship of other pricing areas, stated:

[I]n setting rates for the future, we cannot limit our consideration to one area, and ignore the nation-wide situation. We find that 24 cents is consistent with nationwide costs of new gas, and calculated to permit the interstate market to make some inroads into the trend of gas sales to seek the intrastate market in the Texas Gulf and other competitive market areas, nationwide. *Id.*

172. *Id.* at 29.

173. *Id.* at 17. The FPC said "... we have a wealth of postrecord data open to our notice. We will refer to the data base as so broadened for the computations in the sections following, because the purpose of that discussion is not to fix new costs on the line-by-line basis, but rather to show the breadth of the range of choices open to us." *Id.* Since the choice to be made was ultimately a rate expressed as a rule, such use of official notice was deemed justified. However, the postrecord data were also adjudicative facts to which ad hoc rules were being applied and which constitutional due process would dictate adducing on the record if the data were subject to controversy; "solicitation of comments" thereon would not necessarily be adequate. See K. DAVIS, ADMINISTRATIVE LAW TREATISE § 15.00, at 508 (Supp. 1970). The post-record data were not used merely "to verify" record data and were certainly "matters of substance" within the meaning of due process. See *Market St. Ry. v. Railroad Comm'n*, 324 U.S. 548, 561-62 (1945).

174.

<u>Cost Elements</u>	<u>COST OF NEW GAS-WELL GAS IN CENTS PER MCF</u>	
	<u>Examiner's Conclusion</u>	<u>Commission Range</u>
Depletion, Depreciation and Amortization of Production Investment Costs:		
Successful Well Costs	2.77	2.70-4.10
Lease Acquisition	1.13	1.13-2.03
Other Production Facilities	.34	.33-.73
Exploration and Development Costs:		
Dry Holes	1.44	1.64-1.97
Other Exploration Costs	1.70	1.29-2.18
Adjustment for Exploration in Excess of Production	1.16	-
Production Operating Expense	2.70	3.11
Return on Production Investment	4.90	6.24-10.29
Return on Working Capital	.35	.47-.72
Net Liquid Credit	(3.50)	(4.10)-(4.41)
Regulatory Expense	.14	.14
<u>Subtotal</u>	<u>13.13</u>	<u>12.95-20.86</u>
Royalty [at 14 percent of total]	2.30	2.27-3.65
Production Tax [at 6 percent]	.99	.97-1.57
Total	16.42	16.19-26.08

See 89 P.U.R.3d at 29.

The cost of flowing gas was not similarly reexamined but was increased to 15 cents per Mcf "[i]n order to assure that inaccuracy shall not result in the producers receiving less than their cost, including a proper rate of return" ¹⁷⁵ Fixed future escalation provisions were made for both new and flowing gas. ¹⁷⁶

The FPC also concluded that unless modification was made in the refund obligations of producers, new funds provided might be diminished in discharging such obligations. In light of this possibility, it provided by rule that refund obligations could be reduced by credits for each Mcf of new gas reserves committed by the producer to jurisdictional sales. ¹⁷⁷ Rate escalation rules, providing a pattern for increase in contract rates in effect prior to October 1, 1968, were also approved and made contingent upon the dedication of additional amounts of gas to interstate commerce. Commitments of new gas were, however, required to be applied first to the satisfaction of outstanding refund obligations and only thereafter as a basis for an escalation in price. All of these provisions were deemed necessary to attract new entrants to natural gas production in the area. ¹⁷⁸

After the decision in *Texas Gulf Coast* the *Southern Louisiana II* decision ¹⁷⁹ was almost anti-climactic. However, there were important procedural differences between the two proceedings. In *Southern Louisiana II* a final order had been issued by the FPC and affirmed by a court of appeals, albeit with the abortive admonition to reexamine the order in relation to supply and demand; a new investigation into area rates, coupled with an order for proposed rule-making therein, had been issued and designated as *Southern Louisiana II*; finally, the FPC had before it an offer of settlement from producers which it was prepared to accept, as distinguished from *Texas Gulf Coast* where the Commission merely utilized the offer as a guideline. ¹⁸⁰

The FPC made short shrift of arguments on behalf of public

175. *Id.* at 31-32.

176. *Id.* at 41-42.

177. *Id.* at 34.

178. *Id.* at 34-36.

179. *Southern Louisiana Area Rate Proceeding*, CCH UTIL. L. REP. ¶ 11224 (FPC 1971).

180. *Id.* ¶ 11224, at 12801-03.

bodies that it was without power to reopen and retroactively change a legislatively determined rate. It relied wholly upon the interpretation of its authority by the court of appeals which had specifically made the power to reopen any part of the *Southern Louisiana I* order an integral part of the remedy of the court.¹⁸¹ However, the Commission cautiously consolidated the *Southern Louisiana I* proceedings and order with the later proceedings, reopening the earlier proceedings presumably on a theory of mistake or new evidence. It was thus not merely changing an earlier determined rate in a new later proceeding and could be deemed in compliance with the *Arizona Grocery* and *Baldwin* cases.¹⁸² New orders were made effective from October 1, 1968, the date of the original order. The order providing notice of proposed rulemaking did not take the same form as in the *Appalachian and Illinois* proceeding since this proceeding did not purport to be wholly a rulemaking proceeding; coupled with the notice of proposed rulemaking was an order reinstituting investigation into the justness and reasonableness of natural gas rates in the Southern Louisiana area.¹⁸³ As in the case of *Appalachian and Illinois*,¹⁸⁴ however, ultimate results were cast as formal rules only as to the rates themselves.

Reexamination of the *Permian* model methodology and official notice of later data were largely a replay of what had been done in *Texas Gulf Coast*. As a result a price of 26 cents per Mcf was finally promulgated as a rule and termed "the just and reasonable rate subject to [specified] automatic escalation."¹⁸⁵ Reductions in refund obligations were promulgated as rules in the pattern of *Texas Gulf Coast* with the same justifications given for adopting the procedure.¹⁸⁶

CONCLUSIONS

What of the next round, presumably *Southern Louisiana III* or

181. *Id.* ¶ 11224, at 12800-01.

182. See notes 135-39 *supra* and accompanying text.

183. CCH UTIL. L. REP. ¶ 11224, at 12800.

184. 86 P.U.R.3d 16 (FPC 1970).

185. CCH UTIL. L. REP. ¶ 11224, at 12809. The need for the increase was challenged by the American Public Gas Association, and there were abortive attempts to impeach the declining reserve figures on which the FPC relied to sustain the increase. *Id.* ¶ 11224, 12805-06. For an industry response, see Johnson, *New Directions in the Regulation of the Gas Industry*, in 19TH ANN. INST. ON MINERAL LAW (1972).

186. CCH UTIL. L. REP. ¶ 11224, at 12811-12. See note 177 *supra* and accompanying text.

even a nationwide proceeding? In *Appalachian and Illinois*, the FPC said:

We recognize that as an administrative agency, governed by congressional mandate, we cannot take any action to raise or lower the price of gas—or take any other action relating to regulation—without affording due process to those affected, and without satisfying ourselves on all available evidence that the public interest, including the consumer interest in an adequate supply of natural gas, is protected

. . . .

On the other hand . . . [i]n application, the effect of commission action under [NGA] §§ 4 and 5 is prospective—the former from the time of filing for an increase, . . . the latter from the time of issuance of a final order therein. These proceedings are classified as rule makings under the APA . . . and the procedure we followed satisfies [that act]. Thus, these proceedings are valid since interested persons had “an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. . . .” Here interested parties were also given an opportunity to make an oral presentation *at a conference* A record was made of all evidence which was considered by us Thus, we find that the procedure followed in this case adequately satisfied both . . . the Natural Gas Act and . . . the APA.¹⁸⁷

It seems at least highly unlikely that, having rediscovered and adapted these APA “rulemaking” provisions, the FPC will not continue to use them in avoidance of the “full-blown” evidentiary hearing it once thought was imposed upon it by NGA §§ 4 and 5.¹⁸⁸

The new procedures and determinations resulting therefrom have yet to be fully tested in the courts.¹⁸⁹ It is not untimely, there-

187. 86 P.U.R.3d at 19-21 (emphasis added).

188. Under a policy recently announced, the FPC now proposes “to examine the justness and reasonableness of proposed rates in section 7 proceedings instituted under this section, thus avoiding the uncertainty of reserving rate determinations for subsequent section 4 or section 5 action.” 37 Fed. Reg. 16192 (1972). “Contracts approved unconditionally pursuant to the alternative procedure will be free from any later attempt to impose a refund obligation.” *Id.* at 16193. *See also id.* at 18721, 20114. Thus, ad hoc interpretive ratemaking criteria may now be formulated in a rulemaking procedure which is not even addressed to ratemaking as such but to certification under § 7. The process may thereby be further removed from the ability of public interest bodies to scrutinize, since certification proceedings will be as frequent as there are new transactions to certify as compared with the relative infrequency of an area price proceeding.

189. Since this article was set in type, the decision in *Rocky Mountain Area Rate*

fore, to consider the legislative history underlying the APA exemption of rulemaking from full adjudicatory requirements, and it is also pertinent to reexamine the reasons for including ratemaking in the rulemaking process rather than in the adjudicatory process.

As noted earlier, it seems reasonably clear that a major objective of the APA draftsmen in including ratemaking in rulemaking was exemption from the full separation of functions requirements which the APA imposed upon adjudication.¹⁹⁰ Commentaries at the time of the adoption of the APA indicate that the ratemaking processes were deemed so complex and so rife with policy determinations that they should not be left to the initial determination of a single examiner as would be the case in adjudication proper. By the exemption of ratemaking from the adjudication provisions the way would be open to initial preparation of proposed findings by the staff with full opportunity to draw upon all of the expert resources of the agency.¹⁹¹ The same importance was not accorded the greater control over the nature of the hearing which the rulemaking processes vested in an agency because the agency was not required to accord full participation by parties but only an opportunity to be heard to interested persons.

There is the suggestion in the legislative history, however, that when exempted proceedings become accusatory in form or involve sharply controverted issues, the exemption should not apply and adjudicatory requirements should be met by the agency.¹⁹² The General Counsel for the FPC in 1946 argued that such an interpretation was contrary to the plain meaning of the APA, since all types of ratemaking, including the retrospective finding of an unreasonable rate as well as a rate reasonable for the future, were placed within the rulemaking procedures.¹⁹³ But the Solicitor for the SEC noted

Cases, CCH UTIL. L. REP. ¶ 11222 (FPC 1971), which incorporated the procedure, has been upheld by the Tenth Circuit. *Phillips Petroleum Co. v. FPC*, CCH UTIL. L. REP. ¶ 11386 (10th Cir. Feb. 20, 1973). For a discussion of the case, see note 231 *infra*. One commentator has noted that if the rulemaking approach survives challenge, "a nation-wide proceeding to . . . review gas producer's rates . . . will probably be a rulemaking case with no hearing. . . ." Johnson, *supra* note 185.

190. See note 15 *supra* and accompanying text.

191. See S. Doc. No. 248, *supra* note 6, at 203-04, 209-10.

192. *Id.* See Foster, *supra* note 16, at 243, quoting Comments from SEC to Senate and House Committees on the Judiciary, July 25, 1945.

193. Ross, *Federal Power Commission Practice and Procedure as Affected by the Administrative Procedure Act of 1946*, in *THE FEDERAL ADMINISTRATIVE PROCEDURE ACT AND THE ADMINISTRATIVE AGENCIES* 170, 178-79 (G. Warren ed. 1947).

that the effect of the exemption was only to provide for what might be called a "functional" approach by the agencies—that is, to avoid by exemption from adjudication, controversies as to how particular procedures should be labeled under the terminology of the APA and thereby to focus attention on what procedural steps the parties considered appropriate. Thus, the Solicitor indicated that the rules of practice of the Securities and Exchange Commission made it the duty of the parties to specify as early as possible in the proceeding what procedures they deemed necessary or appropriate; the examiner was then charged with reaching a clear understanding as to the procedure which the parties desired.¹⁹⁴ The Solicitor further noted, however, "[o]f course the Administrative Procedure Act would not deprive public security holders of any procedural rights to which they might be entitled as a matter of due process or otherwise, apart from the requirements of the Act."¹⁹⁵

Since there is no retroactive reparations power vested in the FPC except for rates in excess of approved schedules,¹⁹⁶ whether or not retroactive ratemaking is wholly or only partially exempt from the adjudicatory requirements of the APA is not of immediate concern. However, a plausible analysis of the APA can be made which would leave retroactive ratemaking within adjudication with regard to party participation and exempt it only from the adjudicatory safeguards requiring separation of functions. This result would follow from the fact that *past and prospective* ratemaking is exempted in the APA from § 5(c),¹⁹⁷ the requirements on separation of functions in adjudication, but only *prospective* ratemaking is included in rulemaking as defined in APA § 2(c).¹⁹⁸ Thus *past* ad hoc interpretive rulemaking in ratemaking would require full adjudicative party participation in both the formulation and application of rules promulgated therein.¹⁹⁹ And since NGA §§ 4 and 5 require a hearing incident to fixing just and reasonable rates, APA § 4(a)²⁰⁰ should not operate to exempt interpretive or ad hoc rulemaking in

194. Foster, *supra* note 16, at 221-22.

195. *Id.* at 242.

196. See Natural Gas Act § 4, 15 U.S.C. § 717c(e) (1970).

197. 5 U.S.C. § 554(d)(2)(B) (1970). See also Administrative Procedure Act § 2(c), 5 U.S.C. § 551(4) (1970): "[R]ule' means the whole or a part of an agency statement of general or particular applicability of future effect designed to implement, interpret, or prescribe law or policy"

198. 5 U.S.C. § 551(4) (1970).

199. Administrative Procedure Act § 5(b), 5 U.S.C. § 554(c) (1970).

200. 5 U.S.C. § 553(b)(3)(A) (1970).

connection therewith from the notice and participation requirements of APA § 4,²⁰¹ as would be the case if there were no such NGA requirement.

Assuming that *formulation* of ratemaking criteria such as the *Permian* methodology can now be carried on as rulemaking in accordance with APA § 4(a) and (b),²⁰² what degree of participation is assured to parties in the adjudicative fact-finding process incident to *applying* the interpretive methodology or ad hoc rules? Since the APA assures no more than rulemaking participation with respect to *all* prospective ratemaking, there could be substantial factual controversies in rules *application* where the parties need not, under the APA, be afforded an opportunity to offer rebutting testimony through witnesses or to cross-examine witnesses submitting either documentary or oral evidence. However, if such opportunities are denied in reliance upon the APA, parties could plausibly fall back upon constitutional procedural due process²⁰³ as guaranteeing such greater participation even though not provided by the APA. Congress can maximize the agency's utilization of expert resources and facilitate the agency's conservation of money and personnel by relegating the actual rulemaking aspects of ratemaking to the lesser protection of limited participation provided in APA rulemaking; where there are truly substantial controversies over *adjudicative* facts, however, the Constitution would seem to require a "full-blown" evidentiary hearing.²⁰⁴

The *Texas Gulf Coast* and *Southern Louisiana* area rate proceedings were both initiated under NGA §§ 4 and 5 and conducted as full evidentiary hearings with presentation of witnesses and cross-examination, all in full compliance with § 5²⁰⁵ of the APA. As a consequence, the ad hoc formulations of *Permian* methodology for area rates were made in a full adjudicatory context with opportunity for parties and intervenors to take exception to such formulations and to propose counter-formulations or rules.

201. An exemption for interpretive or ad hoc rules is provided only from the requirement of publication before effectiveness by virtue of APA § 4(c), 5 U.S.C. § 553(d)(2) (1970), which makes such publication inapplicable to "interpretive rules and statements of policy."

202. 5 U.S.C. §§ 553(b), (c) (1970).

203. See note 195 *supra* and accompanying text.

204. See *Ohio Bell Tel. Co. v. Public Util. Comm'n*, 301 U.S. 292 (1937); *United States v. Abilene & S. Ry.*, 265 U.S. 274 (1924).

205. 5 U.S.C. § 554 (1970).

However, in the *Appalachian and Illinois* proceedings, it will be recalled, the entire procedure was based on the exception of ratemaking from the adjudicatory provisions of the APA and was *entirely* conducted as proposed rulemaking pursuant to § 4²⁰⁶ of the APA. A copy of the FPC staff's comprehensive report was attached to the notice, the notice stating that the staff recommendations largely reflected standards and principles approved by the courts in the *Permian* rate decision. The FPC solicited comments thereon by interested persons and stated that it would make appropriate revisions; it indicated, however, that since many of the usual area rate controversies would not be in issue, it saw no need for the lengthy full hearing approach.²⁰⁷ In other words, in lieu of the full adversary setting of *Permian* in which representatives of state public service commissions and consumer groups were given status as intervening parties with full opportunity to cross-examine producers' witnesses as to methodology and in which producers' counsel were given the same opportunities with respect to staff and public distributors' witnesses, the FPC proposed to proceed and did proceed on the basis of "comments of all interested parties, supplemented by conferences and such limited hearings as might be requested and deemed by it to be necessary."²⁰⁸

The new rulemaking approach to ratemaking matters thus raises serious questions as to whether the public interest will be adequately protected therein.²⁰⁹ It poses the danger that "settlement proposals" by producing interests may not be subjected to the same scrutiny as they would under the full adversary adjudicatory process. The setting may be one in which the FPC may unduly indulge its

206. *Id.* § 553.

207. 86 P.U.R.3d at 19-23.

208. *Id.* at 21.

209. The need for "streamlining" procedure because of the number of parties involved would be considerably diminished if regulation were confined to the 70 producers of 90 percent of the gas, thus very substantially reducing the administrative burden. In that event, of course, the case for full adjudicatory procedures would also be more formidable, since public hearings with full intervention by public service commissions and other consumer bodies would be a crucial weapon in safeguarding the public interest in the consideration of methodology and selection of data. The limited number of participants might also underscore the need for scrutiny of the state of industry concentration under the antitrust laws. See Diener, *Area Price Regulation in the Natural Gas Industry of Southern Louisiana*, 46 TULANE L. REV. 695, 721-23 (1972). But see *Texaco, Inc. v. FPC*, 41 U.S.L.W. 2332 (D.C. Cir. Jan. 2, 1973), for the judicial view that such "deregulation" of small producers, though imaginative, outruns FPC statutory powers.

preoccupation with "industry consequences" such as the "worsening gap between supply and demand" and with the proposition that "price must have a major responsibility for eliciting new supplies,"²¹⁰ to the detriment of the public interest in the elimination of monopoly profit and conservation of a scarce resource.

The primary reason for the inclusion of ratemaking in rulemaking and the exclusion of rulemaking from adjudicatory requirements in §§ 5(c) and 8(a)²¹¹ of the APA was to free the agencies from the single examiner decisional technique and thus to make possible a decisional pattern permitting the full expertise of the agency to be brought to bear in the formulation of policy rules and procedures where complex ratemaking and other financial issues were involved.²¹² The exemptions were also a recognition of the legislative character of ratemaking and the formulation of rules for the determination of rates, particularly for the future.²¹³ Only when a substantive regulatory statute itself provided opportunity for an agency hearing, and rules were to be made upon the record therein, was there to be a limited application of the adjudicatory procedures—that is, provision for a qualified examiner to preside at the hearing and to participate in the decision with agency discretion to substitute for an examiner's report a recommended decision by the staff. Even with the staff participation in the rulemaking decision, however, there was clear recognition in APA § 8(b)²¹⁴ of the constitutional requirements imposed by *Morgan v. United States (Morgan II)*²¹⁵ as to notice of the issues and opportunities to meet them fairly.²¹⁶ Thus, where the examiner report procedure was to be departed from and a recommended decision submitted by a "responsible employee," § 8(b)²¹⁷ required that adverse parties be afforded an opportunity to take exception to such recommended decision and to present opposing findings and conclusions. There did not appear to be any legislative intent to remove the prosecuting staff from an

210. Southern Louisiana Area Rate Proceeding, CCH UTIL. L. REP. ¶ 11224, at 12803 (FPC 1971).

211. 5 U.S.C. §§ 554(d), 557(b) (1970).

212. See note 190 *supra* and accompanying text.

213. See note 190-91 *supra* and accompanying text.

214. Administrative Procedure Act § 8(b), 5 U.S.C. § 557(c) (1970).

215. 304 U.S. 1 (1938).

216. *Id.* at 18 ("[t]he right to a hearing embraces not only the right to present evidence but also a reasonable opportunity to know the claims of the opposing party and to meet them").

217. 5 U.S.C. § 557(c) (1970).

advocate's adversary position even though the initial recommended decision might not be prepared under full separation-of-functions conditions.

In the *Permian* proceedings, the FPC adhered to full adjudicatory procedures and a full adversary position for the staff with no mention of "proposed rulemaking" in the initial notice and order for investigation of rates. The examiner was fully qualified under APA §§ 7 and 11²¹⁸ and prepared an initial decision without participation by the staff.²¹⁹ Except as agency expertise was reflected in the staff exhibits and staff participation in the hearing, there was no other utilization of agency expertise of a character to violate the separation of functions requirements of the APA. In fact, in *Permian* the examiner called his own witness in order that he might have the benefit of a relatively disinterested party's comments on the various proposed models for area rates and for procedures thereunder.²²⁰ The staff, producers and intervening parties all filed briefs with the examiner preliminary to his decision. This procedure was repeated when the examiner's report was submitted to the FPC for review and issuance of a final decision. Throughout the proceedings the staff occupied a full adversary position vis-à-vis the producers, and no attempt was made to utilize the procedures available under §§ 5(c) and 8(a) of the APA.²²¹

In its present utilization of the rulemaking procedures, as exemplified in the *Appalachian and Illinois* case, the FPC, of course, evidences an intention to comply fully with the constitutional requirements of notice and opportunity to be heard set forth in *Morgan II*²²² and to accord an adjudicatory hearing in a conventional public hearing arena wherever there are factual controversies.²²³ Absent pressure for such an adjudicatory hearing, however, the staff's role is one of submitting written analyses of data submitted by producers pursuant to questionnaires, with the *Permian* model and methodology to be applied thereto.

The results of the examiner's deliberations in *Permian* were embodied in an examiner's initial decision which was served on the

218. *Id.* §§ 556, 3105.

219. 34 F.P.C. at 172.

220. *Id.* at 308.

221. 5 U.S.C. § 554(d), 557(b) (1970).

222. See notes 214-17 *supra* and accompanying text.

223. 34 F.P.C. at 238.

producers, the staff and the intervenors. The ad hoc methodology (interpretive rules) adopted by the examiner was subjected to searching criticism, with the relative merits of ad hoc methods adopted by the examiner compared with the alternatively proposed rules of the opposing parties.²²⁴ Under the new procedure there need be no such full airing of ad hoc methodology. Proposals for changes in the *Permian* model and the data utilized will be contained in an FPC staff report and served on the producers and other interested parties. However, there will be no routine public hearings in which the staff proposals and the responses and criticisms will be subject to the public spotlight: "[T]he staff's recommendations will be considered in light of any comments submitted by interested persons, and . . . [the FPC] would make appropriate revisions."²²⁵

While this procedure satisfies the *Morgan II* requirement embodied in APA § 8(b)²²⁶ that adequate notice of the proposed ad hoc procedures be served on the affected parties, since the report of the FPC staff is the equivalent of the examiner's initial decision in this respect, the *public hearing* drops out and is supplanted by comments on the staff report to be "considered" by the FPC with the possibility such comments may elicit revisions.²²⁷ This procedure

224. 86 P.U.R.3d at 21.

225. *Id.* In some respects the FPC approach stops short of what has been done by the Federal Communications Commission (FCC), and in some respects it moves beyond the FCC. The FCC has attempted to move the staff into the decisional process by limiting its role in the hearings to the development of a full and complete record and by forbidding the staff from taking a conventional adversary position. However, the FCC adheres to full public evidentiary hearings with the omission of full adversary participation therein by the staff. On this basis the FCC justifies drawing the staff into the decisional process. See *American Tel. & Tel. Co.*, 2 F.C.C.2d 142, 146 (1965). On the other hand, the FPC staff is apparently not precluded from vigorous advocacy in reporting on the application of the *Permian* cost model to data submitted by producers and others, but full evidentiary hearings will not be had unless there are "substantial factual controversies." *Appalachian and Illinois Area Proceeding*, 86 P.U.R.3d 16, 21 (FPC 1970). Both the FCC and FPC eliminate the examiner's role. It has been suggested that the FCC errs in limiting the staff's role as advocate, K. DAVIS, *supra* note 173, § 13.00, at 449-57 (Supp. 1970), and that, without resorting to such limitation, it could still utilize the staff in the decisional process if staff and other ex parte views were available for exception in a recommended decision, with no participation thereafter. This procedure would also meet the criticism of FCC Commissioner Loevinger that FCC procedure permits one party, the staff, access to ex parte advocacy while denying it to other parties, particularly the utility. 2 F.C.C.2d at 163 (Loevinger, C. dissenting).

226. 5 U.S.C. § 557(c) (1970).

227. The recommendations of the Administrative Conference, S. Doc. No. 24,

may pose great danger in removing the staff from the full advocate-adversary role performed by it in a conventional public rate hearing. While the letter of the *Morgan II* decision would appear to be complied with, it is less clear that its spirit has been met. In *Morgan v. United States (Morgan I)*²²⁸ the Supreme Court said that "[a] proceeding of this sort . . . has a quality resembling that of a judicial proceeding."²²⁹ Part of the resemblance would certainly lie in the routine public quality of a judicial proceeding with availability for press and other media coverage. While in the present approach, the *producers* are clearly accorded the "cherished judicial tradition embodying the basic concepts of fair play"²³⁰ set forth in *Morgan II*, a question might well be raised whether the newly evolved procedures will assure completely fair play and full development of methodology in the public interest by the FPC staff, as aided by the public service commissions and consumer and conservation groups.

The weakness of the FPC's proceeding under formal rulemaking with the rate and accompanying terms and conditions as the only formal rule promulgated, is that the procedure submerges and devitalizes both the role of the interpretive ad hoc rulemaking process, as seen in the formulation of the *Permian* model and methodology, and the vital role of the adjudicative fact-finding process, as seen in the selection of data to which the *Permian* model and methodology were to be applied. It seems doubtful that the APA draftsmen intended this result even though the literal words of the Act seemingly permit it.²³¹

88th Cong., 1st Sess. 103-06 (1963), provide a possible solution in lieu of the experimentation now going on at the FCC and FPC. The Conference recommends preserving the traditional role of the examiner and public hearing but giving the examiner greater access to expert assistance in the preparation of his initial decision, thus speeding up the process. In the greater flexibility provided by the APA's classification of ratemaking as rulemaking, such expert assistance could even come from the staff advocates so long as their views were identified and thus subject to exception. See K. DAVIS, *supra* note 173, § 13.00, at 455-56 (Supp. 1970).

228. 298 U.S. 468 (1936).

229. *Id.* at 480.

230. 304 U.S. at 22.

231. See discussion beginning at note 3 *supra* and accompanying text. As noted earlier, the draft bill from which the idea of "ratemaking as rulemaking" was derived, S. Doc. No. 248, *supra* note 6, at 161, 166, provided for the formal publication of interpretive rules presumably with application to follow in adjudicative proceedings. It is also to be noted that in commenting upon the incorporation of ratemaking as rulemaking, a spokesman cautioned that "[t]here are . . . some instances . . . which tend to be accusatory in form and involve sharply controverted factual issues to which agencies should not apply the exceptions because they are not to be

interpreted as precluding fair procedure where it is required." *Id.* at 203-04. The comment might have been meant as a suggestion that adjudicative fact finding incident to application of interpretive rules formulated in a ratemaking proceeding would require full evidentiary hearings at the agency level. But the compromise resulted in a transfer of the entire ratemaking process from adjudication to rulemaking, leaving untouched the exemption of interpretive rules from formal rulemaking procedures. If the draftsmen had intended to completely free interpretive rulemaking in ratemaking from adjudicative processes, they might have provided a parenthetical exclusion of ratemaking in Administrative Procedure Act §§ 4(a), 4(c), 5 U.S.C. §§ 553(b)(3)(A), (d)(1) (1970). Since the draftsmen did not do this, arguably they intended as to interpretative rulemaking, even in ratemaking, "to leave the matter of notice and public procedures to the discretion of the agencies concerned."

A commentator on the FPC utilization of its newly discovered rulemaking powers has suggested that:

When the rule-making power of an agency depends on a general statutory authority to adopt rules and regulations, the crucial questions in each instance of its application to issues that are also subject to adjudication is whether the statute by implication requires these matters to be determined case by case and whether affected parties possess procedural rights not accorded in the rule-making hearing Fuchs, *Agency Development of Policy Through Rule-Making*, 59 Nw. U.L. REV. 781, 800 (1965).

Since this paper was set in type, the Tenth Circuit has upheld, in *Phillips Petroleum Co. v. FPC*, CCH UTIL. L. REP. ¶ 11386 (10th Cir. Feb. 20, 1973), the authority of the FPC to proceed by rulemaking procedures in fixing area rates. However, the majority opinion strays far afield in sustaining the power of the FPC. The court accepts the reasoning that, because the APA classifies ratemaking as rulemaking, to achieve exemption from the separation of functions limitations of APA § 5(c), 5 U.S.C. § 554(d) (1970), the ratemaking function may be deemed a conventional rule issued pursuant to NGA § 16, 15 U.S.C. § 717o (1970), which merely defines terms or prescribes the form and content of statements. This "bootstrap" operation enables the court to conclude that the NGA vests a "very broad discretion" in the FPC in determining the form of its proceedings. Thus, the FPC is seemingly sustained in its statement that

In a rulemaking proceeding, *such as the instant one*, our primary objective is the acquisition of information which will enable us, *inter alia*, to determine just and reasonable rates The purpose is not to allow interested parties to define the issues or narrow the scope of the proceedings. On the contrary, in soliciting comments . . . and in relying upon the experience gained through previous area rate proceedings, we are building a record from which we can make a determination of . . . producer rates CCH UTIL. L. REP. ¶ 11386, at 13772 (emphasis added).

The majority of the court were unwilling to perceive that a ratemaking proceeding is not just ordinary "rulemaking" but is the formulation of ad hoc rules which may be vigorously opposed with respect to their content and operation, as well as in their application to often conflicting facts. A strong dissent notes the possibility of such disputed issues of fact which should be resolved in an evidentiary hearing. The controversy will no doubt be resolved by the Supreme Court if the circuits differ on the issue, or possibly, because of its importance, even if they do not. In that forum, it is to be hoped that the hybrid status of ratemaking as ad hoc rulemaking and fact finding, and the legislative history which indicates that the rulemaking exception was intended primarily to allow staff participation in the decisional process and not to limit the adversary process, will be more fully explored.