Opinion No. 154

Williams Pipe Line Company
21 FERC ¶ 61,260 (1982), reh'g denied,
22 FERC ¶ 61,086 (1983)

As a result of the remand to the Federal Energy Regulatory Commission by the Court of Appeals for the District of Columbia of Farmers Union Central Exchange, et al. v. Federal Energy Regulatory Commission, 584 F.2d 408 (D.C. Cir. 1978) (Farmers Union I), the Commission issued Opinion No. 154. (Williams Pipe Line Company, 21 FERC ¶ 61,260 (1982), reh'g denied, 22 FERC ¶ 61,086 (1983)).

The Commission's Opinion included a discussion of the history of the oil pipeline industry. (Id. at 61,578-61,583). The Commission used three basic premises upon which its ultimate determinations were grounded. These premises were: (1) oil pipeline regulation would prevent discrimination among shippers (Id. at 61,584); (2) oil pipeline rates have a minuscule impact on ultimate consumers (Id. at 61,585); and (3) the oil pipeline industry is generally subject to competitive market forces. (Id. at 61,608).

The Commission's regulatory approach in Opinion No. 154 would have left rate determinations generally to market forces, and used regulatory scrutiny only when a proposed rate change is protested by a shipper or other interested party. The Commission also ordered its staff to refrain from instituting oil pipeline rate proceedings in the absence of protests. (Id. at 61,612).

The Commission also adopted the valuation rate base methodology that had been traditionally employed for oil pipeline regulation. (Id. at 61,632, 61,696 n.295). However, the Commission did not adopt a traditional industry-wide guideline for rate of return. It took a new approach, to be applied on a case-by-case basis, which included a real entrepreneurial rate of return on the equity component of the valuation rate base. The Commission also held that the results produced by these methods would be acceptable as long as they did not produce abusive results. (Id. at 61,644-49).

Opinion No. 154

Williams Pipe Line Company,
21 FERC ¶ 61,260 (1982), reh'g denied,
Opinion and Order on Remand from the
United States of Court of Appeals for the
District of Columbia Circuit with Respect to
the Contemporary Validity of Traditional
Standards for Testing the Legality of Oil
Pipeline Rates: (1) Reaffirming Those Standards
in the Main but Modifying Them in Certain
Respects Insofar as the Computation of the Rate
Base is concerned; (2) Prescribing New Criteria
for the Derivation of Maximum Permissible Rates of
Return; (3) Dealing with Certain Other Relevant Matters;
and (4) Directing Further Proceedings Herein for the
Purpose of Applying the Revised Standards to the Facts
in the Instant Case
22 FERC ¶ 61,086 (1983)

[¶ 61,260]

Williams Pipe Line Company, Docket No. OR79-1-000, et al.

Opinion No. 154; Opinion and Order on Remand from the United States Court of Appeals for the District of Columbia Circuit with Respect to the Contemporary Validity of Traditional Standards for Testing the Legality of Oil Pipeline Rates: (1) Reaffirming Those Standards in the Main but Modifying Them in Certain Respects Insofar as the Computation of the Rate Base is Concerned; (2) Prescribing New Criteria for the Derivation of Maximum Permissible Rates of Return; (3) Dealing with Certain Other Relevant Matters; and (4) Directing Further Proceedings Herein for the Purpose of Applying the Revised Standards to the Facts in the Instant Case

(Issued November 30, 1982)

Before Commissioners: C. M. Butler III, Chairman; Georgiana Sheldon, J. David Hughes, A. G. Sousa and Oliver G. Richard III.

Appearances

John M. Cleary, Frederic L. Wood, and *Edward J. Twomey* for Mid-Continent Petroleum Shippers

Donald L. Flexner, Donald A. Kaplan, Robert Fabrikant, Peter J. Tomao, Nancy H. McMillen, Jade Alice Eaton, Rosalyn J. Rettman, Arlene Pianko Groner, and *Margaret Guerin-Calvert* for the United States Department of Justice

Robert Hallman, Lawrence A. Gollomp, Bruce C. Driver, and *Michael D. Oldak* for the United States Department of Energy

Robert F. Scott, Michael J. Hogg, Harold E. Spencer, and *Stephen C. Herman* for C. F. Industries, Inc.

Robert G. Bleakney, Jr., David M. Schwartz, Robert L. Calhoun, Paulette S. Kessler, William J. Collingsworth, John S. Estill, and *Bradford G. Keithley* for Williams Pipe Line Company

Howard J. Trienens, Frank L. Heard, Jr., Charles E. Graham, James R. Kinser, Howard D. McCloud, Emil A. Wienecke, Jures M. Perlberg, Shalom L. Kohn, R. Eden Martin, Lawrence A. Miller, and *Patrick H. Corcoran* for the Association of Oil Pipelines

A. Duncan Whitaker and *W. Thomas Haynes* for Explorer Pipeline Company

H. Newell Williams, John T. Updegraff, Robert E. Jordan III, Steven H. Brose, and *Clifford G. Holderness* for Arco Pipe Line Company

Kent B. Hampton, John E. Compson, James F. Bell, and *Thomas E. Fennell* for Marathon Pipe Line Company

Cheryl C. Burke and *William A. Hutchins* for Phillips Pipe Line Company

Jack D. Head, Bolivar C. Andrews, James W. McCartney, Albert S. Tabor, Jr., and *Carol A. White* for Texas Eastern Transmission Corporation, Trans-Ohio Pipeline Company, and Allegheny Pipeline Company

Thomas M. Davidson, Jack W. Hanks, Allan B. Garten, and *Jay A. Zawatsky* for MAPCO Inc.

Jack Vickery and *Cary V. Sorensen* for Belle Fourche Pipeline Company and Acorn Pipe Line Company

John A. Ladner, Sherman S. Poland, James G. White, Jr., and *William A. Mogel* for Sun Pipe Line Company

Albert R. Beal, Robert H. Young, and *C. Stephen Angle* for Buckeye Pipe Line Company

Frank J. Duffy, Walter E. Gallagher, and *Peter C. Lesch* for Hydrocarbon Transportation, Inc.

Frank L. Heard, Jr., Clifton D. Harris, Jr., Richard J. Flynn, Eugene R. Elrod, and *Stephen S. Hill* for Exxon Pipeline Company

George M. Knapp, James L. Lewis, Gwendolyn D. Prioleau, and *Maureen Wilkerson* for the Staff of the Federal Energy Regulatory Commission

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Background

Oil pipelines are expensive. In the argot of economists, they are "capital-intensive." [1] As a result, there is a substantial barrier to entry into the industry in the sense that substantial resources are a prerequisite to entry.

Oil pipelines have often been built by large oil companies for fairly fundamental reasons. First, they have the wherewithal. Second, they face the practical necessity of moving their product to market. Thus, they have a significant self interest in moving their own crude from wellhead to refinery and their own finished product from refinery to market. [2]

When it comes to transportation, the large integrated oil companies are their own best customers. At first blush, the rates that they charge themselves for transportation services would seem to matter only to themselves. [3] They are simply transferring money from one pocket to another. That *looks* like mere bookkeeping. But it can be more than that. In the situation referred to in footnote 3 it *is* more than that. And some think that oil pipeline rates can be of some social significance even when there is only a single shipper-owner and even when that shipper-owner is its own sole customer.

Suppose that the shipper-owner gives its pipeline operation a large measure of autonomy. Suppose further that it treats the pipeline as an independent profit center. In that event, the integrated firm will treat the full amount of the pipeline charge that it pays to itself as a real cost, indistinguishable from other real costs incurred in arm's-length transactions with unaffiliated suppliers.

If that be so, the people who set the integrated firm's pricing policy will seek to pass the full amount of the pipeline charge on to the ultimate consumer of the firm's products. They will give little or no weight to the fact that a substantial portion of that charge returns to the firm itself in the form of pipeline profit. Should this scenario be accurate, consumers have a stake in these rates, even in those of a pipeline that serves only a single shipper-owner. [4]

The agitation over these issues is almost as old as the oil business itself. The factors that have engendered the controversy are:

First, though oil can be moved by train, by ship and by truck as well as by pipe, there are many situations in which pipelines have an insurmountable cost advantage over other modes of carriage. As one perceptive commentator who has had many years of practical experience in the business has said:

> It is the general consensus that pipelines are by far the most economical means of large-scale overland transportation for crude oil and products, clearly superior to rail and truck transportation over competing routes, given large quantities to be moved on a regular basis. This has been true for many years; figures are readily available for 1964, when the typical long haul pipeline rate was 10 to 20 percent of the rail rate. More specifically, pipeline rates average about $\frac{1}{5}$ of rail rates and about $\frac{1}{20}$ of truck rates and pipelines can usually compete favorably with all marine transportation except for ocean going long-haul supertankers. [5]

Second, the industry says that these numbers are enough in themselves to show that its rates are modest. Its critics take a different tack. They say the numbers show that (i) the pipelines' advantage over their competitors is so crushing that there is seldom much of a competitive contest between an oil pipeline and a transportation medium other than a pipeline; (ii) it follows that the shipper-owners can realize mind-boggling profits on their pipeline operations and nevertheless keep their rates far below those that truckers and railroads absolutely have to charge [6] in order to cover costs; [7] and (iii) this means that people in the oil business need access to a pipeline and that for most of them such access is a matter of survival. [8]

Third, there is the problem of the small producers and the small refiners that are neither big enough nor rich enough to build their own pipelines. They are constrained to use the pipelines built and owned by their larger and richer competitors. For small firms that have no proprietary interest in the pipelines over which they ship, the pipeline charge is a very real and a very substantial cost. None of that cost comes back to them as dividends or interest. And the large companies to whom they pay it are competitors of theirs. It is charged that public policy here confronts a perverse economic environment in which the big and the rich have the power to choke the life out of folk of lesser means.

Let us look at the small producer. He normally sells to the large, integrated companies. But those companies do not rely entirely on him. They also have their own production. If they can produce oil for themselves at prices that the independent finds uneconomic, they will rely on their own resources rather than on him.

The pipeline charge can be important in this instance for several reasons. First, the shipper-owner never pays more than the real cost of the transportation service—including, of course, the cost of the capital invested in the pipeline. However, the freight rate that the shipper-owner exacts from his independent supplier-competitor consists of that real cost of carriage plus what could be a very liberal helping of monopolistic gravy that goes into the shipper-owner's coffers. [9] If this occurs, it implies that the independent producer who has no ownership interest in a pipeline can neither bargain about prices with the integrated shipper-owner from a position of strength nor compete on equal terms with the shipper-owner's own production affiliate. [10]

This may not matter very much for the lucky independent who happens to be well situated in a flush field. It is said, however, to matter quite a lot to the independent who is not quite so lucky, the one who is at the margin in a field past its prime.

Excessive pipeline rates are also said to make it impossible for small independents to explore and develop on an equal footing with the major integrated companies.

Let us shift from the independent producer to the independent refiner. He is, it could be argued, in a double bind. He pays pipeline charges coming and going. To begin with, he buys crude from the majors at prices which include excessive pipeline charges. So he has to pay more for crude than the majors do. That is so because one has to eliminate the shipper-owner's putative excess pipeline profit in order to arrive at his *real* cost of crude. For the independent refiner, on the other hand, the *real* cost of crude and its *nominal* cost are one and the same.

Then the independent refiner has to send his gasoline or other refined product to market. He normally uses a pipeline for that. But who owns that pipeline? An integrated company, or a group of them. Once again the pipeline owner or the coalition of pipeline owners charges more than the competitive cost of carriage. So the shipper-owners can make a handsome profit on gasoline (or other refined products) at prices that spell disaster for the independent refiner. And its pipelines and pipeline rates are the lever for monopolistic pricing.

There are two serious issues to be evaluated. The first is that oil pipelining is a "natural monopoly" or a "natural oligopoly". The second problem is that the pipeline monopolists are not for the most part primarily interested in pipelines. To them, pipelines are not an end in themselves. They are a means to an end. That end is dominance in oil. The integrated companies are not trying to make money out of pipelines. They are trying to make money out of oil. Hence they are under an irresistible temptation to use their control of the pipelines to embitter the lives of the independents, to make their condition burdensome, to reduce them to a state of dependent independence, and to preclude them from posing an appreciable competitive threat. [11]

So the shipper-owners should be strongly motivated to set oil pipeline rates at levels higher than those that independent transportation companies interested in competitive markets would find optimal. [12]

Thus high pipeline rates [13] make for concentration in the oil industry. [14] They prevent the independent producer of crude from getting a fair price for his product and stifle the independent refiner. [15] They also create an industrial milieu in which the motorist, the homeowner, and everyone else who uses an oil-based product are all mulcted by monopoly prices. [16]

Some Questions About the Model

At this point questions arise. Among them are these:

(1) Is the model historically accurate? Are the shipper-owners a kind of a firing squad? And are the shippers who are not owners that squad's helpless victims?

(2) Suppose that the model is a faithful portrait of things as they once *were*. Does it necessarily follow that it is an equally faithful portrait of:

(a) The *recent past*?

(b) The *present*?

(c) The industrial environment as it is likely to be in the *foreseeable future*?

(3) Have there been significant contemporary changes in the economic climate? Have countervailing forces that were formerly weak or absent now come into play? If so, have those forces materially lessened the power that used to flow from the ownership of an oil pipeline? Has the non-owner's actual or alleged plight been significantly mitigated? [17]

(4) Assume that it is inherent in the structure of the oil industry that firms that own pipelines will often have significant advantages over those that don't. Is that sufficient to give rise to significant public concern? [18] What do we have here? Gross inequities that cry out for redress? Garden variety byproducts of large-scale enterprise that benefit the consumer over the long run and are therefore best left undisturbed? Suppose that there is some measure of evil, potential evil, or something in between here. Is that evil small or large? Best endured? [19] Or better cured?

(5) Is therapy appropriate at all?

(6) If there is to be therapeutic intervention, what form should it take? Should it be drastic? For example, should integrated oil companies be barred from the pipeline business [20] and thus compelled to resort to genuinely independent transportation companies? [21] Or will gentler measures suffice?

(7) Can a regulatory approach solve the problem? [22]

(8) If so, how should the regulators approach their task?

(9) Should they intervene aggressively?

(10) Or should they concern themselves only with the grossest abuses and the most shocking injustices?

These are not simple matters. The evidence with respect to them is ambiguous. It has to be interpreted. And the interpretation that the particular interpreter comes up with depends in large measure on his or her frame of mind.

In petroleum economics, as in art and in love, beauty is in the eye of the beholder. What some find alluring others find repulsive. That is why rivers of ink have been spilled on the questions here presented. History shows that the source of this Niagara of words and numbers is a conflict between big business and small business. More specifically, what is involved (or what used to be involved) is a collision between Big Oil and Little Oil.

What Is Going On In This Specific Case?

Who Is Fighting Whom For What?

Neat generalizations well supported by history do not always capture every facet of contemporary reality. Thus, for example, in the instant case the position historically espoused by the champions of small business and of Little Oil is ably and pertinaciously advocated by the Kerr-McGee Corporation, an integrated oil company.

Now Kerr-McGee is not one of the industry's giants. But it is no pygmy either. Its gross assets come to about $5 billion. Its annual gross receipts are approximately $3.8 billion. Last year its net profits after taxes came to $211 million. It has some 18,000 stockholders. Their equity interest in Kerr-McGee has an aggregate book value of about $1.5 billion. So Kerr-McGee is no Mom-and-Pop enterprise. It is a large company by any standard. [23]

Kerr-McGee is something of an industry maverick. But that seems to be so only with respect to pipelines and pipeline rates. [24] In other respects Kerr-McGee is no dissenter from the industry consensus. It appears to be a member of the petroleum establishment. [25] Like other large integrated oil companies, Kerr-McGee both owns pipelines and ships much of its oil over pipelines owned by other people. [26] The Williams Pipe Line Company is one of the carriers that gets business from Kerr-McGee. Kerr-McGee thinks Williams' rates are much too high. Two of Williams' other customers take the same view. [27]

Williams agrees with Kerr-McGee and its allies that the rates are far from what they ought to be. But its diagnosis of what is wrong with them diverges from that of Kerr-McGee. Williams says that its rates are too *low*, that they do not yield adequate recompense for the risks assumed, and that ferocious competition is a market reality for it specifically and for the oil pipeline industry generally.

Williams maintains that it is operating in a frigid economic climate that prevents it from earning what it thinks it ought to earn. So Kerr-McGee and the other complaining shippers are buying valuable transportation services at bargain basement prices. But those shippers are very greedy. That their rates are already ludicrously cheap is not enough for them. Motivated by almost unbelievable avarice, they have resorted to the legal process in pursuit of an outlandish effort to knock rates that are already much too low even lower.

So far we have an ordinary rate case, a squabble between those who pay and those who get paid about how much is too much and how little too little. But there is more (much more) than that to this massive affair. For one thing, the case has been in progress for more than a decade. [28] That is an uncommonly long time, even by the relaxed standards of expedition that seem characteristic of "big" cases before ratemaking agencies.

The affair has dragged on for so long because it has become a great "test case" about oil pipeline rates and their regulation. But it is an anomalous test case on that subject for two reasons: First, the attack on the status quo is being made by a large oil company-all of the other large oil companies are much enamored of the status quo in oil pipelining and maintain that an assault on it is an assault on the American way of life and on the foundations of Western civilization itself. Second, the target of the attack is not an integrated oil company.

Like practically every other oil pipeline company, Williams has a parent. But its parent is not of the Exxon, Mobil, Gulf, Shell, Kerr-McGee breed. The Williams Pipe Line Company is a wholly-owned subsidiary of a Tulsa-based conglomerate known as The Williams Companies. The parent is in lots of businesses. [29] It is in coal, [30] in fertilizer, [31] in metals, [32] and in real estate [33] as well as in oil pipelines. [34] It is also a producer of crude oil. [35]

So Williams is heavily involved with both the *production* of oil and its *transportation* over a pipeline system. Nevertheless, Williams is not an integrated oil company. For one thing, it is neither a refiner nor a marketer.

Second and more important for present purposes, little, if any, of the oil that Williams carries over its pipelines is its own. [36] Hence the link between Williams, *qua oil* company, and Williams, *qua oil transportation* company, is financial, not functional. The transportation system and the oil producer are under common ownership. But they do not serve each other.

It is as though a diversified industrial holding company that happened to own a steel company also owned an insurance company. If the insurance company wrote casualty insurance and if the steel company bought its casualty insurance from its own captive insurer, we would have a case of *"integration."* But suppose that the insurance company were solely or primarily a life insurer. Now steel companies seldom have much need for life insurance. So a link between a steel company and a life insurer would be an instance of *"conglomeration,"* not of *"integration."*

That in essence is Williams' situation. Accordingly, it regards itself (and is generally regarded by others) as an "independent" pipeline company, *i.e.*, a pipeline company that is entirely or almost entirely engaged in selling transportation services to people who are unaffiliated with it. [37] There are several such independent oil pipeliners. In absolute terms some of them are quite large. [38]

Hence they are important factors in some markets. Some of them have been very successful indeed. But the independents are few. They are a minority in the trade. On an industry-wide basis, the shipper-owners' dominance remains overwhelming. Accordingly, the oil pipeline controversy has up to now been a controversy about shipper-ownership. That is what the industry's critics have traditionally regarded as *the* problem. They have not been up in arms about exploitation *by* the independents. Had they been much concerned about that, the critics would have found themselves in a strange position.

Who are the independent pipelines' principal customers? The major oil companies.[39] After all, they are the ones with lots of oil that they want to move from one place to another. Hence concern about the misdeeds of the independent pipeliners would have to rest on the premise that they are taking the major oil companies over the hurdles and ripping them off. Up to now at least, nobody seems to have been terribly worried about that. Those who "exposed" the pipeline problem exposed what they regarded as monopolistic or oligopolistic wrongdoing in oil.

What they were really worrying about was not pipelines, but oil. Their concern about the pipelines was, as they themselves always stressed, at bottom, a concern about the *ownership* of the lines. They were upset about the fact that so few of the lines were owned by independent transportation companies. So they could scarcely be expected to go into an uproar about wrongs perpetrated by the relative handful of independent pipeliners. After all, the principal victims of those misdeeds would be the very same major oil companies whose iniquities the critics were so heatedly attacking.

So critics of the status quo in oil tend to be kind to independent pipeliners. Indeed, one well-known critique singles Williams out for special praise. It says in pertinent part:

> Storage facilities or tankage are necessary for the efficient operation of the pipeline. Tankage is required at the input point so that the shipper can tender the oil to the pipeline in proper quantities (usually the minimum tender or tenders in excess of that amount). Tankage is required along the pipeline, known as working tankage, to accommodate line size changes. Finally, tankage is required at delivery points for the delivery of the oil from the pipeline. Thus, the availability of tankage can have a distinct impact upon the ability to use the pipeline.
>
> As a general rule, pipelines do not provide tankage at input and delivery points. Working tankage along the route of the pipeline is provided, but is available only for pipeline operations and not for delivery or storage purposes.

As early as 1914, Oklahoma's Attorney General West, testifying before Congress, stated that common carrier pipeline transportation was of no advantage to independent operators unless there was storage.

Others have commented on the lack of storage facilities for use by independent shippers as well as the large capital investment required to furnish sufficient tankage at input and delivery points. Shippers on pipelines have emphasized the importance of provision of storage facilities to increased access to pipelines.

Williams Brothers, an independent pipeline, is a prime example of a pipeline with common tankage available to all shippers. Williams provides this service at many points along its pipeline for a fee. Many small shippers have been able to take advantage of pipeline shipments through Williams Brothers and deliver to many points with minimum capital investments. Competition from independ ents, as a result, is more intensive in the area served by Williams than in most other areas of the country.

In stark contrast to the Williams Brothers operation is the experience of an independent marketer desiring to use Explorer pipeline for shipment and delivery to the Dallas area. This independent marketer was able to arrange for a contract for gasoline with the refiner-owner connected to the Explorer system. The marketer did not have a terminal connected to Explorer for deliveries in the Dallas area, nor did he have a terminal close enough to the pipeline route to make a connection economically attractive. The marketer contacted several companies with terminals connected to Explorer but was unable to secure any space. Even major companies with prior relations with the marketer or friendly attitudes toward the marketer refused . . . terminaling space.

The refiner-owner attempted to intervene in this situation, since the contract was a good one and provided a new marketing opportunity. The refiner-owner went to the owners of other terminals connected to Explorer without any success. The refiner-owner was aware that one of the owners of Explorer had excess terminal capacity in the Dallas area that was available for purchase. The refiner-owner was able to conclude an arrangement for terminal space with this owner; however, the terminal owner placed a veto power in the contract permitting the terminal owner to veto any marketing arrangement not to its satisfaction. When the refiner-owner attempted to use the terminal for deliveries to the independent marketer, the terminal owner vetoed the arrangement. The refiner-owner therefore was not able to make deliveries to the independent marketer and the contract eventually fell through. This same refiner-owner found that it was unable to build its own new terminals in areas along Explorer where it did not have existing terminals, since the cost would be too great and would make any marketing efforts uneconomic.

Terminals at delivery points are extremely important to independent marketers. Without delivery tankage, they cannot obtain a product from pipelines unless the owners of the tankage permit it. New companies without their own existing tankage, even substantial majors, may find it difficult to enter new markets if they must rely on existing terminals (with veto restrictions or other similar arrangements) or on constructing new tankage. Experience indicates that independent marketers willing to enter new markets *if terminals such as those Williams Brothers operates exist*, have been stymied from entering markets served by pipelines through privately owned terminals. The disadvantage is not a theoretical one, but one that is very real and one that effectively limits access to most major integrated oil companies' pipelines. [40]

At this point, two observations seem relevant. First, oil pipeline owners have done nicely under the status quo. So their affection for it is unsurprising. Some may be reminded of *Matthew 6:21:* "For where your treasure is, there shall your heart be also." This is a factor that should be borne in mind. And we do bear it very much in mind. Business enterprises are not eleemosynary institutions. Nor are they supposed to be disinterested servants of the public interest. That is our role, not theirs. As George Bernard Shaw once observed, "Cynicism may be a sin. But is rarely mistaken."

When an industry takes a strong position on a public policy question, it normally does so because it has an ax to grind. Nothing in our experience suggests that the oil industry is an exception to this rule. It gets excited (and it has gotten quite excited here) when dollars and cents are at stake. Litigants who have money at stake take positions calculated to maximize their economic welfare. That is inherent in the nature of things. It is an obvious fact of life. But it would be a mistake to make *too* much of that fact. Something that is good for integrated oil companies may also be good for society. Or it may not. There is no presumption either way.

Second, propositions should be dealt with on their merits. The motives of those who put the propositions forward seldom call for much analysis. When private parties are involved, those motives are rarely mysterious. And they have no necessary bearing on the merits.

Thus, for example, defendants in criminal cases are always out to save their own skins. But that is no reason to discount *everything* that they say. They may be telling the truth. And they may be innocent. Even if guilty, prosecutorial misconduct or concepts basic to ordered liberty may entitle them to an acquittal. [41]

There are vast differences between economic regulation of the type here involved and criminal proceedings. In some respects the two types of cases are as different from each other as they could possibly be. But similarities of a sort can also be found. Both areas involve limitations on a private person's freedom to do as he pleases. In both that freedom yields to legislative conceptions of the social interest. In economic regulation, as in criminal justice, those who have to administer the legal order may sometimes think those legislative conceptions dubious or downright strange. Nevertheless, they are not at liberty to substitute their private policy preferences for those of the legislature. [42]

As administrators of the statute under which this case arises, we have a duty to discharge. That duty is to carry out the intention of the legislature, insofar as that intention can be divined from materials that are sometimes cryptic. Here those materials are very cryptic indeed. This makes our task extraordinarily difficult. That extraordinary difficulty has had much to do with the regrettable delays in disposing of this matter.

Broader Implications

So this case is somewhat odd. It is also very old. Those features of the litigation are important. Far more important, however, than those case-specific aspects of the matter are its general implications. [43] Those have been agitated for the past century.

They go to the heart of the oil pipeline rate issue. The debate about that issue is part of a much bigger debate. That bigger debate is not about pipelines. It is about oil.

Is the oil business a "monopoly"? A "shared monopoly"? An "oligopoly"? "Cartelized"? A complex blend of oligopoly and competition where whales "compete" with minnows and elephants dance among chickens? More competitive (perhaps a great deal more competitive) than that but nevertheless an industry in which the beneficent flame of competition does not always burn quite so brightly as the late Adam Smith thought it should?

Or is oil a workably competitive industry mindlessly harassed by moonstruck anti-business idealogues and ill-informed politicians who equate bigness with badness, who are still fighting quixotic populist wars against John D. Rockefeller's ghost, who are wilfully blind to technological imperatives and to the major exporting countries' enormous market power, who are oblivious to efficiency concerns, who have made an inflexible dogma out of an English economist's amusing aphorism that "Small is beautiful," [44] and who seek to apply that dogma to an industry in which it has as much place as a fur coat in the baggage of a traveler bound for the Equator? [45]

People's answers to those big questions about oil influence their answers to smaller and essentially ancillary questions about oil pipeline rates.

What Was The Climate Of Opinion That Led To The Regulation Of Oil Pipeline Rates?

Today the questions that we have posed evoke diverse answers. Back in 1906, however, they evoked virtual unanimity. Those virtually unanimous answers were hostile to the industry. [46] Most Americans thought the oil business in dire need of radical reform. [47] Practically everybody in the Congress took the same view. So did the President. [48]

Nineteen Hundred and Six was a great Progressive year. And John D. Rockefeller and his Standard Oil combine were Progressivism's primary targets. [49] Rockefeller himself was widely regarded as Public Enemy Number One.

Miss Ida M. Tarbell had much to do with this. Her nineteen articles on *The History of the Standard Oil Company* appeared in McClure's Magazine from 1902 to 1904. [50] What they did to Standard had something in common with what Harriet Beecher Stowe's *Uncle Tom's Cabin* did to slavery.

Stowe was a fervent Abolitionist. And Tarbell was just as fervent a partisan of Little Oil. Tarbell was a champion of the independent producer and the independent refiner. [51] She thought that Rockefeller and his henchmen had driven the independents to the brink of destitution [52] and that they had done so by criminal means. [53] She excoriated them for that. [54]

Typical of Tarbell's viewpoint is this sketch of the idyllic small businessman's paradise that the Standard Oil Company ruined:

> Life ran swift and ruddy and joyous in these men [of the Oil Regions]. They were still young, most of them under forty, and they looked forward with all the eagerness of the young who have just learned of their powers, to years of struggle and development. They would solve all [their] perplexing problems of over-production, of railroad discrimination, of speculation . . . They would meet their own needs. They would bring . . . oil refining to the region where it belonged. They

would make their towns the most beautiful in the world. There was nothing too good for them, nothing they did not hope and dare. But suddenly, at the heyday of this confidence, a big hand reached out from nobody knew where, to steal their conquest and throttle their future. The suddenness and the blackness of the assault on their business stirred to the bottom their manhood and sense of fair play, and the whole region arose in a revolt which is scarcely paralleled in the commercial history of the United States. [55]

Another famous Tarbell passage identifies the assailant and describes his tactics. It goes like this:

Very soon after Mr. Rockefeller began to "acquire" independent refineries, whose owners were loath to sell or go out of business, unpleasant stories began to be circulated in the oil world of the methods used in getting the offending plants out of the way. When freight discriminations, cutting off crude supply, and price wars in the market failed, other means were tried, and these means included, it was whispered, the actual destruction of the plants. [56]

A third Tarbellism that bears quotation reads:

[T]he work of acquiring all outside refineries began at each of the oil centres. Unquestionably the acquisitions were made through persuasion when this was possible. If the party approached refused to lease or sell, he was told firmly . . . that there was no hope for him; that a combination was in progress which was bound to work; and that those who stayed out would inevitably go to the wall . . .

All over the country the refineries . . . sold or leased. Those who felt the hard times and had any hope of weathering them resisted at first. With many of them the resistance was due simply to their love for their business and their unwillingness to share its control with outsiders. The thing which a man has begun, cared for, led to a healthy life, from which he has begun to gather fruit, which he knows he can make greater and richer, he loves as he does his life. It is one of the fruits of his life. He is jealous of it-wishes the honour of it, will not divide it with another. He can suffer heavily his own mistakes, learn from them, correct them. He can fight opposition, bear all-so long as the work is his. There were refiners in 1875 who loved their business in this way. Why one should love an oil refinery the outsider may not see; but to the man who had begun with one still and had seen it grow by his own energy and intelligence to ten, who now sold 500 barrels a day where he once sold five, the refinery was the dearest spot on earth save his home. He walked with pride among its evil-smelling places, watched the processes with eagerness, experimented with joy and recounted triumphantly every improvement. To ask such a man to give up his refinery was to ask him to give up the thing which, after his family, meant most in life to him.

To Mr. Rockefeller this feeling was a weak sentiment. To place love of independent work above love of profits was as incomprehensible to him as a refusal to accept a rebate because it was wrong! Where persuasion failed then, it was necessary, in his judgment, that pressure be applied-simply a pressure sufficient to demonstrate to these blind or recalcitrant individuals the impossibility of their long being able to do business independently. It was a pressure varied according to locality. Usually it took the form of cutting their market. The system of "predatory competition" was no invention of the Standard Oil Company. It had prevailed in the oil business from the start. Indeed, it was

> one of the evils Mr. Rockefeller claimed his combination would cure, but until now it had been used spasmodically. Mr. Rockefeller never did anything spasmodically. He applied underselling for destroying his rivals' market with the same deliberation and persistency that characterised all his efforts, and in the long run he always won. There were other forms of pressure. Sometimes the independents found it impossible to get oil; again, they were obliged to wait days for cars to ship in; there seemed to be no end to the ways of making it hard for men to do business, of discouraging them until they would sell or lease, and always at the psychological moment a purchaser was at their side.
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> * * *
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> [A]t first none of the small refiners would listen to the proposition to sell or lease made them . . . by the representative first sent . . . They would have nothing to do, they said bluntly, with any combination engineered by John D. Rockefeller. The representative withdrew and the case was considered. In the meantime conditions . . . grew harder. All sorts of difficulties began to be strewn in their way-cars were hard to get, the markets they had built up were cut under them-a demoralising conviction was abroad in the trade that this new and mysterious combination was going to succeed; that it was doing rapidly what its members were reported to be saying daily: "We mean to secure the entire refining business of the world." . . . Most of the concerns were bought outright, the owners being convinced that it was impossible for them to do an independent business, and being unwilling to try combination. All . . . the little refineries which for years had faced every difficulty with stout hearts collapsed. "Sold out," "dismantled", "shut down" is the melancholy record of the industry during these four years . . . The scars left in the Oil Regions by the Standard Combination of 1875-1879 are too deep and ugly for men and women of this generation to forget them. [57]

One scholarly treatment of oil matters at the turn of the century concludes that Tarbell's work "inflamed the public's long-standing hostility to the combination as nothing before had." [58] That observation is followed by this resume:

> In Washington, Theodore Roosevelt, who became President in 1901, played upon and compounded this antagonism by repeatedly picturing Standard as the nation's outstanding example of an evil trust. John D. Rockefeller became a prime target for monopoly haters. After 1902 Rockefeller routinely received threats on his life. During this period the oil baron kept a revolver beside his bed at night, and his pastor hired Pinkerton detectives to mingle with the crowd that gathered each Sunday to watch the devout millionaire attend church.
>
> Concurrent with hostile publicity, a series of investigations established an exceptionally solid basis for legal action against the combination . . . In 1900 the United States Industrial Commission released a massive thirteen-volume report filled with damaging material on Standard Oil. The new federal Bureau of Corporations filed an extensive report on the transportation phase of the industry. All of these emphasized Standard Oil's dominance of the industry and its frequent resort to anticompetitive practices. [59]

Another historian summarizes the situation this way:

> The near-monopoly position of Standard Oil and its aggressive use of its near-monopoly power had made it an archetype of the alleged evils of big business well before the turn of the century. President Theodore Roosevelt used the combination as a convenient whipping boy for his attacks on unfair competition

and railroad rebates. His case against Standard Oil was orchestrated by the Bureau of Corporations, organized in 1903, which at politically strategic times released the fruits of investigations of alleged abuses in the petroleum industry, most of them centering on Standard Oil. Against this background and the background of numerous state legal actions, the federal government in 1906 instituted a major antitrust case against Standard Oil (New Jersey) [Now Exxon Corporation] . . . [60]

The Government won that great case. [61]

But litigation takes time. And big antitrust cases take lots of time. Hence the final decision against Standard did not come until 1911. It did not grant, nor had the Government sought, what contemporary antitrust lawyers call "structural relief."

No attack was made on integration, as such. The decree merely required that the company now known as Exxon Corporation spin its host of subsidiaries off to its shareholders. That liberated those subsidiaries from their erstwhile parent. But the parent's principal stockholders were now the principal stockholders of the subsidiaries. So there was a question about how much had really changed. [62]

The question is not answered by pointing out that the oil industry of today is quite different from the oil industry as it was when John D. Rockefeller was its dominant figure. [63]

Did the 1911 decision produce these differences? Was it even a substantial factor in bringing them to pass? Those are the questions. Some answer them in the negative. They point out that:

(1) Standard's monopoly had begun to erode before the antitrust case was brought. [64]

(2) The former Standard companies continued to work together and were for many years linked by a community of interest. [65]

(3) The really dynamic factor in the situation was neither the "law" nor its oracles on the Supreme bench. It was the automobile. That made for an enormous expansion in the scale of the industry's operations and shaped its contemporary structure. [66]

Differences of opinion about the real impact and the ultimate effects of Theodore Roosevelt's "Great Case" [67] against the Standard Oil Company of New Jersey are of little moment [68] here and now. [69] The important thing for us about that litigation is that the Congress of 1906 was not disposed to await its outcome with folded hands. That Congress was itching to do something to Standard Oil then and there. [70]

That "something" took the form of a legislative attack on the pipeline problem. This was logical. Standard's pipelines seemed to be the keys to its kingdom. [71] Its mastery over transportation was widely viewed as the means by which it condemned the independent producer of crude to starvation prices unilaterally dictated by it, while at the same time it throttled the independent refiner by barring him from access to crude at a price that would enable him to compete with it. [72]

Other forces were also at work. One of them was a sharp fall in the price of crude. The aggrieved producers blamed that on Standard and on its stranglehold over transportation. They concluded that "they had been duped into exploration and production to save the combination that expense." [73] The result was an outburst of righteous indignation. The temper of the times was such that the cry fell on receptive ears. [74]

Also worth mentioning was the concern about transportation problems in general that led to significant increases in the Interstate Commerce Commission's power over railroad rates. That enhanced authority was given by the Hepburn Act of 1906. [75] Now oil pipelining was a form of transportation. And Standard Oil's links with the railroads were notorious.

That was so in spite of (perhaps it would be better to say because of) the fact that Standard's pipelines were in competition with the railroads. But that competition related only to the carriage of crude. Until the 1930's pipelines were used only for that purpose. Refined products generally went by rail. [76]

This state of affairs spawned chummy relationships between Standard and the railroads under which Standard kept its crude pipeline rates high, thus enabling the railroads to hold on to business that they would have lost had Standard passed the lower costs of pipeline transit on to unaffiliated shippers. The railroads reciprocated by giving Standard preferential bargain rates on refined products. They also gave Standard "drawbacks." A "drawback" was a portion of the freight rate that a Standard competitor had paid. When X, an independent refiner, paid a dollar in freight charges to the Pennsylvania or the New York Central, some portion of that dollar was paid to Standard. Hence X was subsidizing Standard in two ways. The first subsidy came from the high pipeline rates he had to pay Standard whenever crude was shipped to him over a Standard pipeline. The second came from the "drawbacks" that Standard collected on X's shipments of refined merchandise. [77]

Against that background it is not surprising that the Congress of 1906, which was looking at transportation problems in general and which had resolved to beef up the Interstate Commerce Commission's theretofore feeble authority over that sphere of the economy, also decided to bring oil pipelines under the ICC's regulatory aegis. That decision was implemented by the Lodge Amendment to the bill that became the Hepburn Act. Senator Henry Cabot Lodge of Massachusetts, the amendment's sponsor, made it very plain that the only purpose that he had in mind was to attack Standard Oil. He was not interested in pipelines generally. [78]

The elder Henry Cabot Lodge's sponsorship of this measure speaks volumes about the Standard Oil Company's place in the American Pantheon at the turn of the century. Lodge was a staunch conservative. No one thought that Boston Brahmin a foe of the established order. Yet he was bent on doing "something" about Standard Oil. [79]

The Senate was of like mind. Its yea vote on Lodge's oil pipeline proposal was unanimous. [80] Now the United States Senate of 1906 was not a revolutionary assembly. Many of its members were quite conservative. Some of them were very friendly to large-scale enterprise. Yet all of them were eager to demonstrate their aversion to Big Oil. They did that by voting for a bill aimed solely at Standard.

Standard was not the only "trust" about which turn-of-the-century Americans were agitated. Much was said and written at the time about the *Whiskey Trust*, the *Sugar Trust*, [81] the *Tobacco Trust*, [82] the *Harvester Trust*, [83] the *Ice Trust*, the *Steel Trust*, [84] and the *Beef Trust*. [85] But none of them evoked special, industry-specific legislation that was fashioned for the sole purpose of checkmating a particular monopolist. In that regard Standard stood alone. [86]

There are probably at least two reasons for Congress' unique treatment of Standard. First, rightly or wrongly, Standard was perceived as the very embodiment of commercial viciousness. Its founder and guiding genius had come to be regarded as the robber baron par excellence. Second, the viciousness, the immorality, and the robbery seemed to revolve in large measure around transportation—around the evil combination's extortion of rebates from the railroads and around its monopoly of pipeline transit.

Why Do We Afflict Our Readers With All This Ancient History?

We do not consider these historical materials peripheral. On the contrary, we regard them as central. The result we reach is strongly influenced by them. The historical background shows that oil pipeline regulation is quite different from the other things we do.

Those other functions were inherited from the former Federal Power Commission. That agency's tasks were difficult. [87] But its essential mission was clear. It was in business "to protect consumers against exploitation." [88] That is also our business. Consumer protection is what we are here for. Of course, that function must be performed with scrupulous regard for the legitimate claims of those we regulate. Nevertheless, it is the consumer's interest that is paramount. The statutes on which we spend most of our time and energy were carefully designed to close gaps in the protective fabric that the states had previously fashioned for the consumer's benefit. That is so clear that even lawyers have been unable to dispute it. Thus history gives us a good light by which to steer when we deal with electric power and with the transportation of natural gas.

Oil pipelines are a horse of another color. The Federal Power Commission had nothing to do with them. They were regulated by the Interstate Commerce Commission. That agency approached its oil pipeline tasks in a spirit quite different from the one that animated our predecessor, the Federal Power Commission. When it came to oil pipelines, the ICC gave little, if any, heed to the claims of the consumer, the apple of the Federal Power Commission's eye. The ICC developed a body of oil pipeline lore that gave oil pipeline companies a far broader measure of entrepreneurial freedom than public utilities enjoy at either the State or the Federal level. Of course, it can be said that the "public utility" label doesn't fit here. [89] Suppose that is so. Let us then put the "public utility" tag to one side. Surely, the "transportation" hat fits. Oil pipelines move stuff from place to place. That is "transportation," isn't it? Moreover, the owners of the pipelines are commonly referred to as "carriers." Indeed, the Interstate Commerce Act tells us that most of them are "common carriers." [90]

Yet the agency that administered that statute fashioned a special system for oil pipelines. That system differed materially from and was far more indulgent to the regulatees than the agency's railroad and motor-carrier methodologies. The salient feature of the ICC's oil pipeline jurisprudence was its permissiveness. Indeed, it was so permissive that one United States Supreme Court justice was led to observe that the Interstate Commerce Act's "pipe-line provisions, for one reason or another, have never been enforced as effectively as might be desired." [91]

On October 1, 1977, the newly hatched Federal Energy Regulatory Commission succeeded to the ICC's oil pipeline estate. [92] That peculiar heritage included this case, which was then in the Court of Appeals for the District of Columbia Circuit by reason of an appeal by Kerr-McGee and its allies from an ICC decision adverse to them. It was a troubling and an anomalous legacy.

The legatees were the five people who had been chosen by President Carter to get this agency under way. [93] Their principal preoccupation was consumer protection. That was their mission. Yet they found themselves presiding over an oil pipeline operation that seemed to make no sense in terms of consumer protection.

The historical record is somewhat murky. Hence we cannot be certain that our predecessors would have read it as we do. However, they are not here anymore. Their responsibilities have devolved on us. So it is the present Commission's reading of the pertinent history that counts.

That reading leads us to several conclusions. Oil pipeline rate regulation is not a consumer-protection measure. It probably was never intended to be. It is and was a producer-protection measure. [94] The heart of the matter was that "Small independent *producers*-who lacked the resources to construct their own lines, or whose output was so small that a pipeline built to carry that output alone would be economically unfeasible-were in a desperate competitive position." [95] The quotation is from the Supreme Court. [96]

That body is both final and infallible for our decisional purposes, so we start from the premise that what Congress was seeking to redress was an imbalance of economic power among *entrepreneurs*. That goal neither requires nor warrants the strenuous regulatory efforts long deemed appropriate and indeed essential in consumer protection. Moreover, the sometimes arcane analyses that regulators make in their pursuit of the ultimate consumer's welfare may well be out of place when the regulatory goal is the much humbler and far more limited one of protecting one group of businessmen against predation by another group of firms that is richer than the first and that also happens to enjoy a superior strategic position.

Accordingly, we believe that the ICC's permissive stance on oil pipeline rates was not quite so outlandish as it seemed to us when we first encountered it. This does not mean that we endorse uncritically all that the ICC did and all that it failed to do in this field. On the contrary, we have serious reservations about that agency's oil pipeline rate performance. [97]

More vigor in an earlier day might have been better. The pipeline rates of yore reflected a gross imbalance of bargaining power between the buyers of pipeline transit and the sellers of that service. [98] Since oil gluts were chronic, crude oil prices normally low, and independent producers' margins razor-thin or absent, pipeline charges bulked large in the economics of petroleum. Vigorous efforts to reduce those charges would, we think, have alleviated the plight of the independent producers of those days. Such efforts would also have helped the independent refiner. They might have done enough for him to make the market for refined products appreciably more competitive than it in fact was. Had that happened, consumers would have benefited. It is hard to be sure about these things. Only fools speak with assurance about how hypothetical historical scenarios would have worked themselves out, about what North America would be like today had the colonists never broken with the Mother Country, about what course American history would have taken had the Republican National Convention of 1860 chosen Seward rather than Lincoln, about the precise nature of the foreign policy problems that the United States would be confronting in 1982 had Czar Nicholas II been born under a luckier star and blessed with more political acumen and had Lenin not abandoned the practice of law in Saint Petersburg for revolutionary politics, or about what the ultimate structure of the oil business would have been like if John D. Rockefeller had never been born. But a cautious "could be, might have been" seems in order.

Accordingly, the first reality we confront in reviewing the propriety of the ICC's methodology in the context of today's world is that both independent producers and refiners appear *generally* to be far less in need of rigorous protection than they were in Ida Tarbell's day. That is not to say that close scrutiny of the oil pipelines' conduct is not warranted when an independent producer or refiner calls foul, claiming refusal of access, undue preference or discrimination. But as a group, independent producers and refiners appear to have a lesser claim on this agency's time and resources than the ultimate ratepayers for whom protection is sought under the other statutes that we administer. [99]

Another factor that weighs rather heavily on our minds is that even if Congress intended its 1906 oil pipeline legislation to protect consumers as well as producers (and we believe it probably did at least to some extent), rigorous cost-of-service enforcement of that law would have a negligible impact on the prices that consumers pay. The transportation economics of oil differs from that of gas and electricity. In the latter industries the transportation charge bulks large in the price that the consumer pays. In oil, on the other hand, the charge is an almost infinitesimal component of the price to the ultimate consumer. Only in the context of the Trans Alaska Pipeline System do we find an apparent exception.

Today oil is a high-value commodity. Hence the relative cost of transporting it has fallen. The point is very simple. When oil cost $2 per barrel and a 40-cent charge had to be deducted from the price to yield the producer's net-back, the pipeline charge was infinitely more important to the producers - and the consumers-than it is today when oil is $30 a barrel and the pipeline charge is, say, 60 cents. In the first example, the transportation cost was 20% of the cost of the raw material, but only 2% in the latter. Query whether the substantial costs of rigorous oil pipeline regulation justify an incremental consumer benefit of a fraction of 2%? We believe the answer to be a clear "no." [100]

As should by now be obvious, we find the case for aggressive Federal intervention in oil pipeline ratemaking flimsy. To engage in such a fight would be only to benefit those who need no help. [101] The war would have to be financed by the taxpayers. That there are higher fiscal priorities seems plain.

There are also related equity considerations. Lots of taxpayers are poor. But few oil producers and refiners are. So the opposite view would have the poor pay for a way to enrich the not so poor. That is hardly an appealing public policy.

This does not mean that we intend to leave oil pipeline rates to the unfettered workings of the market, although perhaps they would be better left there. Congress foreclosed that option long ago. It has given us a mandate to regulate. That determination binds us. Unless and until Congress changes the statute, we are constrained to assume that it still serves valid public policy purposes. Our administrative discretion is clearly not broad enough to encompass deregulation or nullification of the statute by administrative fiat. It is, however, broad enough for us to define a regulatory procedure which makes some sense in the contemporary economic environment. As the Supreme Court told us in the context of the Natural Gas

Act, it is the end result of our regulation, and not the particular ratemaking methodology we employ, that counts. [102] Thus, we feel free to adopt a light-handed method of regulation for this industry. And much of the ICC's methodology serves that end.

The considerations we deem controlling are stated at greater length in the pages that follow. Some will doubtless find that length excessive. [103] Others will find it unendurable.

We do not expect everyone to find our analysis convincing. Indeed, we doubt that any of the litigants will find either the analysis or the result to which it leads wholly satisfactory. The industry is much enamored of the ICC's methodology, which it considers divinely inspired and legally required. [104] So we expect it to applaud our decision to stick with the ICC's rate-base methodology. It is less likely to be ecstatic over our views of depreciation and rate of return.

The industry is almost certain also to be indignant over our refusal to accept any of its suggestions for "updating" the system in ways that would make it more comfortable and more remunerative for the regulatees. Equal or even greater indignation can be expected from most of the industry's critics. They will undoubtedly censure us for willful failure to see the light of reason and for blind adherence to a methodology that was flawed from birth, that is a relic of the Paleolithic Age of economic regulation, that should therefore have been retired for senility decades ago, and that now belongs in a historical museum of regulatory pathology. [105]

Of course, we think these criticisms mistaken. [106] In the rest of this Opinion we try to explain why. But we are mindful of Judge Learned Hand's aphorism that "the spirit of liberty is one which is not too sure that it is right." [107] So it is at least arguable that it is we who are mistaken. Our reading of what the social interest calls for in this field could be wrong. [108]

There is, however, another area in which we speak with greater certitude. All concerned should, we think, agree that it is high time for Congress to take a fresh and a hard look at oil pipeline rate regulation. What we have here is a 76-year old statute that was enacted in a great hurry, [109] that was unsupported by any semblance of economic analysis, [110] that was in large measure a response to an immediate problem which was viewed as a desperate emergency, [111] and that is an artifact of the age of the horse, the buggy, and the kerosene stove. [112]

Unless and until that legislative re-examination is made, oil pipeline rate law will remain a quagmire for this agency and for reviewing courts. Judges and administrators will have to guess about what the Congress of 1906 thought or would have thought about an economic and a technological environment that it could not possibly have foreseen. These essays in legal fiction based on conjectural hypotheses about a largely imaginary legislative intent will breed more litigation, more opinions, and more law review articles. [113] That will be good for printers, for producers of paper, for builders of library shelves and, of course, for lawyers. But it is unlikely to add anything visible to either the sum of human knowledge or the general welfare.

There are a number of options for the Congress. It could:

(1) Deregulate oil pipelines in toto and restore the pre-1906 era of unadulterated laissez-faire in oil pipelining; [114] or

(2) Abandon any effort to regulate rates, as such, while preserving both the common carrier obligation to serve all comers and the ban on undue discrimination among shippers; [115] or

(3) Preserve a modest measure of rate regulation, but state explicitly and illuminatingly that what it has in mind is something much gentler, much less pervasive, and by no means as thoroughgoing as the elaborate exercises customary in public utility regulation; [116] or

(4) Retain regulation but confine it to cases in which it is clear that the carrier's market power is so substantial as to warrant governmental intervention in the pricing process; [117] or

(5) Give this Commission or some other ratemaking agency an unambiguous mandate to regulate oil pipeline rates rigorously and to do all that regulators can do to see to it that those rates do not exceed the rigorously defined cost of providing the service; or

(6) Heed at last the hoary cry for a statute compelling the integrated oil companies to divest themselves of their pipeline operations, thus making oil pipelining a genuinely independent transportation business rather than a branch of the oil industry.

Were Congress to choose one of those options and to do so after informed debate and on the basis of a legislative history that illumines the statutory text, courts and agencies charged with interpreting and applying that text would have guidance as to what is expected of them that is now virtually nonexistent.

Our point is that the task of articulating what public policy *should be* toward this important industry is for the legislative branch. True it is that this Commission, like other administrative agencies, has important quasi-legislative functions. But when one says that, he must emphasize the word "quasi." To fill in gaps and spell out details is one thing. To state the basic goals of public policy and to draft a model code for their implementation is quite another.

Here we are asked to embark on an undertaking of the latter type. And we decline to do so. The concerns that lead us to refuse the invitation to write a new constitution for the oil pipeline industry extended to us by the complaining shippers, by the Antitrust Division of the Department of Justice, and by our own staff are not "legal" in the narrow lawyer's sense.

We assume that we have the authority to do what the critics of the pipeline status quo ask us to do. [118] The question is not one of law about what our powers are. It is one of policy, political science, and prudence. The restaints that we have to heed in this situation are not those that the "law" imposes on us. [119] They are those that we should impose on ourselves, remembering that we are neither judges with the institutional prestige, the life tenure, and the nearly total independence that Article III of the Constitution gives to the Federal judiciary nor legislators chosen by and directly accountable to the electorate. [120] It behooves us to remember that our role in the American polity is humble, that we are not elected by the people and that we have no mandate to make the world over. [121] Absent a clear and a contemporary legislative mandate directing us to do so, it is not for us to reshape the oil pipeline industry or any other industry.

Were there a showing that the status quo makes for gross injustice or that its effects on the general welfare are palpably deleterious, a different situation would be presented. [122]

We think it impolitic to change for the sake of change. And it is not clear to us that vigorous regulation for vigorous regulation's sake is a good thing. Hence we are not persuaded that we should turn this important industry upside down merely because the regulatory system that we inherited from the Interstate Commerce Commission does not comport fully with some people's notions of rationality and logic. But we do not deem ourselves totally impotent. What the ICC made, this Commission, that agency's statutory successor in this field, can unmake.

What Did The Congress of 1906 Actually Do About Oil Pipeline Rates?

What Does The Statute Say?

The Hepburn Act of 1906: [123]

(1) Made most interstate oil pipelines [124] common carriers; [125]

(2) Required that their rates be "just and reasonable;"

(3) Banned undue discrimination among shippers;

(4) Made the Interstate Commerce Commission (after October 1, 1977, the Federal Energy Regulatory Commission) responsible for seeing to it that rates actually conformed to these standards;

(5) Prohibited "rebates;" and

(6) Provided for the forfeiture to the United States of three times the amount of any illicit rebate. [126]

What Did The Congress of 1906 Mean When It Directed That Oil Pipeline Rates Be "Just and Reasonable"?

What makes one rate "just" and another "unjust?" And where is the legal litmus paper whose color tells us that this rate is "reasonable" and that one "unreasonable?" [127] That is the question before us. And it is not an easy one. [128]

"Just and reasonable" is an ethical, not an economic concept. [129] The words pack a powerful moralistic punch. Who can be against "justice" and for "injustice?" And who will declare himself a foe of the "reasonable" and a partisan of the "unreasonable?"

Such people are as rare as those who will freely concede that they despise good and love evil. The difficulties arise when one tries to bring these high-level abstractions down to earth. Sellers do so in one way [130] and buyers in another. [131]

For the lexicographer, the phrase "just and reasonable" is as vague as the phrase "good, true and beautiful." For the utility lawyer, however, the words "just and reasonable" have become a term of art. That term may not be geometrically precise. But the underlying idea is clear enough to be workable.

A rate is "just and reasonable" when it is "cost-justified." If one were writing a hornbook on the "just and reasonable" concept, he or she would state the following black-letter rules:

(1) A rate is "just and reasonable" if it produces revenues equal to the cost of supplying the regulated service.

(2) If the revenue produced by the rate exceeds the cost of service, it is unjustly and unreasonably high.

(3) If the rate does not give the regulated entity a fair opportunity under prudent management to recover its total cost of service, that rate is unjustly and unreasonably low.

(4) The cost of the capital needed to supply the regulated service is one of the costs for which the regulated entity must be reimbursed. That cost does not differ in essence from such other costs as wages, fuel, and taxes.

(5) When fixed-income securities (bonds and preferred stock) are involved, there is nothing especially difficult about measuring the regulated entity's cost of capital. The contract between the borrower and the lender fixes the cost of the funds supplied. One need look no further. [132] If the X Power and Light Company sold 2-½% bonds back in 1946 when high-grade bonds yielded that [133] and if some of those bonds are still outstanding, the cost of that money is still 2-½%. That X Power and Light Company would have to pay 13% for *new* money in 1982 is irrelevant. That is so because the holders of the 1946 bonds can never get more than the 2-½% that their contract calls for.

(6) When we move from fixed-income securities to common stock, the application of the cost of capital principle becomes much more difficult. The difficulties stem from the nature of the common stockholder's contract. Unlike the bondholder or the preferred stockholder, he does not bargain for a fixed sum of money. Nor is he assured of a constant quantum of purchasing power. What the common stockholder buys is an interest in a hypothetical stream of anticipated future income. The cost of that interest to its issuer-creator can never be quantified with precision. [134] So regulators must content themselves with rough approximations of that cost.

(7) So much for the fair rate of return to which the investor is entitled. But a fair rate of return on *what*? To say that one is entitled to a fair opportunity to earn, say, 15% does not tell him very much unless he knows whether that 15% is 15% of a hundred dollars, 15% of five hundred dollars, or 15% of a thousand dollars. This is the so-called "rate base" question that has bedeviled regulation from the very beginning. Today and for the past generation the conventional answer to that question has been that the investor is entitled to a fair return on the dollar amount that prudent managers would have had to expend in order to bring the facilities into being less the portion of that amount already recovered from ratepayers through the depreciation component in the cost of service. [135] No attempt is made to arrive at the "real," "true," or "fair" value of the property. Nor is what people paid for their stock deemed relevant to the rate base question. [136] Instead, the regulators look to actual cost or net investment. That standard "measures the rate base by a summation of the actual legitimate costs of plant and equipment devoted to the public service (including or plus allowances for interest during construction), with appropriate deductions for accrued depreciation and with reasonable allowances for working capital." [137] It is generally called the depreciated original cost standard, because:

(a) A dollar of depreciation expense is viewed both as a cost to be borne by the consumer and as a recoupment of investment by the supplier of capital. Suppose, for example, that a plant cost $10 million to build and that its useful life is assumed to be 40 years. Suppose further that 20 of those 40 years have already elapsed. This means that $5 million of that $10 million has already been recovered over the years from the ratepayers in the depreciation component of the cost of service. Hence the "investment" on which a fair return is to be earned is now only $5 million. Contentions that the plant is really as good as new (or even better because it has actually improved with age) are deemed irrelevant. Nor is the regulated entity permitted to gain anything by arguing that it underestimated the facility's useful life, which means that its depreciation allowances were overstated and that the plant's present value is higher than its depreciated book value. That is so because regulated entities are not permitted to earn returns on capital expenditures that they have already recouped from their customers.

Accordingly, one may not claim that a property has traveled nine-tenths of the way to the junk heap for cost of service purposes and that that same property is just about to begin to wear out a little bit for rate base purposes. When a dollar of depreciation goes into the cost of service, that same dollar comes out of the rate base.[138]

(b) It differs from conventional accounting practice, which focuses on "historical cost," *i.e.*, the price that the present owner paid to whoever sold it to him by going back to the "original cost," *i.e.*, the amount prudently expended on the creation of the facility. [139]

A distinguished student of regulation puts the point this way: "[I]nvestors are not compensated for *buying* utility enterprises from their previous owners any more than they are compensated for the prices at which they may have bought public utility securities on the stock market. Instead, they are compensated for devoting capital to the public service." [140]

(8) What of inflation? Suppose that it were to be shown that a plant built in 1962 at a cost of X dollars would cost at least three times that sum were it to be built today. Is this ignored? Do the regulators assume that a hundred dollar dividend check in 1972 and a hundred dollar dividend check in 1982 are really one and the same, in spite of what the Consumer Price Index, the Gross National Product Deflator and common experience tell us about the sharp decline in the purchasing power of our monetary unit? The answer to this is that inflation is not ignored. The equity investor is compensated for it. That compensation is in the allowed rate of return. When that rate is derived from stock market data, it includes the premium that equity investors demand to insure themselves against anticipated inflation. Thus, the equity investor has the benefit of a fluctuating *market* return on his investment, rather than the rigid rate of return traditionally given to the bondholder.

(9) Compensating the equity investor for inflation all over again in the rate base after he has already been compensated for it in the rate of return overstates the cost of equity capital. [141] There is no more reason to do that than there is to overstate the cost of postage [142] or the cost of labor. [143]

(10) The depreciated original cost methodology is not based on the transparent fiction that a dollar is always a dollar. [144] Nor does it reflect a regulatory fixation on ancient accounting entries in dust-covered ledgers. Rather, it reflects:

(a) An aversion to overcompensation and to double counting, an aversion implicit in the cost-based concept; and

(b) Administrative convenience—there is no objection in principle to indexing the rate base to the purchasing power of the dollar, while eliminating the inflation component from the rate of return so that it is a so-called "real" rate, *i.e.*, a rate that would satisfy a rational investor in an inflation-free world.

(11) One arguable difficulty is that most regulated entities get most of their capital by borrowing and by selling preferred stock. As we have already observed, people who lend money and people who buy preferred stock cannot possibly benefit from upward adjustments to the rate base. [145] Their claims are fixed-dollar claims. [146] This means that the full benefit of the inflation-adjusted rate base goes to the common stockholder who supplies only part of the enterprise's capital. [147]

These concepts have not been spelled out in the Statutes at Large. Nor would they be known to one whose knowledge of regulation came solely from turning the pages of the United States Code. [148] As Justice Douglas said when he spoke for the Court in a great landmark case:

> Congress . . . has provided no formula by which the "just and reasonable" rate is to be determined. It has not filled in the details of the general prescription . . . It has not expressed in a specific rule the fixed principle of "just and reasonable." [149]

With respect to utilities, however, the conceptual system that we have outlined has long been part of the conventional wisdom. [150] True, the ideas involved are not spelled out in the statutes. They have been fashioned by regulatory agencies in response to the statutory mandate and blessed by the courts as an appropriate way to reach a proper "end result." [151]

What Congress was driving at in electricity and in gas was "the lowest reasonable rate." [152] It thought it essential that utility "rates be as low as possible." [153] The cost-based concept is a means to that end. So is the idea that the public interest demands that the supplier of equity capital be limited to the lowest return that will induce him to furnish fresh money on terms fair to the old investors and to just enough, to the bare minimum, that enables the enterprise to function well under private ownership.

But the Congress of 1906 was not the Congress of 1935 or of 1938. Nor can electricity and gas be equated mechanistically with the transportation of oil. There are some important differences between the transportation of oil, on the one hand, and the enterprise traditionally called "public utilities." [154]

The Commission has stated those differences this way:

> The statutes that we administer are drawn on the premise that buyers of electric power, natural gas transportation services, and oil pipeline transit are in no position to bargain on an equal footing with the sellers of those things.
>
> In those areas of the economy Congress saw what it deemed an imbalance of economic power. To redress that imbalance, it:
>
> (1) Required that the seller's rates and charges be "just and reasonable", and
>
> (2) Authorized and directed this Commission to put flesh on the bones of that vague and amorphous ideal, to apply that fleshed out ideal to the kaleidoscopic variety of situations that arise in these complex and variegated industries and to

> see to it that the buyers actually receive the benefit of the protective shield that Congress intended them to have.
>
> * * *
>
> When we work with electric power and natural gas, we focus on the ultimate consumer of energy. He is the person we are here to protect. . . .
>
> * * *
>
> But that rationale does not fit the oil pipeline case. In electric power and in natural gas we regulate the interstate wholesale aspects of industries whose intrastate and retail branches are subject to all-pervasive state regulation. That regulation is "cost-based". So . . . wholesale rate increases "flow through" to retail bills in short order . . .
>
> In oil, however, we deal with a relatively small regulated portion (pipeline transit) of a vast unregulated whole (oil). Hence the prices people pay for gasoline, for heating oil, and for other petroleum-based products are determined not by regulatory concepts, but by market forces. True, transportation costs enter into those market prices.
>
> Normally, however, the pipeline charge does not bulk large in the price of the end product. Moreover, market prices are influenced by such a variety of forces and factors that a pipeline rate increase (or for that matter a decrease) can well be rendered inaudible by, if it is not wholly lost in, the surrounding "noise". If the market for petroleum products is strong, prices will rise. And that is so even if pipeline charges stay the same. Conversely, if the cost of pipeline transit rises in a weak market for oil, producers and refiners will have to absorb much (and perhaps in some circumstances all) of the increased transportation cost. [155]

Some of the footnotes to the order from which we have just quoted are also germane to the instant inquiry. Footnote 1 distinguished natural gas production from natural gas transmission. It reads:

> Natural gas *production* [emphasis in the original] presents a special case that has been the subject of a heated public policy controversy for decades. That controversy is of no moment for present purposes. So we put it to one side. .

In this case too we put natural gas production "to one side." Suggestions have been made by witnesses and by counsel that the production of natural gas has much in connection with the shipment of oil over a pipeline. We find the idea hard to follow. And we give it little weight.

Pertinent in that regard is footnote 25 to the order to which we point. This footnote reads in pertinent part:

> Eccentricities of the particular industry must always be kept in mind. We take the word "eccentricities" from Mr. Justice Jackson's provocative dissent in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 628-660 (1944), in which he observed at page 629 of 320 U.S. that "Solutions of these cases must consider eccentricities of the industry which give rise to them. . . ." [156]

The Commission addressed one such "eccentricity" in footnote 21 to the same document, which reads:

> Though oil prices have been *"controlled"* from time to time, they have never been *"regulated."* Control is not to be confused with regulation. Regulation seeks to set just and reasonable prices. Controls do not purport to have much to do with the justice or the reasonableness of an *individual* [emphasis in the original] price. Controls simply seek to keep prices from rising. They do that by making the price as of some more or less arbitrarily chosen date or base period the maximum lawful price to which sellers must thereafter limit themselves.

This brings us to the impact of oil pipeline rates on consumers. The Commission dealt with that in the text of its 1980 order. The pertinent passage reads:

> From a consumer-welfare standpoint, oil pipeline rate increases are a horse of an altogether different color from increases in the wholesale cost of electric power and natural gas—in the instant case, for example, even if the *total* increase were to be flowed through, the impact on a consumer using 20 gallons of gasoline a week would be only 58.4 cents a year. [157] (Emphasis in the original).

The pungent footnote (n.23) appended to that statement points out that that 58.4 cents a year is "A far cry indeed from the consumer impact of the electric and gas rate increases that come before us."[158]

At a slightly later point in the text of that same order the Commission spoke of a "significant difference between the consumers of electricity and gas, on the one hand, and the shippers of oil, on the other." That difference, said the Commission, "comes to the fore when we look at the economic status of the two populations."[159]

The order continued:

> Nothing that has come to our attention suggests that there is a significant number of poor people who own oil wells or oil refineries. True, there is always somebody at the margin. And it is also true that even at today's prices there are some people in the oil business who are having a difficult time. Even for those marginal entrepreneurs, however, a pipeline rate increase is unlikely to have an impact at all comparable to the impact of a substantially higher gas bill or an inflated electric bill on a household that subsists wholly or almost wholly on social security benefits, unemployment compensation, the statutory minimum wage, or an inflation-ravaged fixed income.
>
> And even when we go up the economic ladder, we encounter millions of consumers in circumstances far more necessitous than those of all but the merest handful of producers and refiners. [160]

The Commission made the foregoing observations in 1980. And the statute was passed in 1906. However, much of what the Commission said in 1980 was also true in 1906. In 1906, as in 1980:

(1) Oil prices were unregulated; [161] and,

(2) There was no mechanism for flowing the benefit of lower oil pipeline rates through to the consumer.

Against this background, we see little, if any, reason to assume that the Progressive-Era Congress of 1906 that was legislating on behalf of independent oil producers [162] was thinking *exactly* the same thoughts about crude oil pipelines that the Depression-era Congresses of 1935 and 1938 were thinking about electric power and about natural gas transmission when they legislated on behalf of consumers. [163]

The words used at the turn of the century were the same as those used in the 1930's. But that tells us very little. Indeed, it tells us next to nothing. [164]

The phrase in question, "just and reasonable," is a high-level abstraction. It is a mere vessel into which meaning must be poured. The meaning can come only from the context in which the words were used and from careful attention to the ends that the legislators had in mind when they used them.

What do we see when we make that examination of context and purpose?

In electric power and in gas we see firms that render public services that everyone has always regarded as essential. From their very beginnings those firms were confronted by a formidable public ownership movement. At times that movement waxed. At other times it waned. Never, however, did it become extinct. [165]

The public ownership movement was far from extinction in the days of the New Deal. On the contrary, it was very formidable indeed during the Terrible Thirties when Federal regulation came to gas and electric rates. [166] It was also strong during the Progressive Era when the states began to regulate. [167]

The picture that emerges in electricity and in gas [168] is one of an industry haunted by what was from its perspective the specter of socialization. [169] To ward that evil off, the industry was prepared to cut a deal with its critics. The essence of the arrangement, which is still in effect, was that:

(1) The industry would submit to—indeed, it would welcome—regulation. [170]

(2) Though many years elapsed before that regulation had much real impact[171] or was cost-based in practice, [172] in theory at least, utility regulation was always fairly rigorous. [173]

(3) Monopolistic franchises and legally protected shelter from the icy blasts of competition were the quid pro quo that the industry received in return. [174]

(4) So over the years a tight regulatory structure was built as a politically acceptable, juridically sanctioned half-way house between unregulated private monopoly and outright public ownership. [175]

The oil pipeline picture has little in common with this. Consumers made no direct use of the lines. So there was no outcry from them. The outcry came from Standard's crude oil suppliers and to a lesser extent from its independent refiner-competitors. [176]

They were the people who either:

(1) Used the lines, or

(2) Wanted to use them or thought that they wanted to use them—but were precluded from doing so by Standard's prohibitive rates and by its other restrictive practices.

Since this was a quarrel among businessmen, there was no agitation for public ownership. [177] The number of Americans who cared enough about the pipelines to worry much about them and who were also radical enough to contemplate their socialization was far too small to fuel a really formidable movement for Government ownership.[178] Beleagured and detested though the Standard Oil Company was, it had no reason to share the fear of expropriation that haunted utility managers and utility investors.

Hence Standard, unlike the utilities, had no incentive to barter away any of its pre-existing entrepreneurial freedom with respect to its pipelines in return for shelter. from either:

(1) A drive for public ownership; or

(2) Competition.

Neither public ownership nor competition (actual or potential) from other people's pipelines was any threat to it.[179]

That is why Standard, unlike the utilities, resisted the the very idea of rate regulation[180] as long as it could, all the way up to the Supreme Court.[181] Of course, that is peripheral. Our primary concern is not with what the Standard Oil Company had in mind. It is with what the Congress of 1906 had in mind.

But that Congress didn't say what it had in mind.[182] So we are reduced to drawing inferences about its intent from the historical context in which it worked. There is no other way.[183]

When we look at the Hepburn Act's oil pipeline provisions in the historical context in which they are embedded, the first thing that strikes us is a negative. Congress was *not* legislating about *"utilities."* It was legislating about *"transportation."* It was amending the Interstate Commerce Act. And it was entrusting the administration of that amendment to the ICC.

Now in 1906 the ICC neither relied nor purported to rely on a rigorous cost-based paradigm. Its rate jurisprudence at that time was embryonic, inchoate, and notable neither for lucidity nor for tightness of reasoning.[184] It was a seat of the pants, informed (sort of informed anyhow) hunch, chancellor's foot, curbstone equity, rough justice kind of thing. It had little in common with the clear-cut concepts that the Federal Power Commission developed decades later.[185] Congress must have known that.[186]

We do not mean to say that the FPC was logical and precise, while the ICC clung obsessively to illogic and to imprecision. That is not so at all. What is involved is not a difference in reasoning power. It is a difference in the nature of the task.

Regulation at the FPC was, and regulation at the FERC still is, on a firm-by-firm basis.[187] That is true of public utility regulation generally. The regulators look intensively at the particular company under examination. Next week they take that same close look at some other company. These firm-specific inquiries lend themselves to meticulous cost analyses, to refined measurements of a particular firm's "cost of capital," and to efforts to align prices (a rate is nothing but a special kind of a price[188]), with costs as perfectly as fallible human judgment, the kaleidoscopic variety of real-world situations, and the slips and the glitches inherent in all kinds of adversary proceedings and in any kind of fact-finding permit.

Regulation at the ICC, on the other hand, was, and we believe still is, industry-wide in the main. That Commission dealt and deals with railroads and with truckers that compete with each other. It had to consider "weak" carriers as well as "strong" ones. It had to keep competitive relationships constantly in mind. Hence it *had* to be looser, more impressionistic, and conceptually fuzzier than a utility commission likes to be.

Examples may help make the point. When the Public Service Commission of the State of New York passes on the rates that people in New York City have to pay to the Consolidated Edison Company for gas and electricity, that Commission will generally have little reason in the normal case to consider the rates charged by other companies to other people in other places. [189] Ditto for this Commission when it passes on the rates that Consolidated Edison:

(1) Pays to the natural gas pipeline companies that sell it gas; and

(2) Charges other utilities for electric power that they buy from it for resale.

The position of the Interstate Commerce Commission in 1906, the key date for us when we try to figure out what the Congress of that year probably had in mind, was quite different. When that agency dealt with rail rates for the carriage of freight and passengers from New York to Chicago, it had to look at half a dozen different carriers who were vying with each other for that traffic. Some of those roads were very strong.[190] Others were weak. [191] The Commission had to consider the roads as a group and strike a balance between the *collective* interest of the carriers, on the one hand, and their ratepayers, on the other. [192]

It can, of course, be argued that general propositions about "transportation" in general versus "utilities" in general are meaningless here. Those who take that view would stress that whatever may have been going on with the railroads back in 1906, the pipelines were then as monopolistic as any business has ever been. They would proceed to point out that Congress knew that. Their conclusion would be that these rates were meant to be regulated tightly and that idle musings about transportation tradition do not advance the oil pipeline inquiry.

These arguments are not wholly implausible. [193] But we believe there is much more to be said on the other side. Oil pipelining was a specialized kind of transportation. The industry had been intimately associated with the railroads. Since the pipelines carried only crude at that time while refined products went by rail, we find it intrinsically implausible that Congress wanted to create two separate regulatory schemes—one for oil that moved by rail and the other for oil that moved by pipe. [194] We think it infinitely more probable that Congress thought that it was looking at a unitary oil transport problem that had been confused and confounded by partial regulation relating solely to railroads from 1887 to 1906 and that it broadened the coverage of the Interstate Commerce Act to include oil pipelines in order to close what must have been regarded as a pernicious regulatory gap.

Should that hypothesis be correct, it follows that:

(1) No radical break with transportation tradition was intended. [195]

(2) There is no historical support for the view that the legality of an oil pipeline rate *must* be tested solely by reference to the cost of service methodology traditionally applicable to utility rates. We move from these relatively inconclusive speculations about what the Congress of 1906 may or may not have intended about the extent to which traditional transportation lore was to be applicable to this very special type of carrier to another area in which history gives us a better light. [196]

What was the agitation that led to the statute about? What was the nature of the complaints? What was the evil perceived by those who sought and obtained legislative relief? What was the mischief to be suppressed? [197]

The answers we get when we put these questions to the historical materials in this field differ markedly from those produced by a study of the history of utility regulation, State or Federal. [198]

Turn of the century pipeline complaints and lamentations were unique. The charge against the railroads, against the electric companies, against the gas companies, and against the telephone and telegraph industries was that their rates were too high. [199] The charge against John D. Rockefeller was not this run-of-the-mill allegation that his rates were above the cost of service. It was that his rates were *"far"* above the cost of service and *"altogether excessive."* [200]

Indeed, Standard's rates were said to be "prohibitive." [201] That charge is worth a pause. It is, we believe, unprecedented in the annals of regulation.

Sellers want to make money. They want to buy cheap and sell dear. But they want to sell.

That is as true of monopolistic sellers as it is of those less happily situated. Electric companies want to sell electricity. Gas companies want to sell gas. And the American Telephone and Telegraph Company wants people to use the telephone.

But the old Standard Oil Company did *not* want people to use its pipelines. [202] It wanted to be in a position that enabled it to force the independent producer to sell his oil to it. [203] And it also wanted to reduce the independent refiner to a state of vassalage by creating an industrial milieu in which he was absolutely and totally dependent on Standard for his raw material. [204]

Prohibitive rates were a means to that end. [205] Congress wanted to forbid both the use of the means and the attainment of the end. The policy at which it fired was a policy of "prohibitive" pricing.

Against this background, it seems clear to us that the authors of the Hepburn Act's oil pipeline provisions did not use the words "just and reasonable" in the sense in which public utility lawyers have used them since the 1940's. [206]

We think that what was meant was not "public utility reasonableness," but ordinary commercial "reasonableness." [207] To be specific, we discern no intent to limit these carriers' rates to barebones cost. What we perceive is an effort to restrain gross overreaching and unconscionable gouging. [208]

Is the Original Understanding Really That Important?

The parties answer this question in the negative. The matters and things into which we have been delving for a good many pages were neither briefed nor argued. We gather that counsel deemed them irrelevant. [209]

What about the industry's adversaries? They too are loath to enmesh themselves in the events of 1906. Their legal position rests on public utility concepts that did not flower until after the Hepburn Act had been on the books for many years.

Now the lawyers engaged in this case are very able. That their notions of what is relevant differ so greatly from ours is a matter of some consequence. It suggests that we are giving more weight to history than it deserves. [210]

We are shaping public policy for the world of 1982, not the world of 1906. Why not do so in the light of our assessment of contemporary needs and of our conceptions of justice and reasonableness? Why worry so much about what Henry Cabot Lodge the elder may or may not have thought when neither he nor his colleagues told us what they thought? [211]

Why not do as the Supreme Court has done? When the High Court had to pass on the Fourteenth Amendment's impact on segregated public schools (a question somewhat more momentous than those that confront us here), it looked at lots of historical lumber. And it then brushed that whole body of antiquarian lore aside with a laconic, "we cannot turn the clock back to 1868 when the Amendment was adopted."[212]

Why then do we seem to be trying to turn the clock back to 1906 when the Hepburn Act was adopted? There are several answers to that. One is that the Commission is not the Supreme Court. Another is that the Interstate Commerce Act is not the Constitution. [213]

But the best answer is that we do not look to the entrails of 1906 for guidance as to what we *should* do. That would be silly. We go to the historical record only for the purpose of seeing what we *can* do. History limits our range of choice.

Sometimes it does so loudly and clearly. Assume, for example that we were to conclude that there are no longer any valid public policy reasons for regulating oil pipeline rates, that indeed there never were any such reasons, and that the Lodge Amendment to the bill that became the Hepburn Act was a pernicious political accident. We would not be free to act on that judgment. We would be in the position of a Prohibition-era Federal judge who in his private capacity considered the Eighteenth Amendment preposterous and disgraceful but who was nevertheless bound while at work to do what he could to enforce it.

In other instances history's voice is softer and less distinct. But it is not wholly inaudible. Here, for example, the complaining shippers and their allies tell us that the "*law*" is that we must regulate these rates in exactly the same way that we regulate the rates over which the former Federal Power Commission had jurisdiction. We are told that we have no choice, that the mandate for rigorous, cost-based regulation is inflexible and inexorable.

We go to the historical record to see whether that is true. We find that it isn't. That is an understatement.

What we actually find is a most substantial question about our power to regulate this industry along classical public utility lines. Our power to conform it in toto to the somewhat less stringent but nevertheless quite intrusive model that characterized other types of common carrier regulation until the deregulatory initiatives of recent years is also questionable.

These questions stem from:

(1) What Congress did about the pipelines in 1906; and

(2) What it did not do about them in later years.

The record of inaction is as prominent here as the record of action. [214]

Post-1906 amendments to the Interstate Commerce Act gave the agency that administered that statute a veritable arsenal of regulatory controls [215] over the construction of new facilities, the abandonment of service, the quality of service, and the finances of the carriers. [216] But these augmented powers were not granted with respect to oil pipelines. [217] What we have here is pure rate control unaccompanied by other restraints on entrepreneurial freedom. Legislators intent on rigor would, we think, have fashioned something more rigorous. [218]

The only judicial opinion that has ever dealt with the substance of oil pipeline regulation took the same view. [219] In that opinion the Court of Appeals for the District of Columbia Circuit said:

> *[W]e may infer a congressional intent to allow a freer play of competitive forces among oil pipeline companies than in other common carrier industries and we should be especially loath uncritically to import public utilities notions into this area without taking note of the degree of regulation and of the nature of the regulated business.* [220]

The Commission's Oil Pipeline Task

From the foregoing, we see that the Commission is:

(A) Neither free to deregulate this industry; nor

(B) Under an inflexible duty to regulate it in exactly the same way that the former Federal Power Commission regulated electric power prices and natural gas transportation rates.

Between those extremes there lies a wide middle range. The Commission's task is to find the point within that range at which the social cost-benefit ratio is optimal. That is no easy matter. We are not altogether sure that we have landed in the right place. [221] But we believe we have.

What we are sure of is that the road to our destination does not run through a law library. The answer for which we search cannot be derived by parsing precedents. [222] The maps we need are not juridical. [223] They are statistical. [224]

What Does Economic History Tell Us?

We turn to the statistics we deem relevant.

The heading suggests that we are about to inflict another historical disquisition on the parties and on the readers of our reports. And that is true. There is lots of history in this section. But it is here only for perspective. Our primary concern at this point and in the rest of the Opinion is with the world of today and of the recent past. This section is presentminded. So we begin with the present.

And we look at it through the consumer's glasses. We do so because we are ourselves consumers and because they are the people we are here to protect. So the logical questions with which to begin are: "How important is this subject to consumers? How much do they have at stake? Do they have *anything* at stake?"

The answers are clear.

For the contemporary American consumer, the most significant thing about the oil pipeline rate controversy is its utter insignificance. On an overall, industrywide basis, the pipeline charge came to 61 cents a barrel [225] in 1981. [226] Since there are 42 gallons in a barrel, that is approximately 1.5 cents a gallon. No great cause for perturbation there.

It can, of course, be argued that these figures understate matters. Some will say that they understate them badly and that realism demands that they be doubled. The argument in support of that position would be that the consumer pays two pipeline charges—one for the journey of the crude from well to refinery and the other for the journey of the end product from refinery to point of distribution. There is something to that. But it is an overstatement. Not every barrel of oil travels over pipes twice. Indeed, some of it never enters a pipe. And much of the rest of it travels by pipe for only a short distance.

Thus, for example, crude that comes into this country from abroad and crude produced in the coastal regions of the United States may travel by tanker and barge to refineries that are on the water. The product that those refineries turn out may also travel by water. To take that into account and to arrive at realistic estimates, we look to the pertinent aggregates. When we do so, we see that:

(A) In 1981 the American people spent at least $240 billion for petroleum products. [227]

(B) On the other hand, oil shippers paid a total of about $6.6 billion for pipeline transit. [228]

(C) But more than half of that $6.6 billion in aggregate revenue was generated by the Trans Alaska System. That is significant for several reasons. One is that practically all of the money paid to the consortium of integrated oil companies that owns the Trans Alaska System was a "wash." The system's owners paid it to themselves. That is so because on the Trans Alaska System there is an almost total identity of interest between the shippers and the owners. For all practical purposes, the shippers are the owners and the owners are the shippers. [229] Now that may be a bad thing for other people in the oil business. It may also be a bad thing for society in general. It may therefore call for rate controls of the utmost rigor, *i.e.*, for controls as stringent as those that the governing statute permits us to impose. [230]

What we are trying to do right now, however, is to gauge the short-run impact that pipeline rates have on the consumer. And though an argument can be made that the Trans Alaska rates have such an impact, the notion seems a bit far-fetched. [231] Of course, things are not always as they seem to be at first blush. To determine whether there is or is not a significant discrepancy between appearance and reality insofar as the impact of the Trans Alaska Pipeline System's rates on the American consumer is concerned and to consider the special public policy implications, if any, of the sheer size of that facility, of the fact that its rates per barrel are several times those charged for typical pipeline journeys in the Continental United States, and of the special risks that its construction may or may not have entailed, we put that case to one side for individualized treatment. [232] That being so, it would be wrong to toss the very special Alaskan numbers into our general statistical stew. The resulting concoction would be noisome and unnutritious.

(D) Hence we confine ourselves to the $3.22 billion collected in 1981 by common carrier oil pipelines other than TAPS. That is approximately 1.34% of the $240 billion that we consider a rock-bottom estimate of the nation's oil bill. So it is apparent that we are not dealing with something of the first order of magnitude.

(E) Three billion dollars a year (and in round numbers that is what we are talking about) is a lot of money. But it is not very much when viewed in relation to the nation's total oil bill.

(F) Moreover, our concern is with regulation and with what regulation can do for consumers. And here we are driven to the conclusion that oil pipelining is an industry in which the most assiduous, the most richly informed, the best-intentioned, and the most amply financed of regulatory efforts is incapable of doing anything of substance for the consumer. Viewed from his perspective, the amounts involved are too small to be worth worrying about. That is one factor. But there are also others which well may be more important. Those we consider significant are:

(1) The total absence of any legal mechanism for flowing the benefit of pipeline rate reductions through to the ultimate consumer; and

(2) The absence of any plausible basis for believing that the mechanics of the marketplace will necessarily lead to that result.

Our skepticism on that last score does not stem from a lack of faith in the market. It stems from the fact that oil is an extremely complex industry. [233] So the pricing process is also complex.

The forces that shape the price of the end product are many and varied. Hence there is no assurance that lower transportation costs to the refiner will *necessarily* mean lower prices for the motorist and the homeowner. [234] It might mean that to some extent at some times and in some circumstances. But in the short run at least it is just as likely to mean better margins for refiners who are not shipper-owners. [235]

Let us bring that last point down to earth. Is it likely that the arduous, protracted, pertinacious, and, we assume, quite expensive litigation effort that Kerr-McGee has made in this case [236] was motivated solely by a disinterested passion for consumer welfare? [237] That Kerr-McGee is interested in lower pipeline rates is clear. Is it equally clear that it is interested in them because it is yearning to act as a wholly uncompensated conduit through which the benefit of truly cost-based pipeline rates can be passed on to the American people? [238]

We think not. We think that Kerr-McGee's managers embarked on this litigation because they thought that success in it would benefit the company's shareholders. We see no reason to believe that consumer benefit was a significant factor in their cost-benefit calculations. [239]

This is not to say that it is wholly inconceivable that some consumers might in some circumstances reap some slight benefit from lower oil pipeline charges. But we do not see how that benefit could ever be large enough to be visible to the naked eye. [240] It would, if present at all, be of sub-microscopic dimensions.

From the consumer's perspective, oil pipeline rate regulation is akin to efforts to do something about the high price of shoes by controlling the price of shoe laces, [241] to contain the cost of food by seeing to it that the price of spice [242] is always "just and reasonable," [243] and to limit the cost of apparel by hitting hard at the price of buttons. [244]

Few rational consumers (and we assume that consumers are as rational as businessmen [245]) would expect much from such endeavors. [246] Such, so far as we can tell, is the consuming public's view of oil pipeline rate regulation. The subject appears to evoke nothing but yawns in consumerist circles.

That conclusion rests on these circumstances:

(1) Consumer groups and consumer spokesmen frequently intervene in proceedings before us.

(2) These proceedings have been well publicized. Everybody seriously interested in oil knows about this case.

(3) An earlier rulemaking proceeding that covered pretty much the same ground was also widely publicized. [247]

(4) Yet neither in this case nor in the abortive rulemaking did anybody who styled himself or herself a consumer or a consumer advocate darken either our door or the ICC's. [248]

That tells us something. And what it tells us is important. Neither consumers nor their champions deem the oil pipeline rate problem cosmically significant. Of course, law is not made by Gallup poll. Participatory democracy has yet to reach that point. Nevertheless, the fact that the putative beneficiaries of a proposed crusade are calmly indifferent to the crusaders' strenuous labors on their behalf cannot be shrugged off as wholly meaningless.

Suppose, for example, that the National Labor Relations Board and the courts that review its decisions were being urged to adopt a certain construction of the National Labor Relations Act on the ground that it would do wonders for organized labor. Suppose further that:

(1) This was being said—forcefully and elaborately said—by certain *employers*, by labor economists retained by those employers, and by members of the National Labor Relations Board's own staff; but that

(2) The labor movement itself were studiously indifferent to the whole fuss.

Would not such a state of affairs lead one to wonder about the validity of the policy premise being propounded? Would it not suggest that the self-styled "friends of organized labor" who were fighting so hard for its cause were really fighting for something quite different or in the alternative that they failed to think the subject through? [249]

Some will doubtless brand these views narrow-minded, short-sighted, and simplistic. This is a subject about which emotions run high. So we expect that. We also expect to be told that:

(1) We have merely repeated what we said at an earlier point [250] in fewer words.[251]

(2) This tactic of proof by reiteration won't wash. [252]

(3) Arithmetic was a marvelous invention. It has done wonders for humanity. But it has its limitations. Adjudication is not bookkeeping. A public policy inquiry into numbers begins with their magnitude. But it does not end there. Some numbers are more strategic than others. It is fallacious to look at A, find that it amounts to a billion dollars, then look at B, see that B also comes to a billion dollars, and conclude that A and B are equally significant. A billion dollars here is not necessarily the same as a

billion dollars there. In one context that sum may have a far greater impact on the economy and on society than it does in another.

(4) And the sums here involved are of decisive import. The monies that pipeline users pay to pipeline owners shape the structure of the oil industry. Hence the effect that pipeline charges have on the prices that consumers pay cannot be gauged by bookkeeping calculations.

(5) The Commission has forgotten the paradigm that it itself developed at the outset of this Opinion. [253]

Our difficulty with this critique is that it is wholly *a priori*. It is founded on the premise that the ownership of a pipeline carries with it the power to exploit. The central idea is that the structure of the oil industry enables pipeline owners to squeeze pipeline users. [254]

Now it is quite true that the Congress of 1906 legislated on the basis of these concepts. [255] No subsequent Congress has re-examined them. Hence we are constrained to regard them as valid in today's world. So we start from the premise that there is an evil to be remedied, or at the very least a potential evil to be curbed. [256] But Congress did not assess the *extent* or the gravity of that evil or potential evil. It left that to us. And we cannot discharge that function rationally unless we begin with some measurements.

There is an infinite variety of squeezes and potential squeezes. Some are almost imperceptible. Others can be fatal. At what point in that continuum does the oil pipeline squeeze fall? To answer that, we have to look at the numbers. When we do that, we begin with the $3 billion in gross receipts that the oil pipeline industry collected in 1981. But the industry's staunchest foes would not maintain that *all* of that $3 billion was unjustly extorted. They would concede that at least some of it was earned. How much of that $3 billion would these people say was "excess profit"?

We don't know. And we doubt that they do. Out-of-pocket expenditure for labor and supplies do not bulk as large in oil pipelining as they do in other businesses. Nevertheless, there are some such expenses. Moreover, capital investments are extremely substantial. Since the constitutional guarantees in favor of private property apply to integrated oil companies and to others who own pipelines, allowance must be made for a fair return on investment and for the depreciation of the facilities.

In assessing the magnitudes involved we must always keep in mind the fact that most of the oil that travels over the nation's pipeline network belongs to the shipper-owners themselves. So most of the putative "excess revenue" is a wash. Hence the very most that can be involved in broad social terms is a possible shift of a few hundred million dollars a year from the major integrated oil companies and from such "independent" pipeline operators as Williams to independent producers and independent refiners.

Some doubtless think that this would be good. Assume that they are right. The question then arises, *how* good would it be? We see no tenable basis for the view that this shift of income from pipeline owners to pipeline users would yield societal benefits large enough to warrant aggressive governmental intervention.

What could such intervention accomplish? The most that it could do would be to make the independents in the oil business slightly better off and the major integrated companies slightly worse off. What would that do for the people who are not in the oil business and who constitute the overwhelming majority of the American population? That is the question that concerns us when we ponder schemes for radical change. We have not received a satisfactory answer to it.

As noted many pages ago, "we are in an area where there is a counter-argument to every argument." [257] So we confidently expect some to argue that our social arithmetic is badly flawed. They may well point to what history tells us about prohibitive pricing in this field. The reasoning would doubtless go something like this:

(1) What is wrong with oil pipeline rates is that they go, if unrestrained, to sky-high levels.

(2) The higher those rates go, the more serious the problem.

(3) If they go high enough, *nobody* can use the lines other than those who own them. These outlandishly high rates force the independent producer to sell in the fields to the majors. Stratospheric rates for refined products cripple the independent refiner. Those make it impossible for him to bring his gasoline, heating oil or other product to market on viable terms.

(4) In that situation *all* of the pipelines' business comes from the owners themselves. They do not collect a nickel from anybody else. The whole thing is a "wash." So from a bookkeeper's vantage point, there is now no excess revenue at all.

(5) The more serious the problem, the less important it is. That is palpable nonsense. It shows how deceptive pure numerology can be here. The truth is exactly the other way around. The lower the visible excess revenue contributed by non-owners, the greater the problem.

That view cannot be dismissed out of hand. It has a long and an involved history. Our problem with it is that it has very little, if anything, of a present and even less of a future.

Many years have now elapsed since much was heard about "prohibitive pricing." It is certainly not what the shipper-protestants in this litigation are complaining about. They do not maintain that Williams is trying to keep them off its lines. [258]

Now we have to take another long look at history. We know that prohibitive pricing was common in 1906. That is why Congress legislated. But nothing actually happened. The law in the books was one thing. The law in action was quite another. Indeed, there was no action. The ICC was preoccupied by railroad problems. So it left the pipelines alone. [259]

That is why things during the Great Depression were pretty much as they had been a generation earlier when Congress legislated back in 1906. Thus in 1931, the first year for which we have reliable data: [260]

(A) Crude sold for 65¢ a barrel.

(B) Pipeline charges averaged 44¢ a barrel.

(C) So the pipelines' charge was 68% of what the producer got for his crude.

That was the "Golden Age" of the pipelines. They were a cash cow for the former Standard companies. But most of that cash was their own. Their enormous pipeline paper profits came from themselves.

Perhaps there was a method to their madness. Were they following the old Rockefeller principle of prohibitive pricing? Did they continue to do so until the Great Depression shook things up? [261]

For present purposes, the troubled years between the stock market crash of 1929 and the attack on Pearl Harbor are notable for two things:

(1) Pipelines became even more important than they had previously been because technological developments (improved seamless and welded pipe, plus electric welding of pipe joints, together with the development of safety devices to cut down malfunctioning operations—all three made their appearance in the late 1920's) permitted gasoline and other refined products to be sent by pipe. This development coincided with the onset of the Depression. So surplus crude pipeline capacity was available. Accordingly, some crude oil lines were converted to refined products use. Their success led to the construction of many new lines for the carriage of refined products.

(2) The regulatory system that this Commission found in place on October 1, 1977, when it inherited the ICC's oil pipeline rate functions was fashioned during the Depression years in response to the ferment of that time.

The Depression recreated the low prices, the gluts, the widespread belief that the pipeline monopolists were choking the small man in oil to death and the demand for drastic action to stop them from doing this that were so prominent at the turn of the century. [262] It was 1906 all over again. [263] So both Congress and the Executive branch were much interested in pipelines. [264]

That interest led to a statute that authorized the President to institute proceedings to divorce pipelines from holding companies whenever unfair practices or exorbitant rates tended to create a monopoly. [265] Once again the industry was haunted by the old specter of divestiture. [266] Its response was to beseech the ICC to "regulate," after a fashion at least.

As a historian friendly to the industry and to the ICC observes:

> Clearly, the regulatory body once feared by pipeliners had now come to be regarded as a bulwark against the danger associated with unpredictable Congressional action. The ICC had shown no disposition to question pipeline practices which would upset pipeline relationships. If anything, the existence of a regulatory statute had strengthened them by accepting the integrated framework as given. What was to be feared, then, was that Congress might, without fully comprehending the consequences, decide to force an alteration in the integrated structure with which the ICC was accustomed to working. [267]

Here, as elsewhere in the economy and in the society, much happened between 1931 and 1941. For one thing there was a tremendous agitation about pipeline rates. [268] That drove pipeline charges down by almost 50%. [269] The 44¢ a barrel paid in 1931 dropped to 24¢ a barrel by 1941. [270] The other blade of the scissors also changed during this tempestuous decade. By 1941 thanks to various New Deal programs, the Texas Railroad Commission's production limitation efforts, and a mild recovery from the depths of the Depression, crude was up to $1.02 a barrel. [271] So in 1941 the pipeline charge was 21% of what the producer got for his crude, compared to 68% in 1931.

Now let us look at 1950. By that time crude was up to $2.51 a barrel, about four times its 1931 price. But the pipeline charge held steady at 24¢ a barrel, roughly half of what it had been during the Depression. So the pipeline charge was down to 10% of the cost of crude.

In 1961 the pipeline charge was still 24¢ a barrel. But the price of crude was higher than it had been in 1951. So the pipeline charge dropped to 8% of the cost of crude.

We move to 1971, when this case began. In that year:

(A) Crude was up to $3.39 a barrel.

(B) But the pipeline charge had dropped to 20¢ a barrel.

(C) So our crucial ratio was down to 6%, a far cry from the 68% of 1931, the 24% of 1941, or even the 10% of 1950.

Moving to 1981 and with the cost of crude at $31.77 a barrel and the average pipeline charge at 61 cents a barrel, we get a critical ratio of 2%. [272]

A transportation charge of 61 cents tacked on to something that costs $31.77 may be too low, just right, or too high. But even if one takes the view that this charge is far higher than it ideally ought to be, it is hard to see how it can be branded "prohibitive." Much water has gone under the bridge since an uproar about prohibitive oil pipeline charges was last heard in the land. Prohibitive oil pipeline rate structures are now a problem for the economic historian.

Prohibitive pricing was consigned to antiquarians long before OPEC and the post-1973 advance in oil prices.

The table below tells the story:

Year	*(1) Barrels Originated (in Millions)*[a]	*(2) Pipeline Revenues (in Millions of Dollars)*	*(3) Revenue Per Barrel (in cents)*	*(4) Cost of Crude (in dollars)*[b]	*(5) Ratio of (3) to (4)*
1931	505	223	44	.65	68%
1932	533	212	40	.87	46
1933	567	217	38	.67	57
1934	593	199	34	1.00	34
1935	767	197	26	.97	27
1936	807	219	27	1.09	25
1937	948	248	26	1.18	22
1938	858	228	27	1.13	24
1939	873	212	24	1.02	24
1940	958	226	24	1.02	24
1941	1053	252	24	1.14	21
1942	1074	245	23	1.19	19
1943	1266	277	22	1.20	18
1944	1424	310	22	1.21	18
1945	1442	304	21	1.22	17
1946	1472	294	20	1.41	14
1947	1618	325	20	1.93	10
1948	1814	376	20	2.60	8
1949	1656	377	23	2.54	9
1950	1822	442	24	2.51	10
1951	2119	524	25	2.53	10
1952	2195	562	26	2.53	10
1953	2296	591	26	2.68	10
1954	2331	617	26	2.78	9
1955	2624	678	26	2.77	9
1956	2858	737	26	2.79	9
1957	2850	730	26	3.09	8

1958	2775	721	26	3.01	9
1959	3031	765	25	2.90	9
1960	3147	770	24	2.88	8
1961	3302	787	24	2.89	8
1962	3457	811	24	2.90	8
1963	3649	840	23	2.89	8
1964	3948	865	22	2.88	8
1965	4247	904	21	2.86	7
1966	4600	941	20	2.88	7
1967	5056	995	20	2.92	7
1968	5407	1023	19	2.94	6
1969	5721	1103	19	3.09	6
1970	6018	1188	20	3.18	6
1971	6114	1249	20	3.39	6
1972	6511	1338	21	3.39	6
1973	6804	1446	21	3.89	5
1974	6648	1587	24	6.74	4
1975	6659	1874	28	7.56	4
1976	6664	2137	32	8.14	4
1977	6719	2818	42	8.57	5
1978	6733	4990	74	8.96	8
1979	7477	5781	77	12.51	6
1980	6501	6356	97	21.19	5
1981	5768	6629	111	31.77	3½
W/O TAPS					
1977	6622	2282	35	8.57	4
1978	6337	2642	42	8.96	5
1979	7010	2897	41	12.51	3
1980	5949	2931	49	21.19	2
1981	5217	3216	61	31.77	2

SOURCES: Interstate Commerce Commission Transport Statistics in the United States 1931--1976; FERC Form P Annual Reports 1977--1981; Petroleum Facts and Figures (1971) pp. 86--87 for 1931--1967; Basic Petroleum Data Book for 1968--1980; Energy Information Administration, U.S. Department of Energy, Monthly Energy Review, for 1981.

[a] Crude and Refined.
[b] Average United States domestic crude price at the wellhead.

Economists like the adjective "marginal." We are tempted to apply that label to these numbers. But we fear that this would be wrong. It would exaggerate their significance.

Something that has escaped us may be lurking beneath this unexciting numerical surface. If so, those who think the oil pipeline rate problem grave must show us what that something is and why it is important. They have not done that. They have not even tried to do it. The statistics we have just presented are in the public domain. The materials on which they are based must be known to the people who worked so hard and so long on this cause. Yet they avoided them. We had to ferret them out for ourselves.

Do those who maintain with an ardor reminiscent of Ida Tarbell that oil pipeline rate reform is one of the great questions before the Republic have a numerical leg on which to stand? That is the question. We conclude that they do not. That suggests that the oil pipeline rate reform crusade is anachronistic. It sounds like a blast from the past. This looks like an idealogical war that has been overtaken by events so that the combatants' rhetoric is no longer in touch with reality.

Let us return to our numbers. They show that pipeline revenue per barrel averaged 24¢ in 1941. In 1951 after the Second World War and after a substantial bout of inflation it had risen by only a penny to 25¢. Thereafter its course was erratic. But it did not escalate upward, as practically every other price did.

Indeed, it fell as low as 19¢ in 1968 and 1969. Remember now that the figure for the year 1931 was 44¢. So the price of oil pipeline transit in *nominal* dollars in 1969 was a mere 43% of what it had been in 1931. In real dollar terms the drop in price was of course far more impressive. True, the price rose after 1970. But that rise was as nothing compared to the rise in the price of oil itself.

As late as 1979 the price was 41¢. In nominal terms that was about 7% lower than 1931's 44¢. Again in nominal terms it was just about the same as 1932's 40¢. What other kind of transportation service could have been bought in 1979 for exactly what it cost in 1932?

The industry's critics would undoubtedly laugh at the notion that these price phenomena stem from an epidemic of altruism among pipeline owners. So do we. When it comes to regulation as it has been practiced up to now, we know that those same critics scoff at it as a meaningless exercise in total futility. That leaves them in a position that seems untenable to us.

They maintain that:

(1) The owners of the lines are grasping and mercenary.

(2) Regulation has not restrained them.

(3) Oil pipelining is essentially monopolistic.

To stick to these theses in their all-out form one must ignore the industry's post-1940 price history. In other words one must remain obsessively fixated on a theory formulated in Ida Tarbell's day. We think this "DON'T CONFUSE ME WITH THE FACTS" stance inappropriate.

It is obvious that something has been holding these rates down. That something must be a marketplace force. The industry labels that force "competition." The parties have spent much time and great energy debating this matter of competition. Each set of protagonists makes valid points. This is a rather "soft" kind of competition. It appears to be of a live and let-live kind. But this does not mean that it is not there. Nor does it necessarily negate a finding of considerable potency.

Competition and monopoly are hard to measure. Save at the extremes (for example, retail local telephone service at one pole and wheat growing at the other), disinterested expert observers often differ sharply about exactly how competitive a given walk of life is. In this industry the inquiry is complicated by the shipper-owner phenomenon. The factors that seem salient to us are these:

(1) The development of large-diameter lines that cost far more to build than the old Standard Oil Company's facilities did back in John D. Rockefeller's day has had two significant effects:

(A) Joint ventures among oil companies have become widespread.

(B) Prohibitive pricing has become uneconomic. That strategy used to be rational. But it no longer is. The owners of the facilities generally want to keep their lines as full as possible. They want to maximize throughput. That objective is incompatible with the old tactic of charging *more* than the traffic would bear and move freely. [273]

(2) No oil company (not even the largest) is wholly self-sufficient in transportation. Every company makes some use at some times of lines owned by others.

To analyze the consequences of this state of affairs, one must dig beneath the surface. Assume for example a pipeline that *looks* as monopolistic as the local electric company. It runs from one inland point to another so that it has no maritime competition to speak of. Moreover, there is no other pipeline in the area. This does not mean that our hypothetical pipeline has the market power that a local telephone company or electric utility has. That pipeline's most important customers are large oil companies. They are the ones who have lots of oil to move.

And some of those companies will have no ownership interest in the line. That will most assuredly be so when, as in the instant case, the line is independently owned.

Is it likely that these large non-owner shippers will long permit even a seemingly monopolistic carrier to loot them? Would Exxon or Mobil permit a Williams, a Buckeye, a Mapco, or a Kaneb to steal it blind? Would Exxon permit Mobil to do so?

We think not. Perhaps there are contexts in which the major oil companies behave like a band of brothers. [274] But brothers have been known to stand on their rights in their business dealings with each other.

True, the potential competition that we think omnipresent here is not the kind of competition on which college sophomores are examined. Nor is it the kind of competition that the agriculturist, the trader in securities, and the retail merchant face. All of the major oil companies are themselves pipeline owners. Hence it is reasonable to suppose that none of them is eager to upset the apple cart. They do not squabble with each other in public about pipeline rates. [275]

So it is quite likely that there are many instances in which shippers deem it politic to pay more (perhaps on occasion a good deal more) than they would like to pay for the sake of peace and quiet. But obviously this patience has its limits. It follows that few, if any, pipeline owners are able to gouge their most important customers with impunity. And since the statute bars rate discrimination, small shippers are the unintended incidental beneficiaries of the potential competition among the giants. Our study of the literature leads us to believe that the Antitrust Division, the carriers' oldest and most persistent adversary, is in accord with these views.

In this case and in related proceedings before us it insists on the crying need for drastic oil pipeline rate reform. It also maintains with great fervor that there will be no justice in the world of oil until pipeline rates are "cost-based" in the public utility sense of that term. We do not impugn the sincerity of the Justice Department lawyers and economists who have made these arguments. Nevertheless we see considerable evidence that they no longer regard oil pipeline *rates* as the central problem. [276] The next section explains what we have in mind.

The Undersizing Hypothesis and its Significance

In recent years the Antitrust Division's economists have developed an analysis that has come to be called the "undersizing hypothesis." It goes like this:

(1) Integrated oil companies try to see to it that there is a shortage of pipeline capacity.

(2) They attain that objective by undersizing their lines.

(3) They do that in order to create a situation in which some of the oil that moves from A to B is forced to travel by truck or by train at costs appreciably higher than those that would be paid were adequate pipeline capacity available.

(4) Thus the marginal barrel that hits the market at B carries an unnecessarily high transportation cost.

(5) The price at B will be set by the cost of that marginal barrel.

(6) That cost is higher than the cost of the barrels that move by pipe.

(7) It is also higher than the *average* cost of all the oil that goes into B.

(8) The result is a phantom freight charge that holds an umbrella over the price of all the oil in the market and that is therefore a significant source of monopoly profit, inimical to the consumer.

Is this what actually happens? Or is it just economic science fiction? Those questions have been much debated. [277] We need not pass on them. They are irrelevant for us. That is so because we have no power to do anything about undersizing.

For present purposes, it really does not matter whether the undersizing hypothesis is true or false. What is important is that:

(1) It has been propounded; [278] and

(2) The Antitrust Division, the industry's most persistent and most knowledgeable antagonist, has propounded it. [279]

This shows that the Division does not believe that the old strategy of gouging and of prohibitive pricing is still viable. After all, that strategy is much simpler than the involved undersizing tactic. It is also much cheaper. [280]

Yet the Antitrust Division believes that pricing policy is supplemented by sizing shenanigans. But would those be resorted to if pricing policies were still what they were in 1906 or 1936? We think not.

The Implications of the Foregoing for Administrative Policy—

Herein of the Public Law Model Versus The Private Law Model

What are the administrative implications of all this?

We think this an area in which the statutory text (having regard to what it does not say as well as to what it says), its historical context, and contemporary economic reality all point to the conclusion that rigorous controls, zealous sua sponte enforcement efforts by the Commission and elaborate multifaceted inquiries into every nook and cranny of the regulated entities' affairs are out of place.

To draw a medical analogy, what we have here is something on the order of an ingrown toenail or dandruff rather than schizophrenia or tuberculosis. Important though public health is, few would see much to be said for a massive commitment of resources to an all-out war on ingrown toenails or dandruff. This is not to say that nothing at all should be done about those ailments. And that is pretty much our view of the oil pipeline rate problem.

It was also the way in which the ICC looked at these matters. That agency considered itself a passive Oil Pipeline Rate Court. Like other courts, it waited for litigants to bring business to it. [281] Until this case came along, none did. [282]

When this Commission inherited the ICC's oil pipeline rate jurisdiction, it found that way of doing or not doing things strange. It was diametrically opposed to the Federal Power Commission's activist tradition. It was scathingly denounced by the Department of Justice and by others as a policy of "See no evil, hear no evil." And it was out of tune with contemporary regulatory thought. [283]

Accordingly, this Commission's staff broke with the ICC's tradition of passivity. When our Oil Pipeline Board was presented with a rate increase filing that looked a bit suspicious to it, it suspended. Those suspensions were numerous. For a long time their duration was seven months, the maximum period permitted by the governing statute.

At the end of 1980, however, the Commission decided that this was wrong. It directed its Oil Pipeline Board "to refrain from suspending for more than a single day." [284] However, the policy of suspending rate increase applications on the agency's own motion whenever its staff saw circumstances that it thought called for an inquiry, even where nothing was heard from anyone who claimed to be aggrieved, remained in effect. It is still in effect.

We must now decide whether it should be continued. After some reflection, we hold that this policy was and is wrong. Hence we now scrap it.

We think that the policy was confused. Those who formulated it took ideas that make sense in and are indeed basic to public utility regulation, ideas to which they were accustomed, and replanted them in alien soil better suited to the private law model. Those who did that acted in good faith and in accordance with their conception of the public interest. However they failed to draw distinctions that seem crucial to us.[285]

The conflicts that the Commission has to arbitrate here are not clashes between helpless consumers and strategically situated sellers. These are conflicts among business men. True, those who sell pipeline transit are generally bigger and richer than those who buy it. Nevertheless, it seems to us that the buyers are well able "to fend for themselves." [286] Hence we find the private law model fitting and proper.

Those who take a different view maintain that the shippers are helpless pawns in the carriers' hands and that they are cowed and coerced. But that conclusion is simply inconsistent with the evidence. It seems to us that history shows that the independent producers in the oil business are entirely capable of protecting their own self-interest and that they are not shy about fighting to advance it. [287] This industry is not populated by pacifists. In spite of the coercive tactics to which John D. Rockefeller is alleged to have been prone, his competitors raised a deafening outcry about pipelines back in 1906. The Great Depression led to a second round of vociferous agitation on this subject. Against that background, the notion that the relative silence that has enveloped this allegedly cosmic issue during the past generation stems from fear and coercion simply won't wash.

Neither have the independent refiners been the least bit shy about taking on the majors with respect to other issues. We have seen much evidence of that in our work under the Emergency Petroleum Allocation Act of 1974. [288] Many of the cases that come to us under that statute involve clashes between large integrated companies on the one hand and small refiners on the other. [289] The small refiners are uninhibited, belligerent and obviously well capable of looking after their own interests.

They are said to be inhibited and passive here. That suggests to us that this subject does not matter that much to them. And if an oil pipeline rate does not matter materially to those who pay it, we find it hard to see why it should matter materially to us or to the taxpayers from whose earnings our salaries come.

Accordingly, we make the following administrative determinations:

(1) From this day forward, no oil pipeline rate filing is to be suspended or investigated unless someone outside the Commission requests such action.

(2) That someone need not be a shipper. He may be a *prospective* shipper who claims that a prohibitive rate will bar him from the line. He may be a dealer in oil who neither ships nor plans to ship over the line, but who nevertheless claims to be adversely affected by the rate. It may be a state or a local government concerned about the impact of the rate on the economy of its area. It may be the Antitrust Division. It may be *anybody* who asserts some semblance of an interest in the matter, as entrepreneur, as consumer, or as citizen. We do not propose to invoke restrictive conceptions of standing. We wish to give everyone who claims to be affected by one of these rates an opportunity to be heard without squandering staff resources on an area that is seldom of moment to consumers.

(3) As a general rule, the Commission's trial staff should refrain from participation in these cases. [290] That is not an inflexible ban. This is an area in which we shall rely on the seasoned administrative judgment of the Director of our Office of Pipeline and Producer Regulation and of our General Counsel. Should they see something in a particular case initiated at the instance of outsiders that causes them to deem staff participation in the controversy appropriate, they are at liberty to commit the Commission's resources to the matter without consulting us.

(4) Save for filings germane to this consolidated cause, for others that have evoked interventions or protests, pending oil pipeline rate investigation and suspension dockets should be resolved expeditiously. Staff is instructed to bring these dockets before the Commission forthwith. The Commission will deal with them as presented.[291]

The Commission's Approach to its Oil Pipeline Ratemaking Task—Another Word

We are about to grapple with the nuts and bolts: rate base, rate of return, and all the rest of it. Before we examine those trees, however, we think it well to say a little more about our view of the forest as a whole. Like the policeman's, the regulator's lot is not a happy one.

Regulators are condemned to steer a difficult and uneasy course between the Scylla of too little and the Charybdis of too much. If they give too little, they frustrate the reasonable expectations of those who have supplied capital to the regulated entities. Over the long run that frustration raises the cost of capital. Hence it is actually anti-consumer. If severe enough and if protracted enough, that course jeopardizes the survival of the regulated industries and the continuity of the essential services they furnish to the community.

If the regulators give too much, they:

(A) Defeat the ends that the authors of the governing statutes had in mind and are thus false to their regulatory mission;

(B) Cause consumers to pay more than they should; and

(C) Encourage pernicious and socially wasteful overinvestment in the industry they regulate.

In recent years utility regulators have by and large worried more about the second set of dangers than the first. They have focused on the consumers' short-run interest. This emphasis has not enabled them to keep rates from rising. That is impossible in this day and age. But they have exerted themselves to restrain the pace of rate increase.

That has doubtless been overdone at some times and in some places. The results have not been good. Nevertheless, one can understand (and up to a point sympathize with) the mechanisms at work.

Politics has something to do with it. Those who pay rates also vote. But that is not the whole story. Regulators strive, and should strive, for "the lowest reasonable rate." The statutes they administer were passed to help the consumer.

Hence it is only natural for the regulators to resolve doubts in favor of the consumer. That propensity pinches the investor now and then. [292] But electric companies, gas companies, and telephone companies seldom go out of business. Rarely, if ever, are petitions for relief under the Bankruptcy Act filed by or against them. They are in a position to withstand a good deal of punishment. Even when their financial position is difficult, they are seldom totally barred from the capital markets. They may have to sell securities on unfavorable terms. But they can generally sell them. Thus regulators are tempted to take a chance. Should hindsight suggest that their decisions have been too niggardly, they can be more generous the next time around. After all, they know that the next time will come quite soon.

We take a different view of oil pipelining. It seems to us that there the dangers of giving too little vastly outweigh those of giving too much. That is not to say that we should go out of our way to give too much.

But it does seem best to err on the side of liberality. That will sometimes cause independents in the oil business to pay a little more than some think they should. But we find it hard to discern any other evil effects.

The consumer's interest in this subject, if he has any at all, is submicroscopic. So his welfare is not implicated. Nor does there appear any real danger of overinvestment. When an electric utility manages to induce regulators to give it a return of 17% even though its true cost of capital is only 12%, its managers have an incentive to overspend and to goldplate. Every dollar they invest in the facility goes into the rate base and thus enriches their shareholders. That is so even if there is no real social need for the new plant.

It is very hard to see that happening in oil pipelines. Those lines are generally built by the integrated oil companies that make greater use of them than anyone else. Overinvestment and the deliberate manufacture of excess capacity would enable them to squeeze a few dishonest dollars out of the independents. But the odds are that every dollar they picked up that way would cost them several dollars of their own.

Remember that they are their own most important customers. That is what makes this industry unique.

Large oil companies have been accused of many sins. Rarely, however, have they been indicted for economic irrationality or for carelessness with their own money. [293] So they are most unlikely to throw huge amounts of money around on pipelines for which there is no need. What percentage would there be in that?

The industry and its foes agree about this. Indeed, its foes accuse it of underinvestment, *i.e.*, of undersizing the lines. That accusation may be unfounded or exaggerated. Even those who are most skeptical about it would, we think, agree that there is no tenable basis for assuming a propensity to overinvest.

The worrisome thing here is underinvestment. That is the real danger. What we think crucial about that is this:

(1) Everybody agrees that the nation needs and will need more pipeline plant.

(2) That plant will not be built unless the major integrated oil companies find it in their own interest to build it.

(3) Those companies have lots of places to put their money. They are under no compulsion to invest in oil pipelines. Should the incentives for such investment appear insufficient to them, they will invest in other things. [294]

(4) Should that happen, consumers will suffer because there are so many situations in which a pipeline that charges much more than members of our staff and people of like mind think appropriate is still far cheaper than trains or trucks.

Enough of things in general. We now move to the specifics.

Rate Base

In its oil pipeline work, though not in other areas, the ICC used a fair value rate base. So the rate base was an amalgam. Its principal elements were original cost and reproduction cost. Those who like that way of doing things say that it is well suited to contemporary needs because it produces inflation-sensitive rate bases. That is true. It does.

Two factors are at work here. The first is that any methodology that blends reproduction cost with original cost is bound to reflect inflation to some extent. The second is that the ICC used *weighted* averages. That is important.

In the case of a new pipeline, the weighting has no significant effect. If the line is new, the cost of reproducing it will in all probability be fairly close to the amount that has just been spent to bring it into being. But most pipelines are not new. Moreover, ours is an age of inflation. Hence estimated reproduction cost is normally higher than original cost. Because the average of the two is a weighted one, original cost becomes the subordinate and reproduction cost the dominant factor.

Suppose, for example, that the original cost was $1 million but the cost of reproduction is estimated at $3 million. The unweighted average of the two would be $2 million. But the weighted average is $2-1/2 million.

Seemingly permanent inflation has been the most striking economic phenomenon of our time. We do not deprecate its significance. Who in his or her right mind would?

However, inflation does not explain what we find here. Assume arguendo that inflation ought to be reflected in the rate base. Why reflect it in this clumsy half-hearted fashion? What need is there for all this complicated blending? Why this peculiar looking formula? [295] Why not go to a pure reproduction cost or replacement cost rate base? Why give any weight at all to original cost?

Other questions also come to mind. How could inflation have had any bearing on the origin of a regulatory system invented during the Terrible Thirties? At that time inflation was no problem. It figured only in economic history textbooks. The economic concerns of the day were mass unemployment and serious deflation.

Thus we see that:

(1) Inflation explains neither the origin of the ICC's rate base methodology nor the industry's passionate love affair with that approach. The explanation obviously lies elsewhere.

(2) Part of it comes from a legal tradition that was long ago discredited and that is now of little interest to anybody who is not a constitutional historian. That tradition held that the Constitution gives regulated industries a vested right to a fair return on the "fair value" of their properties. This explains the origin of the methodology.

(3) The industry's present affection for this ancient tradition stems from the fact that it can be used as the predicate for an argument that the supplier of capital is entitled to an inflation-sensitive rate base plus a rate of return that is also inflation-sensitive.

Mention should also be made of the ICC's treatment of oil pipeline depreciation.

It did not synchronize the annual depreciation charge that enters into the cost of service with the depreciation deductions that enter into the rate base calculations. Assume, for example, property with an estimated useful life of 40 years. Assume further that its original cost was $1 million. For cost of service purposes, the ICC treated these facts in exactly the same way that the Federal Power Commission treated them. Depreciation was computed on a straight-line basis. In our hypothetical case this meant that the ratepayers had to contribute $25,000 a year to the carrier in order to reimburse it for the aging of the property.

When it comes to rate base, however, the two methodologies diverge sharply. The FPC's depreciation rate base methodology is very simple. Whenever a dollar is recovered from the ratepayer by way of depreciation charges, that same dollar is deducted from the rate base.

We return to our hypothetical case. Assume that 30 of the postulated 40 years of useful life are already gone. This means that the facility has travelled three-fourths of the way to the grave. Seventy-five percent of its assumed life span is presumed to be gone forever. So there is only 25% left. Hence the rate base on which the fair return is to be earned is 25% of $1 million or $250,000.

The ICC's oil pipeline rate base calculations do not ignore depreciation. They take account of it. But rate base depreciation is viewed as something different from cost of service depreciation. For rate base purposes, properties are deemed to depreciate at a somewhat faster clip than straight line. After a while, however, that changes. The rate at which the property is written off slows down considerably. [296] Let us return once more to our hypothetical case about the property with a useful life of 40 years, 30 of which are gone forever.

We have seen that under the FPC's method only 25% of that property's assumed value remains in the rate base. Under the ICC's method, however, the proportion remaining in the rate base is 37%. [297] That is important for elderly pipelines. [298]

To see just how important it can be, let us look in our hypothetical situation when the property is 50 years old. [299] Under generally accepted accounting principles and under the FPC's way of looking at things, there is no rate base left. [300]

Since the property is still in use, the consumer continues to benefit from it. But he no longer pays anything for that benefit. He gets it for free on the theory that he has already repaid the the original investment through the depreciation charge.

The ICC, on the other hand, reasoned that anything that is still in use must be worth something. Hence its oil pipeline methodology assigns some value to everything that has not been retired. Thus, for example, the ICC would give our hypothetical 50-year old plant a depreciated value called in its rate base terminology "a condition percent" [301] of 16%. [302] So property that is half a century old and which is worth zero when we wear our gas and electric hats, is worth a tidy sum when we wear our oil pipeline hat. [303]

Enough has been said to show that rigorous logic and Euclidean consistency are not the system's most striking features. [304] That in other circumstances would be a fatal flaw. Were we dealing with matters of vital import to the consumer, these anomalies and inconsistencies would render the method unusable. So too if we were trying to arrive at the precise cost of service. These ancient instruments are much too blunt and much too clumsy for close work.

But this is not close work. Hence the ICC's concepts are usable. They are not ideal. Nor are we overly enamored of them. Were we beginning afresh on a clean slate, we might be inclined to use something different, perhaps something along the lines suggested by Marathon's witness Meyers.

However, in our judgment, to impose such regulatory constraints on the oil pipeline industry would not yield social benefits either to consumers or shippers sufficient to warrant the regulatory costs or the potential disruption of the industry. Our objective here is, therefore, a pragmatic test. For that a rate base that might flunk an examination in logic is usable provided that the combination of rate base and rate of return provides a socially acceptable end result.

In this connection it is essential to remember that the ICC used a highly specialized variant of fair value. [305] Many of the objectives that were aimed at in the fair value mystique of old and that eventually brought it down are inapplicable here. Others are of limited weight.

The differences between classical fair value and the ICC's oil pipeline version of that concept can be summarized as follows:

	Classical Fair Value	*ICC-FERC Oil Pipeline Valuation*
(1)	Was said to be rooted in the Constitution. Accordingly, there was no escape from it.	Not demanded by any legal imperative. Hence Congress is free to alter it. And should a proper showing be made, the Commission is free to depart from it—even under the statute as it is. [306]

(2)	Was hopelessly vague. Many factors had to be considered. But nobody knew which factor counted for how much. The Supreme Court never explained this. Hence rate base controversies "entailed an incredible waste of time and money and inevitably embittered relations between the utilities and the public." [307]	Is precise. The formula eliminates the old fair value bones of contention.
(3)	Was circular. Values were based on earnings. The values thus derived were then used to set earnings. Those earnings became the basis for another set of values. [308]	There is no circularity. Earnings have no bearing on the valuation process.
(4)	The investor was deemed entitled to a fair return on fair value. The fair return was determined by reference to yields on conservative investments. Compensation for inflation was an element in those yields. So it was also an element in the rate of return that the regulators had to allow. But the rate base on which that return was allowed was itself in tune with the price level. Hence investors were compensated for inflation in both the rate base and the rate of return. This made for double counting. That is why regulated industries were so enamored of fair value. And it is also why aggressive regulators and others who spoke for the consumer denounced fair value as a transparently fraudulent device for putting a patina of juridical respectability on whatever it was that the utilities and the carriers happened to want at the moment.	Double counting is not inherent in the system. When it sets rates of return, the Commission can take account of the fact that the principal sums on which those rates of return are to be earned are far higher than they would be under an original cost regime.
(5)	Was based on engineering studies. These sought to determine "real" or "true" value. Thus the rate base could expand even in the absence of inflation. Arguments could be fashioned showing that the plant had been planned with unusual acumen and that its engineering was superlative. If accepted, these contentions led to the conclusion that the facility was worth far more than its original cost, even if price levels and construction costs had fallen.	Is based on objective price indices.

This shows that the Interstate Commerce Commission's oil pipeline version of fair value was not nearly so bad as the classical fair value lore that evoked torrents of polemic from the days of Theodore Roosevelt down to those of Franklin Roosevelt.

It seems clear to us that the ICC's approach to the rate base issue was far better than that laid down by the Supreme Court when it spoke through the first Justice Harlan in 1898. [309] This shows only that the ICC's rate base formula is not as bad as it could be. It does not show that the formula is good.

Our initial reaction was that it was not good. The purpose of all those involved calculations was obscure to us. We were strongly tempted to go to the original cost approach with which we are at home. Affection for the familiar was by no means the only factor pointing in that direction.

Original cost and the practice of using it as the base for rate of return measurements are not mere regulatory artifacts. Putting the distinction between original cost and historical cost (a distinction of moment in the instant case and also one of historical importance, but of little general regulatory significance in the world of today [310]) to one side for the moment, books of account are kept, financial statements prepared and rates of return calculated on original cost throughout the economy. Hence the traditional regulatory emphasis on original cost is in very large measure a mere reflection of long-standing business and financial practice. [311] Of course, that practice has been much criticized of late. In an age of inflation it looks unreal.

Accordingly, the Securities and Exchange Commission and the accounting profession have sought to develop materials that would alert users of financial statements to the impact of inflation. But those materials do not supplant the original cost statements. They supplement them.

And skepticism about original cost can be overdone. [312] As Professor Kripke, a strong critic of the original cost religion, observes, original cost has the virtues of "objectivity, which makes it easily ascertainable, and comparative freedom from manipulation—*not inconsiderable virtues.*" [313] Even more important for our purposes is the previously noted fact that the language of American finance is an original cost language.

That some may think another language better suited to economic reality is almost as much beside the point as the views of those who think Esperanto better than English. The fact is that the people of this country use English and that one who wants to understand and to be understood by them has to use it too. So too for original cost. People concerned with investments and with economic analysis talk and think in that language. They attach considerable significance to the fact that A Company earns 10% on the book value of its shareholders' investment, while B Company earns 20% on its book equity. The evidence for that is all around us. One need look no further than the pages of *Forbes*, *Fortune*, *Business Week*, The *Economist*, the *Wall Street Journal*, the *New York Times*, the documents filed with the Securities and Exchange Commission, the Federal Government's statistical publications, the investment advisory services, and the reams of literature emitted by brokerage houses in their quest for commissions to see that this is so.

The oil pipeline industry acknowledges the utility and the validity of original cost measurements. When accused of gouging, profiteering and of being more remunerative than its critics think it should be, the industry does not answer by pointing to the modesty of its returns on valuation. It answers by comparing its returns on net book investment to those of other industries on their net book investment.

What of inflation? The industry goes on at great length about that. It contends that the original cost methodology is inherently incapable of supplying the investor with adequate protection against inflation. Economic history is said to show that this is necessarily and inevitably so. We pondered this contention for a long time. That delayed this decision.

The delay, which has been protracted, is embarrassing and regrettable. But it was not a wholly unmixed evil. While we were pondering the industry's elaborate and detailed demonstrations that the holders of fixed dollar securities *always* get the short end of the stick, the financial markets began to refute them. In view of the unprecedentedly high real interest rates of the recent past, the sweeping generalizations of the industry's financial metaphysicians are not quite so impressive as they were when the record was made. [314]

We do not rest solely on what we read in yesterday's *Wall Street Journal*. The idea that Newtonian laws of financial motion see to it that the holder of a fixed dollar investment never, never, ever gets a fair chance to break even is hard to swallow. That bondholders and other conservative investors have often lost heavily is not enough to validate the hypothesis. Serious losses of purchasing power are not wholly unknown to equity investors in the unregulated sector. The depressed stock markets of recent years have shown that equities are not always a perfect hedge against inflation.

The fact is that financial sophisticates continue to buy bonds. [315] This industry gets the lion's share of its new capital from such people. Does it maintain that they are all fools? Do oil pipeline bond prospectuses warn that "ANY PERSON SERIOUSLY CONTEMPLATING THE PURCHASE OF THE SECURITIES OFFERED HEREBY IS AN IMBECILE HEADED DIRECTLY FOR DESTITUTION WITH NO CHANCE WHATEVER OF PLEASURABLE DETOURS ON THAT DISMAL JOURNEY?" [316]

Even the industry's lawyers recognize that investors can and will do quite handsomely on a fixed-dollar, depreciated original cost rate base if the rate of return is high enough. They add that this is pure theory, that things do not work that way in the real world. We disagree. [317]

So we began with a strong predisposition in favor of original cost. In a general way that is still our view. We certainly do not propose to depart from the original cost approach to our gas and electric work. But original cost is not a universal solvent.

The answers one gets depends on the questions one asks. When we labor in the vineyards we inherited from the Federal Power Commission, those questions are:

(1) What methodology gives us the best fighting chance of approximating the regulated entities' cost of capital?

(2) What is the best road to that elusive ideal, "the lowest reasonable rate?"

(3) What yardstick will best enable us to compare a particular company to groups of companies, one industry to another, and a given industry to the entire American economy?

To borrow a phrase from the medical profession, original cost is "the drug of choice" there.

But, as has been said throughout this document, those are not our questions here. We do not consider this a public utility inquiry. In our view it is more akin to the sort of an inquiry that a court makes in fixing a "reasonable" attorney's fee, "reasonable" alimony after the breakdown of a marriage, or a "reasonable" price for a good or a service when it holds for the plaintiff in an action sounding in quantum meruit. [318] Costs are important in those contexts. But the inquiry does not end with them. The tribunal does not look solely to the seller's cost. It also considers the benefit reaped by the buyer. In the regulator's lexicon this is known as the "value-of-service" standard. [319]

That weakens the case for the original cost method. We reach that conclusion with some regret. Original cost is easy. It is logical. It has been part of the conventional regulatory wisdom for so long that no elaborate theses need be written in its defense. That cannot be said of the methodology that we inherited in this field. Its merits are not obvious.

Not until we tried to get behind the generalities to see how original cost might actually work in this very special milieu did serious doubts assail us. These doubts have more to do with rate of return than with original cost as such. However, these two subjects cannot be isolated from each other. In regulatory practice they meet and blend. [320] They certainly do so here.

And that gives us lots of headaches. The first headache involves the cost of capital rate of return methodology to which we are accustomed. It calls for an analysis of the capital structure. The purpose of that is to differentiate the returns to which the holders of fixed dollar securities are contractually entitled from the sums that must be given the common stockholder if the enterprise is to attract fresh equity capital and stay on an even keel.

Normally that is easy to do. In oil pipelining, however, it would be hard. The difficulties stem from the widespread practice of financing the lines on a virtually all-debt basis. [321] To oversimplify a bit, the financing process works this way:

(1) Large integrated oil companies and other pipeline owners conduct their pipeline operations through separate entities organized for that purpose. [322]

(2) When money is needed for new projects, the parent causes its pipeline subsidiary to borrow practically all (sometimes all) the requisite funds.

(3) Lenders are eager to buy the pipeline subsidiaries' bonds because their highly solvent parents stand behind them. [323]

That financial format does not make life easy for the conscientious regulator. He suspects that the capital structures conceal more than they reveal. But it is hard to know what to do with that insight.

Some industry spokesmen maintain that oil pipelines are so extraordinarily speculative that no one in his or her right mind would ever buy an oil pipeline debt security, were it not for the oil pipelines' guarantees. Accordingly, they contend that pipeline debt is purely formal. As they see it, an oil company that finances a $100 million pipeline with a million dollars of its own, which it invests in its pipeline subsidiary's common stock, and $99 million in bonds issued by that pipeline subsidiary but guaranteed by its parent bears an equity risk with respect to the entire $100 million. It follows that it is entitled to an equity rate of return on the total sum expended.

This seems implausible. Pipeline companies that are unaffiliated with oil companies manage to borrow substantial sums. This suggests that oil pipelines are not wholly devoid of intrinsic creditworthiness. [324] From a cost of capital perspective the 100% common stock theory is therefore unacceptable.

It is unacceptable because it results in overstated capital costs. [325] As the Court of Appeals for the District of Columbia Circuit has said:

> A company with absolutely no debt is a rare thing, and for a public utility to be without debt is rarer still.
>
> * * *
>
> Rate-payers are subjected to an excessive burden when the revenues to be derived from the rates they pay have to be high enough to compensate the cost of a capital structure consisting entirely of equity financing; levering a capital structure with lower-costing debt relieves some of that burden. [326]

Some of the industry's critics go to the opposite extreme. They dismiss the parents' guarantees as mere legalistic mumbo jumbo. If Goldman Sachs & Company and Morgan Stanley & Company are willing to put their imprimatur on and to distribute $200 million in bonds issued by the X Pipeline company, that shows that the pipeline can stand that amount of debt. So there is no reason to pretend that things are not as they seem. Were we to accept this "just the facts" approach, we would: [327]

(A) Look at the interest payments that the lines actually make to those who hold their bonds; and

(B) Attempt to guess at a fair rate of return on the parent oil companies' modest equity investments.

There is a fundamental difficulty with this "keep your eyes on the pipeline's balance sheet" tack. It flies in the face of common sense. Why would these guarantees be given if the lenders did not want them?

It seems clear to us that the parents are insuring those who lend to their pipeline subsidiaries. Hence the parents are assuming risks. For that appropriate compensation should be given. Analytically, this looks like an insurance function. There may be situations in which the insurer's risk is slight. So its premium should be small. Nevertheless, it should be permitted to prove its entitlement to that premium. [328]

Many experts urge the construction of hypothetical capital structures. We are at home with that. But we are dubious about the actual workings of that procedure in this field. [329] The general idea is very simple. It is that we should view the shipper-owned lines as though they were independent entities. Their links to the oil companies that own them would be ignored.

The question in each case would be, what would this particular pipeline's debt equity-mix be if it stood on its own feet and were managed with an eye to its own best interest by prudent people who sought to raise capital as economically as possible? Sounds good. In practice we doubt that it would be quite so good.

It would, we think, be a perfect field day for regulatory economists. Professor A would testify that he thinks 70% debt and 30% equity right. Professor B would say 53% debt and 47% equity. Professor C would come on strong for 50-50. Miss D from an eminent Wall Street investment banking firm would testify that her computer tells her that 65% equity and 35% debt are the right mix. Mr. E from an even more eminent investment banking firm would have other numbers of his own.

We would have to choose among these scenarios. [330] That prospect is unalluring. The endeavor would be a laborious exercise in guesswork, a venture "into the unknown and unknowable." [331]

So we take a dim view indeed of our ability to estimate this industry's real cost of capital with any semblance of precision. [332]

Let us rise above that. Assume that we worked out a technique for applying conventional public utility concepts to this industry and that this technique made some semblance of sense. Even more fundamental problems would then have to be faced. These flow from the very nature of the conventional regulatory inquiry into rate of return. That inquiry centers on risk.

This makes sense for utilities. Their stocks attract conservative investors—widows, orphans, retirees, trustees, and others who set great store on financial peace of mind. These people value safety. They are risk-averse. Unless tempted by the lure of something extra (without too much risk of losing their capital), they will commit their funds to United States Government obligations, money market funds, certificates of deposit, tax exempts, and utility bonds rather than utility equities. So comparable earnings analyses, discounted cash flow calculations, capital asset pricing models, the derivation of risk premiums, and other such techniques supply useful clues to their probable behavior patterns. [333]

When regulators apply these techniques, they focus on risk. They do so because risk assessment enables them to arrive at a reasonably reliable "guesstimate" of the lowest rate of return that will enable the regulated entity to attract new funds on terms fair to the old investors. Risk is dissected in order to apply the capital attraction test.

Few doubt that this is the right approach to a franchised monopoly or quasimonopoly. Its managers are dedicated to the regulated business. They are not likely to abandon it. Nor will they be prone to do things that could jeopardize the franchise. [334] That returns higher than those they can offer are available on the riskier securities of unregulated enterprises will not deter them from continuing to seek funds from conservative investors. And if the regulators have done their job properly, those investors will respond. Thus in utilities and in economic regulation generally risk analysis is at the heart of the process by which regulators balance the conflict between the investor's interest and that of the consumer.

The oil pipeline case is a far cry from that. To be sure, conservative investors are also present here. But they do not buy oil pipeline equities. There are none available for purchase. These conservative investors buy oil pipeline debt securities. When they do so, they rely in the main on the parents' guarantees.

So the risks are on the parents. [335] What we have here are investment decisions made by oil company managers. [336] They have access to pools of funds. And they are under a fiduciary duty to their shareholders to invest those funds as profitably as they can.

The managers do not suffer from a shortage of investment opportunities. Nor are they risk-averse. If they were, they would not be in the oil business. They are professional risk takers. They are prepared to take chances. Why should they invest in pipelines if pipelines are unlikely to be as remunerative as petrochemicals, filling stations, natural gas exploration, molybdenum mines, mahogany forests, contraceptive pills, mail order chains, department stores, or other outlets for capital that look attractive? [337]

That question is not answered by saying that those other businesses are riskier than pipelines. [338] Assume that our staff and the complaining shippers are right. Assume that most oil pipelines really are low-risk propositions. [339]

It does not follow that the allowed rate of return should be as low as (or even in the general neighborhood of) those that regulators normally give to telephone companies and electric utilities.

That is so because the "investors" at whom we have to look here are not the kind of people who put their spare cash into American Telephone and Telegraph or American Electric Power. That oil pipelines are relatively risk-free will not be enough to induce integrated oil companies and profit-maximizing conglomerates to commit funds. [340] They also need some assurance that they have a fair chance of earning as much on a pipeline as they would be likely to earn on something else in the unregulated sector.

That is our essential difficulty with this massive record. Most of it is devoted to financial analysis. Experts discoursed at length on risk, on competition, on the rates of return that investors in this, that, and the other thing have required, were then requiring, were likely to require in the future, and ought to require were they as rational as the witnesses and also as well-informed as they about the ups and downs in the stock market since 1926, about the history of interest rates, about how bondholders have fared over the long run, and kindred subjects.

Much of this is interesting. Some of it is instructive. And a little of it can honestly be called thought-provoking. However we have not found it especially helpful. In spite of the witnesses' eminence and academic attainments, their testimony seems beside the point. It digs deeply into the financial surface of things. This does not take us very far.

It has been said that "war is too important to be left to generals." [341] Our situation here is similar to that. We are not fighting a war. But so long as the statute remains as it is, we have great power over the oil pipeline industry's revenues. This means that we also have the power to influence the behavior of potential entrants into that industry as well as the volume of new construction.

The vital role that this industry plays in an advanced industrial society that runs largely on oil makes our oil pipeline powers awesome. Hence those powers must be exercised cautiously, circumspectly, and with common sense. The good that an aggressive, free-swinging exercise of our oil pipeline ratemaking authority could yield is vastly outweighed by the harm it might do.

That brings us back to the aphorism about wars and generals. Its teaching here is that it would be a great (and perhaps a very costly) error to look at oil pipeline rates from a narrow economic perspective. Economic insights and financial analysis are important in this context. But they are not all-important.

Sociology and social psychology also bear on our task. Sociological and psychological factors are subtle, imprecise, subjective, and inherently judgmental. [342] But they tell us things that cannot be gleaned from columns of figures about realized rates of return in this, that, and the other industry. [343]

Oil pipelines are built and, after their construction, managed by people. People are not bloodless calculating machines. That is as true of entrepreneurs and managers as it is of people in other walks of life.

Like nations and like professions, industries have cultures. Those cultures, those habits of mind, ways of thinking, climates of opinion, and ingrained behavior patterns, have much to do with attitudes toward risk and reward. [344] The frame of mind in which professional speculators in commodity futures approach risk and reward diverges sharply from that of cautious pension fund managers. Returns attractive to the pension fund folk would evoke yawns among the commodity speculators. And we doubt that the speculators would be ignited by an elaborate algebraic showing that the particular opportunity in question was a low-risk proposition.

They are not normally interested in that kind of thing. What is our point? It is that the pervasive controls, the ubiquitous regulation, and the franchised monopolies long characteristic of electricity, gas, and telephones have formed a culture altogether different from the culture of oil and of the unregulated sector generally. [345] Prospective returns that will induce investment by electric utilities and by natural gas transmission companies are not certain to have the same effect on oil companies. The culture of oil is not a public utility culture. And oil companies have a far wider range of opportunities open to them.

Pertinent to that observation is a piece by Mr. Anthony J. Parisi, a journalist who covers the business scene for *The New York Times*. One of Mr. Parisi's pieces dealt at some length with the Exxon Corporation. He studied it carefully. Among the subjects he looked into was Exxon's way of making investment decisions.

Mr. Parisi's last paragraph states his conclusions about that. It reads:

> The Exxon Corporation doesn't really sell oil, chemicals, electronic typewriters and motors; rather, it owns an array of companies that sell those things. It is, in effect, a fabulously wealthy investment club with a limited portfolio. Each year, it makes investments in 13 affiliated companies that are expected to return that money plus a suitable profit. Those that can show they can make more with more, get more. Those that cannot, do not. It is just that simple, and just that complicated. [346]

That is scarcely the frame of mind of the passive investor with whom utility regulators empathize as he or his advisors make their discounted cash flow analyses and their comparable earnings studies in trying to choose among Hypothetical Power and Light, Supposititious Electric, Imaginary Gas, and long-term United States Government bonds.

The heart of the matter is this:

(1) The United States needs and will need new pipeline investment. [347]

(2) That investment will be made, if made at all, by Exxon and by others similarly situated and similarly motivated.

(3) If the people who make the relevant investment decisions expect oil pipelines to yield enough to make them an attractive capital budgeting option for their companies, the lines will be built.

(4) If not, the lines will not be built.

Hence the original cost rate base, barebones cost of capital rate of return model cannot be expected to work here in the same way that it works in electricity, in gas, and in telephones. This is not to say that the model would not work for oil pipelines. But we think it clear that its oil pipeline fruits would cost more than its electric and telephone fruits. That leads us to be cautious about a switch to original cost. Indeed it makes us chary of the whole idea.

The oil pipeline rate base controversy is not a theological debate. It is a real clash about something real. That something is money.

Those who urge original cost do so because they think it will lead to lower rates. But our analysis suggests that in an appreciable number of instances original cost may very well mean higher rates. For those who pay those rates the great rate base reform would be a Pyrrhic victory.

There is an answer to what we have just said. It is that:

(1) An original cost regime will give the ratepayer a better deal over the long run than the status quo.

(2) Because original cost rate bases fall so sharply as properties age and because oil pipeline plant lasts so long, this will be true however high rates of return may be.

(3) With respect to many existing lines, it is hard to imagine any rate of return short of one that looks like a license to print money that would allow returns commensurate with those now deemed legitimate. [348]

But the other side of that coin is that one who contemplates the construction of a pipeline in an original cost world cannot expect to get as much out of that line as the traditional methodology gives. Hence incentives for oil pipe line investment would decline. That would not be good. [349]

Another serious problem with changing regulatory horses at 76 years into regulation of this industry involves the transitional questions that a radical switch would raise. Many rate bases would be drastically deflated. The industry maintains that this would be confiscatory and therefore impermissible.

We disagree. Rate bases are mere regulatory artifacts. Unlike the physical plants to which they relate, rate bases are abstractions created by the government.

What the government has given it can take away. It is free to redesign its own creations. Of course, the owners of the lines must continue to receive every fair opportunity to earn returns that satisfy the Constitution's anti-confiscation standards. But that could be done under original cost. Pipeline owners have no vested right to the perpetuation of a particular methodology.

That is the law. [350] From a constitutional lawyer's vantage point, we see no impediment to the adoption of the original cost methodology forthwith for this entire industry. But the Commission is not a court of law. It is a policymaking body. [351]

Hence we can and should look to considerations that are out of bounds for the judiciary. In the courts the question is, can the government do this? Here the question is, should the government do it?

That is an important difference. We have it on high authority that "much which should offend a free-spirited society is constitutional." [352] So the mere fact that the Constitution and the governing statute permit us to dehydrate oil pipeline rate bases with the stroke of a pen does not end the inquiry. It begins it.

It appears to us that the people who built the nation's oil pipeline plant must have been influenced in large measure by the presence in this field of a regulatory methodology far more permissive and much more indulgent than anything that we know of elsewhere. [353] That this methodology would stay in place unaltered as part of the fixed order of the universe was by no means a sure thing. The industry professes to have believed that it was dealing with "the laws of the Medes and the Persians, which altereth not." [354] So we are in no position to say that the industry did not believe what it claims to have believed, although it seems rather unlikely that the industry would have claimed to the contrary.

But the ICC's oil pipeline rate methodology had never been judicially tested. Moreover, there were always people who scoffed at it. [355] Hence nobody could really be sure about what would happen to that way of doing or not doing things were it subjected to the fire of judicial review.

So it is hard to see how reasonable people in the industry could have been *totally* confident in the immutability of the ICC's rate base valuation techniques. [356] But neither life nor law is rich in sure things. For entrepreneurs and managers who were making business decisions, not writing law review articles, the belief that matters would probably go on pretty much as they had was a reasonable working hypothesis.

True, that hypothesis does not bind us. But this does not mean that we should ignore it altogether. Why invalidate it, why frustrate expectations founded on it, in the absence of a clear showing that doing so will produce substantial social benefits? [357]

The benefits that should be present before we decree a radical change in the oil pipelines' rate bases are not at all apparent to us. The industry maintains that a switch to original cost would actually be pernicious. One of its key points in that regard is that original cost would be "anticompetitive."

The argument goes like this:

(1) Under original cost the older lines' rate bases would be very low.

(2) So those lines' allowable earnings and therefore their rates would also be low.

(3) New lines, on the other hand, would have high rate bases and high allowable earnings.

(4) Thus new lines would be *permitted* to charge high rates.

(5) But how on earth would they collect them? Who would pay a dollar to a new line when he could get exactly the same thing from an old one for a quarter?

(6) Hence new lines would be unviable.

Accordingly, the industry tells us that "the original cost approach . . . would affirmatively discourage new entry by making it difficult or impossible for a new line to earn the returns which would be necessary to attract capital." [358] The ICC's approach is said to avoid this evil. Why? Because it bases returns on the facility's current value. In current value terms, of course, the difference between an old line and a new line is much, much smaller than it is in original cost terms.

This sounds like a very strange argument. It tells us that we should go out of our way to foster competition. But who is telling us that?

Those who are telling us that are the people who are already in the business. Their eagerness to keep the road wide open for potential rivals sounds unnatural. It is as though an association of supermarket owners were urging the government to keep retail food prices up in order to encourage competition in the grocery trade. Questions would then arise:

(1) Are those already in the business really that eager to welcome an influx of newcomers?

(2) Or do they have something else in mind?

(3) And is this something else money?

(4) What is so great about the competition that they want to foster? It sounds like a cost-raising rather than a cost-lowering competition.

Hence our initial view of the industry's arguments about the beneficent way in which fair value promotes competition was skeptical. This dish seemed to call for a very liberal sprinkling of salt. Economists and others who sing hymns to competition usually do so on the ground that it lowers prices. The charms of a pro-competitive stance that raises prices seem dubious.

Moreover the industry tells us that its capital requirements are huge and its risks horrendous. [359] That picture is unlikely to entice people to splatter pipelines all over the place. Who is going to do that? And where is he going to get the money?

Against that background it is hard to see how oil pipelining can ever be a *frenetically* competitive industry. But there is such a thing as competition among the few. It can be significant. Our study of the record and of the literature persuades us that:

(1) In this industry such competition (actual and potential) is substantial. [360]

(2) That intramodal competition is often supplemented by formidable intermodal competition from barges and tankers. [361]

Hence we did not reject the carriers' contentions about the phenomenon that they label "front end load" out of hand. Instead we pondered those contentions. When we did so, we saw that there was something to an argument that is in some respects overbroad and exaggerated.

That something consists of two elements:

(1) People who want to ship oil have a wider range of choice than people who want the convenience of a telephone, of electric light, or of gas service for cooking. One need

not accept all of the industry's contentions about the ferociously competitive nature of the oil transit business in order to see this.

(2) Original cost regulation bunches income. When the facility is new, and the rate base high, rates must also be high. And when money is as dear as it has been of late, the new facility's rates will often be very high indeed. That is fundamental to the methodology of the original cost system. But the charge to the ratepayer falls steeply over time as the rate base falls. This means that when the facility nears the end of its useful life, rates are low because most of the plant's cost is deemed to have been recovered from the ratepayers through the annual depreciation charges that were an element of the cost of service. [362]

That is fine. But it is fine if (and only if) the regulated entity has sufficient market power to enable it to collect the high rates that original cost regulation permits in the early years.

Assume, for example, that the prevailing regulatory wisdom would allow the enterprise an annual net return of $1 million in its first year of operation, of $500,000 in its tenth year, and of a mere $100,000 in its twentieth year.

But assume further that those who have oil to ship are not constrained to patronize this particular facility. They have alternatives. They can use older pipelines. They can use barges. They can on occasion eliminate transportation charges altogether by exchanging oil with each other. [363]

When shippers and prospective shippers choose among these options, they do not worry about the different carriers' *costs.* Why should they? They worry about the carriers' *prices* and about the relationship between those prices and their subjective appraisals of the value of service to them.

All other things being equal, the value of the service is likely to be fairly constant in real dollar terms. That is so because the shipper is interested in a facility that will carry his oil at a price he is willing to pay. He does not care about the age of the facility. It may be old. It may be fully or almost fully depreciated on the owner's books. Given the proverbial durability of oil pipeline plant, that will often be true. But those things do not affect the pipeline's ability to deliver the goods. And that is what the customer is buying.

The converse is also true. Shippers may be pleased by the presence of a new up-to-date pipeline. But their pleasure does not rise to the level of ecstasy. The shippers remain economic men. They want to buy transportation services as cheaply as they can. They have no special reason to empathize with the financial problems of the new pipeline's owner. So they are not likely to volunteer to subsidize him out of their own pockets.

Hence market forces clash with conventional regulatory principles. That clash spawns the so-called "front end load" problem. To illustrate that problem, we return to our hypothetical case. If there were no regulation, the owner of our supposititious pipeline could expect to take home, say, a fairly steady $650,000 a year.

Under original cost regulation, however, we get the following perverse results:

(1) In the pipeline's early years the regulators would be happy to permit its owner to collect a great deal more than $650,000 a year. But this does not do the owner any

good. Shippers are unwilling to pay the rates the owner has to have in order to take home more than $650,000.

(2) After a number of years, the regulators' edicts and those of the market place come into tune with each other. The rate base has fallen to a figure that produces an allowed return of $650,000. And market phenomena permit the owner to earn that.

(3) But that transient harmony is soon superseded by a new disharmony. The rate base keeps falling. So allowable earnings fall below $650,000. And they keep falling. Now regulation has a real impact. It prevents the owner from actually collecting the $650,000 that he could easily get in an unregulated environment.

(4) Since each rate case stands on its own feet, which means that history is mere history so that the revenue deficiencies of 1982 cannot be made up in 1992, the owner of our hypothetical pipeline cannot expect to recover the historical gap between what the regulators would gladly have given in earlier years and the lesser sums that the market actually gave in those years. [364]

(5) So we have an economic climate that has a chilling effect on new pipeline investment.

(6) There are also some peculiar effects on existing pipelines that compete with each other. Older lines with lower rate bases have an advantage over newer lines with higher rate bases. [365]

Now we do not buy the industry's arguments on this score in toto. [366] For one thing, it appears to us that people who build new pipelines do so because they believe that existing capacity is inadequate. The odds are overwhelming that they see enough demand to make their line viable without crippling the one that is already established. Moreover, it seems safe to assume that the builders of the new line are interested in getting as much money out of it as soon as they possibly can. People who make investments like to see those investments pay for themselves at the earliest possible date. The history of pipelining shows that this industry is no exception to that rule. [367] Like other sellers of goods and services, pipeline owners are normally inclined to charge as much as they can get away with. Hence the mere fact that the new line will have to charge a dollar while its old competitor charges a mere 50¢ is not necessarily fatal to the projected new line. Far from it. If there is lots of oil around that producers and refiners want to move, they will:

(a) Keep the old 50¢ line full; and

(b) Give the new $1 line sufficient overflow to enable it to flourish.

But optimistic scenarios do not always play themselves out quite so rosily in the real world. The people who manage these companies know their business. They are also very able. But they are human. This means that they are fallible. They make mistakes.

And they are not blessed with perfect foresight. Demand patterns change. Throughput fluctuates. This means that even when the basic analysis turns out to be sound so that there is enough business to support a high-priced line most of the time, there are other times when that is not so. [368] At those other times the new line's chances of collecting a dollar for something that somebody else is selling for 50¢ will be slim. [369] That is when front end load bites.

So we think it fairly clear that:

(A) The front end load problem is not wholly imaginary. There is something to it.

(B) Exaggerated (perhaps much exaggerated) though that something may be, it is larger than anything of this kind in either electric power or natural gas. Direct price competition among alternative suppliers is much much rarer in electric power than it is here. Moreover, an electric system is a congeries of plants. Some are old. Some are middle-aged. Some are young. Some have just gone on line. As old plant is retired, new plant is placed in service. So we have little, if any, need to concern ourselves with front end load in our electrical work. Ditto for natural gas. To begin with, natural gas pipeline companies are more than mere transportation companies. They are also merchants of gas. They buy gas from producers. And they resell it to distribution companies. Today the cost of purchased gas accounts for more than 80% of their aggregate expenses. So the front end load effect in natural gas has up to now been minuscule. The cost of the commodity transported has dwarfed the differences in pure transportation expense. [370] Oil pipeline companies, on the other hand, are solely in the transportation business. True, they are normally affiliated with companies that do other things. But this does not alter the fact that they themselves are carriers pure and simple. Hence the front end load phenomenon could mean much more for them than it does for their gas brethren.

So it is not at all clear that original cost is the way to go. In this very special industry an inflation-sensitive rate base would probably be far better. That is so because original cost regulation rests on the implicit assumption that the regulated entity has a realistic chance under prudent and competent management of actually earning the returns that the regulators are willing to allow. When marketplace factors preclude the company from earning that kind of money, the whole approach runs into the sand.

That raises a much-debated question. Should inflation be recognized in the rate of return, which is what utility regulators do? Or should it be compensated by adjustments to the rate base as a number of economists suggest? At first blush the question seems essentially theological. And for utilities, it probably is.

There the question is whether the $15 to which the investor is entitled should be given him because it is 15% of a hundred dollars or whether it should be given him because that $15 is 5% of $300. In oil pipelines, however, the investor's chance of actually collecting the $15 that the regulators want him to have will often be slimmer than it is in other regulated industries. Hence we find the case for an inflation-sensitive oil pipeline rate base strong.

Such a rate base mitigates original cost regulation's income-bunching effect. [371] It does not necessarily follow that the so-called "Oak formula" [372] is the ideal solution to the front-end load, income-bunching problem. Were we writing on an absolutely clean slate, were we beginning afresh in a brave new world, were pipelines a novelty that had just made their appearance, we would fashion an inflation-sensitive, anti-bunching rate base policy simpler and more logical than the ICC's. [373]

The simplest and perhaps the best approach would be one that:

(A) Keeps the rate base in tune with the general price level by linking it to the consumer price index or to the gross national product deflator—this would eliminate the need to keep close track of fluctuations in construction costs and would assure the investor of purchasing power parity, [374] and

(B) Gives a real, inflation-free rate of return on the equity portion of that inflation sensitive rate base—that rate of return must be entrepreneurially adequate without being open-handed—this is, after all, a regulatory statute that we are administering. [375]

But it is not at all clear that the foregoing scheme would be enough of an improvement on things as they are to warrant the social costs entailed. [376] We note in this regard that years of high and protracted inflation have converted the valuation rate base into a virtually pure reproduction cost rate base. [377] On balance, we see no cogent reason to depart from the rate base status quo.

We are not unmindful of the carriers' objections to the Oak formula. Their position is that:

(1) The basic ideas are sound; but

(2) The manner in which they are applied is anachronistic and unfair to the industry.

The carriers score some telling points here. For example, land is deemed worth only half of what it cost. [378] Another anomaly unfavorable to the industry involves the treatment of interest during construction. The rate for that is 6%, [379] which is obviously far too low. [380] Other grievances relate to rate base treatment of damages to land, crops, and timber during construction. These items have not been updated for inflation since 1953. Another failure to update for inflationary change relates to the cost of pipe coating which has not been adjusted for inflation since 1960.

The industry has an excellent prima facie case with respect to these matters. [381] But the sums involved are relatively insubstantial. Hence we see no case for retrospective rate base adjustments.

Prospective relief is something different. That may well be warranted. But the case even for that is far from pressing. The present formula may shortchange the industry here and there.

But it would be wrong to leap to conclusions on this score. We must remember the 6% going value allowance. Were there no undercounting elsewhere, that allowance would be very hard to justify. It would be pure water. The industry itself concedes this. It tells us that "if the ... recommended improvements in the valuation formula are made, then such an allowance [*i.e.*, the allowance for going concern value] could be eliminated." [382]

Of somewhat more moment is the industry's claim that reproduction cost is systematically understated. It points out that the "current" cost figures are not based on the current year. They are derived from a 5-year "period index." That consists of the current year, one future year, as estimated on the basis of its first five months, and three past years. When inflation is severe, this practice of looking at three past years rather than at the current year obviously makes for understatement. However, no claim is made that the understatement is serious. Indeed, the industry appears to concede that the 6% going value allowance compensates for the failure to track inflation adequately.

This is not to say that we are ecstatic about the ICC's formula. It probably needs a hard look. We have already said that we think the industry's criticisms well taken.

But we think that it would be wrong to alter the status quo without looking at the whole picture. The feature of that picture that we find disquieting is depreciation. The two troublesome points there are:

(1) The "mismatch" between the straight line methodology for cost of service purposes and the "condition percent" methodology for rate base purposes seems anomalous. Why is the same thing deemed to be 70% used up for one purpose and only 40% used up for another? There may be good answers to that question. But those given in this record do not satisfy us.

We do not say that the straight line method is good and the condition percent method bad. In view of the durability of the carriers' capital equipment, condition percent may well be more realistic. If so, why confine it to the rate base? Why not use it for cost of service as well?

(2) The assumptions about useful lives and about the rates at which things wear out are based on ancient studies made decades ago. The studies themselves disappeared [383] many years ago. [384] Hence our valuation staff works solely with the conclusions drawn by the deceased authors of those missing ancient books. We suspect that something must have changed in the intervening decades. So we are inclined to take a fresh look.

But this is neither the time nor the place for that. We agree with our predecessors that the big conceptual questions can be and should be dealt with in the adjudicatory mode, which is just what we are now doing. But it also seems to us that this is an inappropriate way in which to get to the bottom of technical details about such things as the useful life of pipe. That is better done through notice and comment rulemaking.[385]

To be fruitful, such a rulemaking should be preceded by intensive staff studies. The whole endeavor would be costly and time-consuming. Would it be worth the cost?

This question calls for further reflection. This is neither the time nor the place for that. We can ponder the point on another day.

For the present at least we shall adhere to the formula we inherited from the Interstate Commerce Commission. [386] We are also inclined to the view that it would probably be best to continue to stick to the rate base status quo until Congress addresses itself to the oil pipeline scene as a whole and supplies us with a better guide to its regulatory treatment than we now have. But that view is tentative. Should there be no legislation and should the Commission be in a position to give the oil pipeline rate base revision question the resources that it needs without detriment to other programs of greater import, we or our successors may revisit this scene. [387]

Our reluctance to dive into oil pipeline rate base depreciation policy in this case at this time stems in large measure from the fact that the data we have seen do not convince us that the conceptually bothersome dichotomy between straight-line depreciation for cost of service purposes and condition percent depreciation for rate base purposes is a source of gross inequity.

Though the industry is old, much of its plant is young. [388] Hence considered as a whole, the industry gets no *present* rate base benefit from the condition percent approach. [389] The 1979 data show that:

(1) Under the straight-line methodology used for cost-of-service purposes, the nation's regulated oil pipeline plant was 42% depreciated.

(2) Under the condition percent methodology that same plant was 47% depreciated. [390]

(3) This means that for rate base purposes the country's regulated oil pipeline plant is carried at 53% of the value that would be assigned to it were depreciation ignored. [391]

(4) Were the condition percent methodology abandoned and rate base depreciation brought into perfect tune with cost of service depreciation, the aggregate oil pipeline rate base would *rise* from 53% of undepreciated value to 58% of undepreciated value. [392]

Hence reform in this area would mean higher rate bases and higher rates. This is not the end that the industry's critics wish to achieve. Nor is the Commission inclined to embark on a crusade for theoretical elegance in oil pipeline rate base depreciation methodology that will result in higher rates for the shippers [393] and that has no visible support from the carriers. [394]

Up to now we have been speaking of the techniques used by our valuation staff and the approach that we propose to take for the present at least to the general problem of rate base depreciation. That approach will not always be controlling when we work in the adjudicatory mode. Concrete cases may arise from time to time in which the gap between cumulative cost of service depreciation and rate base depreciation is so wide and so egregiously disadvantageous to the shippers as to call for a remedy. Suppose, for example, that:

(1) The XYZ Pipeline Company's plant has been fully depreciated on its books. This means, of course, that the plant's entire original cost has already been recovered from the shippers.

(2) Nevertheless, the rate base remains quite substantial because of the glacial pace at which rate base depreciation is taken in the property's later years under the condition percent methodology.

There fairness to the shipper requires that the rate base be pruned. Such pruning may also be called for in cases less egregious than the one that we have just posed. Is that sort of pruning appropriate in the instant case?

We cannot answer that question on the basis of the record before us. However, we believe that the shipper-complainants are entitled to raise it in the second phase of these proceedings. Should they choose to do that, the presiding judge will, of course, consider the question with his usual meticulousness. [395]

More About Rate Base and Depreciation—

What Happens When Properties are Sold?

Reference has already been made to the fact that Williams bought its pipeline system from a group of integrated oil companies back in 1966. [396] The purchase price was far above depreciated book value. It also exceeded the ICC's valuation. The figures on that were:

ICC Valuation—$167.6 million

Purchase Price—$287.6 million [397]

Williams maintains that the purchase price has a bearing on what its rates ought to be. It contends that:

(1) The sale to it was at arm's-length and in good faith.

(2) The practice of ignoring transfers of ownership is peculiar to public utility regulation.

We disagree. We do not question Williams' good faith. But this is not an ethical inquiry. It is an economic investigation.

So we look to the economics of the matter. When we do so, it becomes apparent that the purchase price has no bearing on the ratemaking inquiry. The purpose of rate regulation is to inhibit strategically situated sellers of goods and services from exploiting market power that Congress has found excessive. That end is achieved by imposing rates lower than those that would prevail absent regulation. Regulators who set rates with their eyes on the prices at which properties change hands frustrate that end. They thus defeat themselves.

That is a truism. It is not confined to the utility sphere. It applies to every regulatory scheme that seeks to restrain sellers from pricing freely. Hence it is a wise guide to decision in oil pipelining. For this purpose we see no distinction between that field and the others in which we work.

Once more we resort to a hypothetical case. Assume that:

(1) The City of Zenith requires that residential rents be "just and reasonable."

(2) Ms. Smith owns the Blackacre Apartments in Zenith.

(3) That property gives her a net income of $50,000 annually.

(4) But good rental housing is scarce in Zenith. Were it not for rent regulation; Ms. Smith's property would yield her $100,000 a year.

(5) The Zenith Rent Commission will not permit Ms. Smith to collect that extra $50,000 a year from her tenants.

(6) Suppose, however, that the Rent Commission will permit one who buys from Ms. Smith to raise *his* rents to a level that gives him a fair return on the price he paid.

(7) That produces the following results:

(A) A prospective buyer realizes that the property can produce twice as much for him as it does for its present owner. So he will be willing to pay a price that capitalizes the income that the apartment building can generate for him.

(B) This enables the present owner to appropriate the rents that the ordinance seeks to deny her. She merely capitalizes the income denied her but available to her transferee.

(8) So Ms. Smith sells to Mr. Jones. He promptly raises Blackacre's rents to the level he had in mind when he agreed to the purchase price.

Two things have happened here. The first is that Ms. Smith has captured the economic benefit flowing from her strong bargaining position in the rental market. She has done indirectly what the ordinance prevented her from doing directly. The second is that the tenants are now paying the market-clearing rents from which the ordinance was supposed to shield them. Thus the shield is no shield at all. The controls are formal, not real.

That the buyer and the seller were law-abiding and upright does not alter the fact that their tenants have been deprived of the protection that the city fathers wanted to give. And that is what the Rent Commission must bear in mind. Should it lose sight of that and permit itself to be diverted into moralistic inquiries about good faith and bad faith, it will eviscerate the scheme it is supposed to administer.[398]

What has just been said of our hypothetical Rent Commission is true of this Commission in the instant case. That seems harsh on Williams. The price it paid for what used to be called the Great Lakes Pipeline System must have been based on what it thought it could get out of the facility over the long run. [399] However, Williams chose to enter a regulated industry.

Moreover, it did not ask the ICC for advance assurance that the purchase price would be recognized for ratemaking purposes. [400] Accordingly, we conclude that Williams was testing an obvious juridical danger. It went into this transaction with its eyes open. It elected to assume substantial regulatory risks. The consequences of that may be dismaying for its shareholders. But it is the ratepayers' interest that we must keep in mind. And we agree with the complaining ratepayers that "a mere change in ownership should not result in an increase in the rate charged for a service *if the basic service rendered itself remains unchanged.*" [401]

The ICC appears to have thought as we do. Like this Commission, that Commission refused to sanction a purchase-price rate base. However, our position is not identical with the ICC's. The ICC's rejection of purchase-price ratemaking was half-hearted and ambivalent. Ours is wholehearted and unequivocal.

Though the ICC refused to give its rate-base calculations a purchase price taint or tilt, it took Williams' purchase price into account for cost of service purposes.

The ICC did that by permitting Williams to compute depreciation on its *"historical cost,"* *i.e.* on the price it paid to those who sold it the system, rather than on that system's *"original cost."* [402]

The only justification offered for this nonchalant, half a loaf, split the difference, cut it down the middle, 50-50, the truth must lie between the two extremes style of adjudication was an *accounting* determination which had held that:

> When property is resold at a higher price than that for which it was originally purchased, the new owner is ordinarily entitled to record the price paid in its property accounts and to treat the current cost of ownership as an operating expense over the remaining life of the property. [403]

That precedent however was no precedent at all. The earlier accounting determination had expressly pointed out that "accounting rules . . . are not necessarily dispositive of the manner in which expenditures will be treated to determine the reasonable level of particular rates." [404] So it is not at all surprising that the Court of Appeals took a very dim view indeed of the ICC's performance on this crucial question.

It said:

> [W]e cannot countenance the ICC's *current* (emphasis added) unexplained insistence on irrevocably hitching its ratemaking theory to its accounting rules.

> This linkage is especially troublesome because, when it wrote those rules, the Commission expressly denied them any such controlling impact on rates ... It supported that express denial of linkage with a reminder that the ICC traditionally did not tie rates to "investment as shown on the carriers' books, but rather [to] valuations" ...

Hence, we are left with the ... unexplained anomaly of a valuation rate base coexisting with a purchase price depreciation base ...

> The final irrationality is that the depreciation basis used, unlike original cost, valuation, and other possible approaches, allows depreciation charges, and thus the rates, to change dramatically from one day to the next—so long as a purchase of the assets intercedes—even though the cost of the carriers' public service has not actually changed. It is true that occasional acquisitions of carriers at prices deemed currently reasonable might serve as a mechanism for accurately reflecting inflation's impact on the value of such enterprises. We have our doubts, however, about either the desirability of encouraging acquisitions solely for this purpose, or of depending on their unpredictable occurrence to serve this function. In any case, the ICC in this case purports to have recognized inflation in figuring rate base (and perhaps even rate of return ...) so that a further inflation adjustment by way of increased depreciation charges would seem precipitous and itself unduly inflationary ... [405]

That binds us. Moreover, we agree with it. Accordingly, we hold that:

(1) Williams' purchase price is not entitled to any recognition at all for any ratemaking purpose.

(2) That rule is to apply to all future rate cases involving the purchase of oil pipeline property at prices either above or below depreciated original cost, save for those in which the purchaser shows affirmatively by clear and convincing evidence that the acquisition conferred substantial benefits on the ratepayers. [406]

Rate of Return

Here we have an odd situation. Its salient features are these:

(1) Back in the 1940's the ICC found that the appropriate annual rates of return for this industry were:

(A) 8% for crude lines; [407] and

(B) 10% for refined products lines [408] - the latter were treated more generously because they were deemed riskier. [409]

(2) The process by which these numbers were derived was never adequately explained. [410] No cost of capital inquiry seems to have been made. [411]

(3) Nevertheless, the ICC adhered to its 8% and 10% rules [412] undeviatingly down to 1977, [413] when its jurisdiction over this field devolved on us. [414]

(4) And it did exactly that in the instant case. [415] No one regards this state of affairs as satisfactory [416] or rational. [417] The Court of Appeals found "the conclusions of the ICC in its earlier cases as to appropriate rates of return ... artifacts of a bygone era." [418]

It went on to say:

> We find the ICC's discussion of rate of return ... problematical. Here the total emphasis is on the 1940's precedents: because 8-10 percent was a viable return for carriers of petroleum products from 1940 to 1948, it is said, so must it be today ... [T]he ICC's reliance on its antiquated precedents in determining a reasonable rate of return differs little from a rule that would require modern automobile accident damages to conform to those awarded by juries in 1940. [419]

The Court of Appeals proceeded to ridicule the ICC's crude-refined distinction. [420] It said:

> [T]he Commission in the 1940's held the line for crude oil transmission companies at an 8% rate of return, but allowed gasoline carriers to receive 10%. The only discernible reason for the disparity was the infancy of the gasoline transmission industry ... This special "hazard" having presumably matured out of the picture over the last three decades, we might well have expected the 8% ceiling to be applied to gasoline as well as crude oil carriers—in which case Williams' rate of return would be excessive ... Nevertheless, no explanation is forthcoming from the ICC for its continued reliance on the 10% figure, despite the absence of an important factor used in the ascertainment thereof." [421]

The court did *not* hold the ICC's classical 8% and 10% tests excessive. On that point it said:

> This is not to imply that we think an 8 or 10% rate of return is necessarily excessive. Such modern "hazards" as inflation and the uncertain availability of foreign oil, as well as special risks facing Williams ... may well warrant the opposite conclusion. *Our point is simply that the ICC's criterion for reasonableness—blind adherence to 1940's standards—is unconvincing.* [422] (Emphasis added.)

The need for reform is plain. The question before us is not "should the Interstate Commerce Commission's oil pipeline rate of return methodology be revised?" It is "how should it be revised?"

Some in the industry's ranks maintain that we need not agitate ourselves over this. They think that the requisite reforms were made long ago, that they are already in place, and that all that this Commission need do is to conform its own methodology to the allegedly superior one already fashioned by others. That putatively superior methodology was developed by the Antitrust Division and by the industry itself back in 1941.

It is embodied in what some regard as a famous and others deem an infamous consent decree. That is one of history's ironies. The decree stemmed from the New Deal Justice Department's strenuous albeit unsuccessful efforts to alter the oil industry's structure and to reshape that industry's pipeline segment.

When the late Thurman Arnold took charge of the Antitrust Division in 1938, he placed a high priority on efforts to make the oil industry more competitive. Some of his cases focused on the pipelines. The ones that are relevant here were founded on the Interstate Commerce Act's anti-rebate provisions. [423]

The basic theory was that every dividend paid by a pipeline to a shipper-owner was an illegal rebate. [424] The relief sought was:

(1) A decree enjoining the major oil companies from collecting any future dividends from their pipeline subsidiaries; and

(2) The forfeiture to the United States of three times the dividends collected from those subsidiaries over the previous several years. [425]

These cases were brought in September 1940, when the nation was just beginning to prepare for war. [426] Oil was obviously basic to that effort. Hence the Antitrust Division was under strong pressure to halt its little domestic war on the oil companies so as to facilitate the prosecution of a bigger, a bloodier, and a far more important struggle overseas. [427]

Those pressures became overwhelming after Pearl Harbor. Just 16 days after the December 7 attack on that base, on December 23, 1941, a consent decree was entered. [428] Its salient feature was a ceiling on dividends to shipper-owners. In no calendar year could these exceed the shipper-owners' "share of seven percentum (7%) of the '*valuation*' (emphasis added) of such common carrier's property." [429] Valuation was defined as "the latest final valuation ... made by the Interstate Commerce Commission."

The consent decree had several significant effects. One of them was that it gave the industry a potent motive for seeing to it that the Interstate Commerce Commission made annual valuations. [430] The consent decree's structure is pertinent to that.

The decree entitles the companies to bring the valuations down to date through their own efforts "in accordance with the methods used by the Interstate Commerce Commission." But there is an ambiguity here. What methods? That Commission's *accounting* methods, which are predicated on original cost? Or its oil pipeline *valuation* methods, which rest on "fair value"? [431]

To circumvent this ambiguity and to avoid squabbles with the Antitrust Division, the industry wanted frequent valuations. And the Interstate Commerce Commission gave them. Twenty-three years ago, a House Committee commented:

> The Interstate Commerce Commission's current program to determine pipeline valuations annually was arranged by the industry for its own purposes in connection with the consent decree. Annual valuations, apparently, are not needed by the Interstate Commerce Commission to discharge its own regulatory responsibilities. One effect of this program, however, is to provide an aura of legitimacy to reports the pipeline companies have rendered to the Attorney General pursuant to the consent decree. In its reevaluation of oil pipeline legislation, the Interstate Commerce Commission should eliminate from its valuation program all activities for which it does not have a specific identifiable need in its own operations.[432]

The ICC never acted on that suggestion. This Commission, however, has given it painstaking consideration. Neither this Commission, nor the Interstate Commerce Commission, nor the Federal Power Commission was a party to the consent decree. It is also true that we have no direct involvement in the administration of that mechanism. The Antitrust Division takes care of that. Its competent staff needs no assistance from us.

But this does not end the inquiry. The considerations that seem important to us are these:

(1) Though annual valuations of oil pipeline property are by no means essential to the administration of the consent decree, they do much to facilitate it. [433]

(2) Hence the annual valuations that this Commission makes are of considerable aid to the Department of Justice as well as the industry.

(3) Our valuation staff advises us that the fruits of its labors are also used by state and local taxing authorities. [434]

Accordingly, we conclude that under the existing legal framework the valuation updating program serves a real and a useful social function. [435] Hence we shall for the time being continue to make the traditional annual valuations for the carriers that ask for them. But it is obvious that this is something that will have to be looked at again should the consent decree be vacated or should Congress alter the basic legal structure.

Secondly, the consent decree revolutionized pipeline finance. Large oil companies had, and still have, a tradition of conservative financing. [436] Hence before the consent decree, most of the money invested in the pipelines was equity money. After the consent decree, the industry shifted to borrowing. The borrowed funds did not come from the shipper-owners. [437]

They came from public investors and from institutional lenders. These oil pipeline debt securities were of prime quality because they were guaranteed by the pipelines' highly solvent oil company parents. Interest on them was a deductible business expense for tax purposes.

And since that interest was paid not to the shipper-owners but to third persons, it did not count against the consent decree's 7% ceiling. So pipeline capital structures became highly leveraged. After a while, 90% debt and 10% equity became quite common. It is common today. [438] Returns on those thin equities tend to run high. [439]

It is easy to see why that is so. Let us assume a pipeline with:

(1) A depreciated book value of $1 million; and

(2) A capital structure consisting of $900,000 in debt and a mere $100,000 in equity.

For the moment we put to one side the fact that the valuation methodology that the Interstate Commerce Commission used when the consent decree was entered, that is expressly referred to in that document, and that we now reaffirm, produces rate bases appreciably higher than those founded solely on depreciated book value. We make the simplifying but almost invariably incorrect assumption that rate base and depreciated book value are equal to each other. [440] In such a case the consent decree permits the owners a return of 7% on that million dollars or $70,000. But 90% of the million dollars in aggregate capital is debt. And that debt is owed to persons other than the owners. Hence the interest on it does not count against the 7% limit. Accordingly, all the $70,000 permitted by the consent decree goes to the shipper-owners. This now gives them a yield of 70% on the $100,000 book equity.

Now, we become more realistic. We assume that though the book value is a million dollars, the valuation rate base is double that, or $2 million. So the consent decree permits the shipper-owners to earn 7% on that $2 million or $140,000. However, the depreciated book value of their equity investment is still $100,000 just as it was in the previous hypothetical case. Thus the $140,000 permitted by the consent decree produces a yield of 140% on the $100,000 book equity. [441]

During the 1950's the Justice Department made an unsuccessful effort to sharpen the teeth of the decree's 7% limitation. [442] Remember that the decree states that the 7% is 7% of the shipper-owner's *"share* [emphasis added] of the valuation of such common carrier's property." The Government now came up with the theory that the word "share" referred to the particular shipper-owner's share of the total equity interest in the pipeline. So the 7% was 7% of ICC valuation minus debt to third parties. [443] The Supreme Court rejected this as a strained interpretation and because:

> For 16 years the reports made by the pipelines indicated that the dividends were not computed on the basis of 7% of the current value of the owners' investment but on the total valuation of the carriers' properties. For that 16 years the Government accepted this interpretation without challenge. Yet today it renounces this long-standing acquiescence and claims that the decree imposed limits it had not previously sought to enforce.
>
> The Government contends that the interpretation it now offers would more nearly effectuate "the basic purpose of the Elkins and Interstate Commerce Acts that carriers are to treat all shippers alike." This may be true. But it does not warrant our substantially changing the terms of a decree to which the parties consented without any adjudication of the issues. And we agree with the District Court that accepting the Government's present interpretation would do just that. [444]

The consent decree has undoubtedly been pivotal. But the results that it produces are so odd that we do not see how they can be labelled "just and reasonable." The consent decree is an arbitrary test for distinguishing rates that are "rebative" from those that are not.

But rebativeness has no bearing on reasonableness. The idea that a rate is reasonable simply because it is not rebative [445] makes no sense on its face. [446] The Interstate Commerce Commission rejected it. [447] So do we. [448]

The consent decree is now 41 years old. It was a pragmatic settlement of litigation reached in haste at the outset of a titanic struggle with foreign foes that taxed the nation's energies to the utmost [449] and that dwarfed the questions disposed of by the decree. [450] That settlement took the form of a restraint on *dividends*. It did not purport to restrain *earnings*. But restraints on earnings are what economic regulation is all about.

Viewed as a limitation on earnings (and it can be so viewed [454]), the consent decree is arbitrary and irrational. *Everything* depends on the design of the capital structure. Let us begin with an absurd hypothetical case.

Suppose that an oil company subject to the decree built a new pipeline and that it financed that line on an all-equity basis. [451] Because of the facility's youth, its valuation would be about the same as its original cost. So its shipper-owner would be limited to 7% on its investment. That is far below the rates of return traditionally regarded as normal in this industry. Its gross inadequacy in today's world is patent.

Now we move toward realism. Suppose that the same oil company builds the same pipeline but on an all-debt instead of an all-equity basis. The result of this is that:

(1) Both the permissible earnings and the rates from which those earnings come are far, far higher than they were in the first case—though the nature of the service supplied and the business risks assumed are identical in the two cases.

(2) The shipper-owner gets a substantial return (7% of the total valuation [452]) on an equity investment of zero. [453]

We agree with the Antitrust Division that the consent decree is an unfortunate historical accident that impedes effective regulation [454] and spawns confusion. [455]

The confusion stems from the fact that the Antitrust Division enforces the consent decree on its own motion. [456] It does not wait for complaints. The ICC, on the other hand, did not act *sua sponte*. Nor does this Commission propose to do so. [457]

Hence the consent decree is both infinitely more permissive in substance than either the ICC's historic 8% and 10% rules [458] or the standards that we now substitute for them [459] and yet far more of a day to day imperative for management than Commission regulation under the "just and reasonable" standard. [460]

This confused and confusing state of affairs has led to the belief that Commission regulation is mere literature [461] and that the real controls are to be found in the consent decree. [462] Other misconceptions flow directly from that.

Among them are these:

(1) Interest on debt is not part of the cost of capital. It is a so-called "above the line" item like wages, fuel, or postage.

(2) Pipeline owners are entitled to equity rates of return on equity investments that they have never made.

(3) To determine what returns are permissible, one takes a long run perspective and averages good years with bad ones. [463]

The other strings to the industry's bow are: [464]

(1) *A parity concept akin to the one so prominent in the economics, politics and sociology of agriculture*—The idea here is that the industry is entitled to rates of return that preserve the *relative* position the ICC gave it in 1940. [465] The argument goes like this:

(A) In 1940 long-term United States Treasury obligations yielded 2-½ percent.

(B) So the 8% that the ICC then found appropriate for crude lines was 550 basis points (a basis point is $\frac{1}{100}$ of 1%) above that.

(C) But today long-term United States Treasury obligations yield 11%. [466]

(D) To get back to where it was in 1940 (and who can brand that desire unreasonable?), the industry needs 550 basis points more than the government bondholder gets today.

(E) Therefore, 16-½% on valuation is an appropriate starting point—11% for long-term risk-free investments plus 5-½% for the traditional oil pipeline risk premium.

But that 16-½% on aggregate valuation is just the startting point.

The industry goes on to tell us that "this Commission must be sensitive to the risks of one-way downward averaging which oil pipelines face." [467] Accordingly, we must move up "by several percentage points." [468] It seems safe to assume that "several" probably means something in the neighborhood of five percentage points. So we are now up to 21-½% on total valuation. [469]

The important features of that 21-½ percent on aggregate valuation number are these:

(1) It is about 38% on original cost. That is so because on an industry-wide basis, valuations are now approximately 78% above net investment. [470]

(2) According to the industry, the 21-½% is just for "low-risk" or "medium risk" pipelines. "High-risk" pipelines [471] would be entitled to more, perhaps much more. [472]

(3) A *legal theory*—The industry insists that the "law" gives it an indefeasible vested right to fair returns on fair values. [473] It maintains that this means that the Commission is constrained to give an inflation-sensitive rate of return on a rate base that is already inflation-sensitive.

We have already made it plain that we find no merit to either argument. The parity argument might be sound if:

(1) There were some reason to believe that the 8% on valuation standard was Solomonically wise when first promulgated; and

(2) Nothing relevant had changed since 1940. [474]

Both assumptions are implausible. Let us start with the idea that back in 1940, 8% was the good, true and beautiful rate of return for oil pipelines. [475] How do we know that? What studies support it? [476] That those who served on the Interstate Commerce Commission decades after 1940 thought (or may have thought) the 8% sacrosanct tells us nothing about what the Commission of 1940 thought. So we must look at what the Commission of 1940 said and did.

When we do that, it becomes apparent that that Commission did not take its 8% rule as seriously, as uncritically, and as dogmatically as its successors did. The 1940 Opinion did not say that an 8% rate was "proper." Nor did it say that 8% was "appropriate." What it said was that an an 8% return was "ample." [477] The industry now claims a vested right to that same degree of amplitude *in perpetuo*. That claim looks very weak to us. [478] Accordingly, we reject it. [479]

The idea that this industry is legally entitled to an inflation-sensitive rate of return on an inflation-sensitive rate base, to what some might call a blow up on a blow up, has already been found fallacious by the Court of Appeals [480] and by us. [481] No more need be said about it. The industry, its able lawyers and its astute economist witnesses have made herculean efforts to convince us that, whether legally mandated or not, the fair return on fair value concept makes good economic sense. Those efforts have been wholly unsuccessful.

What the industry says, in effect, is that the pipeline investor should be treated like a bondholder—but a very special kind of bondholder.

This bondholder has a wonderful bond of a type heretofore unknown to the annals of finance. That bond's principal expands to keep pace with inflation. And its nominal *interest rate* does the very same thing.

Let us suppose a bond in the principal sum of a thousand dollars. Suppose further that the indenture calls for interest at 12%. Assume in addition that:

(1) Ten years have elapsed since the bond was issued, and

(2) The cost of living doubled during that decade.

Thus the bondholder who bargained for an annual income of $120 when his bond was new now needs $240 a year to maintain his purchasing power. [482] But the industry's rate of return methodology gives him double that. It gives him $480.

That is so, because:

(1) The principal has gone from $1,000 to $2,000.

(2) The interest *rate* has also doubled. It has gone from 12% to 24%.

(3) Hence what used to be 12% on a thousand dollars is now 24% on two thousand dollars.

That is not mere compensation for inflation. It is an engine of inflation. The litmus paper test for this bit of financial chemistry involves these questions:

(1) Would one who held such a security fear inflation?

(2) Would he be indifferent to it?

(3) Or would he welcome it with whole-souled cheers?

To put those questions is to answer them. Anybody who held one of these magical Aladdin's lamp bonds would be an ardent inflationist. On that issue he would have nothing in common with other lenders.

Lenders usually loathe inflation. And borrowers generally love it. [483] Here, however, we have a lender for whom inflation is a bonanza. [484]

This industry gets most of its fresh capital from the sale of bonds. Would it dream of selling bonds on the ultra-usurious terms that it now urges us to sanction? And if some demented oil company managers were to think of selling such bonds, [485] how would they defend themselves against a shareholder's derivative action that sought to enjoin the proposed financing as an improvident "waste" of corporate assets? [486]

The record is replete with fancy sophistries about the pipeline investor's desperate need for a double recovery formula in order to protect himself against both actual inflation and anticipated inflation.

Our answer to that is in the form of a question. What would the American Petroleum Institute say if the Oil Workers Union were to announce that:

(1) Like the industry that employs them, the union's members need protection against both actual and anticipated inflation;

(2) The only way in which oil workers can get that protection is through a cost-of-living allowance that is double the amount of the rise in the consumer price index; and

(3) In other words, real justice and true reasonableness for the industry's labor force imperatively require that its wages rise by 10% whenever the cost of living goes up by 5%?

The Institute would undoubtedly say that the union leaders had taken leave of their senses. [487] We do not go quite that far. What we do say is that the industry's rate of return position is fatally unconvincing. [488]

Finding the industry of no assistance on the rate of return issue, we turn to its adversaries for aid. We find none. That is to be expected. The industry's foes think the valuation rate base arbitrary and irrational. In their view, neither fair rates of return nor just and reasonable prices for carriage can be derived from a rate base of that character.

So they content themselves with sermons about the evils of double counting and with the observation that the rate of return on an inflation-sensitive rate base must itself be deflated. In other words, that rate of return must be "real," not "nominal." [489] Up to a point, we agree. [490] But those generalities do not take us very far.

So we are left to our own devices on this crucial issue. The parties' arguments having been so unhelpful and the applicable historical tradition being so palpably deficient, the Commission must fashion its own oil pipeline rate of return methodology. And that is what we now do.

We hold that a fair oil pipeline rate of return consists of three elements:

(1) Whatever amount is needed to service the regulated entity's debt; [491]

(2) When parent company guarantees have been given and when the evidence establishes that those guarantees were material to the lenders, [492] a fully compensatory suretyship premium [493] to the parent-guarantor; [494] and

(3) A *"real"* entrepreneurial rate of return on the equity component of the valuation rate base.

Little need be said about the first element. That regulated entities must at the very least be given every fair opportunity to earn enough to service their debt is axiomatic. The only point on which we need comment in this connection is that we have decided to spurn all attempts to fashion hypothetical "model" or "normal" oil pipeline capital structures.

We see no need for those complications. [495] Oil pipeline capital structures may be strange. They may be abnormal. They may even be pathological. But they exist. [496] Moreover, they were fashioned by the industry to serve its own purposes. [497] Hence we think it fair to hold the industry bound by its own creations.

The second element, the insurance premium, is novel. It will present difficulties. But we are sure that these can be surmounted. [498]

We offer no Model Oil Pipe Line Suretyship Code. That code will have to unfold itself through case-by-case adjudication. Nevertheless, a few tentative observations may be in order.

Some cases should be fairly easy. Assume, for example, that:

(1) The XYZ Pipeline Company, a new venture, has just sold bonds with a 12% coupon.

(2) Those bonds are guaranteed by the pipeline's parents, the X Oil Company, the Y Oil Company, and the Z Oil Company.

(3) Credible expert testimony by persons associated with the rating services, the investment banking fraternity, and the credit insurance industry as well as by academics who have made a speciality of the bond market establishes that absent the parents' guarantees the pipeline would have had to pay 14½%.

(4) Thus we have a prima facie showing that an insurance premium of 2-½% is warranted.

We come to the third and most troublesome member of our rate of return trio. That is the real entrepreneurial rate of return we think essential here. [499] It seems obvious to us that allowed real rates of return on oil pipeline equity investments should be appreciably higher than those the Commission awards to natural gas pipelines and to wholesalers of electric energy. [500]

But how much higher? That question can be answered only by reference to some intelligible standard. That standard must, of course, be rationally related to the real world. [501] When it fashions this yardstick, the Commission must remember that oil companies have lots of places to put their money, that this is also true of the conglomerates that own the so-called independent lines, and that the social need in this field is for returns high enough to induce the construction of new pipelines and to avert the premature abandonment of old ones.

The candidates we find suitable are:

(i) Realized nominal rates of return on the book value of shareholders' equity in the oil industry generally over the past 5 years; [502]

(ii) Realized nominal rates of return on the book value of shareholders' equity in the oil industry generally over the past year; [503]

(iii) Realized nominal rates of return on shareholders' book equity in American industry generally over the past 5 years;

(iv) Realized nominal rates of return on shareholders' book equity in American industry generally during the most recent year;

(v) The particular parent or parents' realized nominal rate of return on total non-pipeline book equity over the past 5 years;

(vi) The particular parent or parents' realized nominal rate of return on total non-pipeline book equity in the most recent fiscal year; [504]

(vii) Total returns (dividends plus capital gains) on a diversified common stock portfolio over the past 5 years—looking to just one year would not work here because the stock market is so volatile; and

(viii) Total returns (dividends plus capital gains) on a diversified common stock portfolio over the long run—25 years, 50 years, or more—the rationale here is that an oil pipeline is a long-run investment, comparable to a 50-year commitment to the Dow Jones industrial average.

How should we choose among these alternative measures? Here we lay down no hard and fast rule. But we suggest that it would normally be proper to choose the measure most favorable to the particular carrier or carriers involved. That may sound like a 1982 version of Teapot Dome. It isn't.

The idea that the yardstick should be liberal to the particular regulated entity actually before us in a concrete case follows logically from our basic concept that what the historical background and contemporary public policy needs call for here is a cap on gross abuse. If the returns do not exceed those being realized somewhere or other in a roughly comparable segment of the economy's unregulated sector, it is hard to see how they can be branded extortionate or abusive. [505]

Our relative permissiveness here makes the risk problem more manageable. Can even the riskiest of pipelines argue that it is so hazardous that it is entitled to more than *anybody* makes *any place* else? What has just been said goes to business risk.

What of financial risk? The industry places much stress on that. It maintains that the financial risk incident to an equity investment of $5 million that is junior to $670 million of debt is horrendous. But those horrendous financial risks for which the carriers' parents seek compensation were manufactured by the parents themselves to serve their own purposes. To the extent that the parents' equity investments in the lines are a gamble, it was the parents themselves who elected to gamble. They arranged the game. And they set the odds.

So when it comes to the financial risks borne by the equity investors in the pipelines, this is a case in which gamblers ask others to compensate them for the special risks to which their own propensity to gamble exposes them. Analogies to elementary doctrines about contributory negligence and voluntary assumption of risk,[506] and to the tax treat ment of gambling expenses, preclude that. [507] In that connection, it must be remembered that the rates of return on equity that we propose to give here are far more generous than those that we or other regulators give elsewhere. [508] To superimpose generous premiums for self-created financial risks on top of very generous compensation for business risks would be far too open-handed. One might as well forget the whole thing and deregulate. That decision is not for us. It is for Congress.

What has just been said should not be misconstrued. It does not mean that we are totally oblivious to financial risk. Nor does it mean that we propose to ignore that factor. It means only that we see no need for case-specific analyses of financial risk. They are unnecessary because compensation for financial risk is built into our general methodology. [509]

We come now to the double counting problem. Up to this point we have been speaking of the application to this industry of nominal rates of return on equity derived from an examination of returns on equity capital in oil generally, in American industry as a whole, and in other unregulated sectors of the economy. [510] Here, however, those rates will be awarded on an inflation-sensitive rate base.

That makes it essential to eliminate the compensation for inflation factor from those nominal rates and to reduce them to the levels that would prevail (or would seem likely to prevail) in a world without inflation.

This can, and in our view should, be done by deducting the inflation allowance that the valuation rate base formula gave the specific pipeline under examination during the particular period in question from the appropriate nominal rate of return.

Assume, for example, that a comparable earnings analysis of the type we envision leads to the conclusion that the PQ Pipeline Company is entitled to a return of 21% on the equity component of its valuation rate base. Assume further, however, that during the relevant period [511] increases in the estimated cost of reproduction new [512] led to a 7% rise in the rate base. [513] To avoid overcompensation for inflation, that rate base increase must be deducted from the rate of return that would have been given had the rate base stayed constant.

So PQ's allowed rate of return on the equity component of its valuation rate base would be 14%, arrived at as follows:

Nominal Rate of Return Derived from

Comparable Earnings Analyses—21%

Less Compensation for Inflation

Obtained From the Write-up of the

Rate Base During the Relevant—7%

Period [514]

Allowed Inflation-Adjusted Rate of

Return—14%

Thus far we have dealt in detail only with our hypothetical carrier's rate of return on equity. At this point it seems well to go further with our suppositious case in order to give a concrete illustration of the workings of the rate of return methodology established by this Opinion. To do that, we make a few assumptions about the PQ Pipeline Company.

Those assumptions, which we think fairly realistic, are that:

(1) The company started out with the 90% debt-10% equity capital structure typical of new pipeline projects.

(2) But PQ has been in business for quite some time.

(3) That has had the following effects:

(a) Some debt has been retired.

(b) Because of the cumulative effect of years of inflation, PQ's valuation rate base is now appreciably higher than the depreciated original cost of its pipeline assets.

(4) PQ's balance sheet reads:

Assets		*Liabilities and Capital*	
At Depreciated Original Cost	$1 Million	Long-Term Debt	$700,000
		Common Equity	300,000
Total Assets	$1 Million	Total Liabilities and Capital	$1 Million

(5) However, PQ's valuation rate base is now double the depreciated original cost of its plant. So its valuation rate base is $2 million, not $1 million.

(6) The embedded interest rate on PQ's $700,000 outstanding bonded indebtedness is 11%.

(7) But those bonds have been guaranteed by PQ's parent.

(8) The evidence establishes that the parent is entitled to a guaranty fee of 2%. These assumptions lead to the conclusion that PQ must be allowed a return of $273,000. Here is arithmetic of that:

(1) Interest on $700,000 of Funded Debt at 11% = $ 77,000

(2) Guaranty Fee to Compensate

(3) Real Entrepreneurial Rate of Return on the Equity Component of the Valuation Rate Base (Computed by Subtracting the $700,000 in Bonds From the Aggregate Valaution Rate Base of $2 Million, a Process That Yields $1.3 Million) at 14%.[515] = $182,000

Total Allowable Return to the Suppliers of Capital = $273,000

Accordingly, PQ is entitled to a composite over-all rate of return of 13.65% on its total valuation rate base of $2 million and double that or 27.3% on the million dollars at which PQ's assets are carried on its books.

Some will brand returns of these dimensions outlandishly high. Those who take that view will focus on the rate of return on equity. When that rate is computed on an original cost basis predicated on books of account maintained in accordance with generally accepted accounting principles, it appears that PQ's owners will have an opportunity to earn 61% (182/300) on the book value of their equity. How does that square with the 14% real rate of return of which we spoke earlier?

This is a good question. Were we dealing with electric power or with natural gas transmission, we should be troubled by it. That is so because when we sit as public utility regulators, we are trying to find the *lowest* rate of return on equity capital that will render the enterprise viable under private ownership. But, as we have gone to some pains to point out, this is not public utility regulation. Hence there is no need to be so parsimonious.

The question we are grappling with is: "How should regulators treat 'leverage'? What disposition should be made in a regulatory context of the gains that equity investors in unregulated enterprises realize by using the 'lifting power of the other people's money,' *i.e.*, by borrowing"?

The public utility answer to that question is that those gains belong to the ratepayer. They are passed on to him in toto. [516] But this is certainly not so in the unregulated sector.

Assume, for example, that someone bought a house for $50,000, that he used $10,000 of his own, and that he obtained a conventional mortgage without a so-called "equity kicker" or "shared appreciation right" for the other $40,000. Now let us suppose that the cost of reproducing the house has risen to $100,000. Does anyone see anything unfair, immoral, or inequitable in the fact that the *entire* gain goes to the person who bought the house with a rather thin equity? Suppose that our hypothetical homeowner rents the house to a tenant. Would anyone use either the original $10,000 equity investment or the $20,000 to which that $10,000 would have grown were only the equity portion of the aggregate investment trended for inflation to gauge the fairness of the rent?

On this oil pipeline rate of return issue we think the unregulated competitive sector a better model to follow and a wiser guide to decision than specialized public utility notions. Those notions have their place. And an important one it is. But that place is in the derivation of the "lowest reasonable rate." That is not our objective here. Here we are setting ceilings that we assume will seldom be reached in actual practice, not floors deemed absolutely essential to generate revenues sufficient to attract conservative investors whose basic orientation is "safety first" and whose expectations of gain are modest. [517]

It is not our objective in this field because our study of the record and of the relevant literature convinces us that:

(1) Competition both actual and potential is a far more potent priceconstraining force in oil pipelining than it is in the other areas in which we work. [518]

(2) Hence public policy can and should rely far more heavily on the market here than it customarily does in the utility field.

(3) For utilities, regulation is central to the pricing process. For oil pipelining, on the other hand, regulation has been, is, and, we think, should continue to be peripheral to the pricing process.

(4) That peripheral function relates to situations in which monopolistic pockets, short-run disequilibria, or other factors produce market prices that are grossly abusive and socially unacceptable.

So the mere fact that a carrier's earnings exceed some bureaucratic appraisal of its true cost of capital is not enough to warrant regulatory intervention. Such intervention should be resorted to only in cases of egregious exploitation and gross abuse. Hence we need a rate of return methodology that will identify such exploitation and such abuse and that will not meddle unduly with the market process.

Allowing the equity owner a return on the total cost of reproducing his assets in the world of today does not comport with the ideas that have been dominant in public utility regulation for the past four decades. That is also true of the notion that the equity owner is entitled to the full benefit of the impact of inflation on the value of assets that his company acquired with borrowed money, which it will repay with a fixed number of dollars without regard to what happened to the purchasing power of those dollars during the term of the loan. But neither of those ideas can be deemed inherently exploitative or grossly abusive.

Moreover, the ratepayers with whom we are here concerned are not consumers. They are business enterprises. So the primary end of the regulatory scheme is not consumer protection. It is equity among entrepreneurs. And entrepreneurs are in the habit of borrowing money for the purpose of acquiring productive assets. When they do that and when inflation leads to an increase in the value of the assets thus acquired, they reap the full gain. Nothing that has been brought to our attention leads us to consider a standard more austere than the one upon which we have settled.

The more austere standard of fairness applied in the utility field [519] cannot be divorced from the stringent regulatory controls on abandonment normal in that type of regulation. [520] Here, however, the carriers are free to abandon whenever they please. They need no permission from us. That raises a problem that we do not encounter in electricity and gas.

What is that problem? It is that the application of an austere rate base, rate of return methodology to regulated firms whose freedom to abandon is unrestrained by legal inhibilitions can engnder preverse incentives for the socially premature but enterpreneurially advantageous abandonment of useful but fully or almost fully depreciated facilities. This is an important consideration for a society that wants to inhibit waste and to conserve resources. It militates strongly against the slavish imitation of the utility model.

We must also point out that the standard we adopt is not nearly so open-handed as it may seem at first blush. True, it permits rates of return on book equity that seem very high. [521] Our illustration about the PQ Pipeline Company shows that.

But those seemingly outlandish returns are a by-product of many years of serious inflation. [522] During those years under our methodology the equity investor gets no compensation at all for inflation in the rate of return. The rate of return on equity is a real rate absolutely devoid of any inflation premium of any sort. Nor has the equity investor been recompensed for inflation in the depreciation component of the cost of service. That is computed on a fixed-dollar basis.

These factors must be kept in mind when one gauges the propriety of the handsome rate base writeups and the creamy returns on book equity enjoyed by the owners of our hypothetical PQ Pipeline Company and by the actual owners of real pipelines of a certain age.

When they are kept in mind, the rate base writeups and the earnings they permit fall into place. Numbers that dazzle arithmeticians who look solely at the book value of common equity in 1982 and at the current rate of return thereon [523] look much less luscious to those who take a longer view and who hold those same numbers up to the light of the four decades of inflation that produced them. [524] We think the longer view sounder.

System-Wide Regulation or Point to Point Regulation?

Oil pipelining is complex and heterogeneous. There are thousands of possible point to point journeys. Each has its own rate. No one pretends that the rate for a particular journey is always nicely attuned to its precise share of the carrier's total burden.

The Interstate Commerce Commission, our predecessor in this field, gave scant attention to particular rates on specific routes. It focused on aggregates. If the total return to capital was within the applicable overall limits, that normally ended the inquiry.

We are now told that this is wrong, that what matters (or what ought to matter) is not just the carrier's overall return, but the justice and the reasonableness of each and every member of the whole class of rates. [525] Thus the Antitrust Division tells us that "the Commission should not countenance an 'averaging' process whereby a pipeline company is allowed to offset an excessive rate of return on one pipeline or pipeline interest against a less-than-permitted return on another, wholly separate pipeline asset." [526]

The industry maintains that "it is entirely appropriate to allow a carrier to 'average out' its profitable routes, to obtain a fair return on an overall basis." [527] It relies heavily on the holding of the Court of Appeals that:

> It is not a fatal flaw that some traffic is carried at rates above total cost; the revenue from such traffic when added to revenues from traffic that competition requires be carried at less than full cost (but with some contribution to fixed cost) yield adequate overall revenues." [528]

On this issue we hold that:

(1) System-wide regulation should and will continue to be the general rule. That accords with traditional transportation doctrine. And it is consistent with (and indeed implicit in) our emphasis and that of the Court of Appeals on the importance of giving free play to competitive factors in this industry. [529] Moreover, this rule avoids the need for refined inquiries into the allocation of costs that would be essential to segment-by-segment regulation. Such inquiries tend to be metaphysical, inconclusive, and barren.

(2) But what has just been said refers to "systems," not to "companies" or to "entities." If the X Pipeline Company has one system in California and a wholly noncontiguous one in Illinois, there is no need to average the two.

(3) The averaging we sanction and endorse is of an *intrasystem*, not an *intracompany* character. [530]

(4) Any showing that a shipper-owner or a group of shipper-owners fashioned a complex of rates that favored it or them and that disfavored non-owners will be viewed with great seriousness. If the Alice Pipeline Company, a subsidiary of the Alice Oil Company, charges low rates for oil moving from point D to point E (practically all of which belongs to Alice itself) and high rates for merchandise that travels from point X to point Y (a route over which Alice moves practically none of its own product, but which is heavily patronized by other shippers), neither a showing of overall reasonableness nor a showing that *total* returns are modest by any standard will immunize Alice's patently discriminatory tactics from strict regulatory scrutiny. [531]

Holding Company Problems—Transactions with and Payments to Affiliates

Most oil pipelines belong to corporate families. They do lots of business with their parents. And they sometimes deal with their siblings. [532]

That a policy of total laissez-faire with respect to this kind of legally sanctioned and economically useful but potentially pernicious "business incest" [533] can saddle ratepayers with illegitimate costs and make regulation into a comic opera remunerative to lawyers but virtually useless to anyone else is obvious.

The industry concedes this. It tells us that "Oil pipelines do not seek recovery for payments to affiliates which would be higher than those which would be charged by an unrelated entity." [534] We are glad to hear that because we could not possibly sanction any such recovery, sought or unsought.

When it comes to burden of proof, however, we part company with the industry. It maintains that "absent specific information to the contrary, payments to affiliates recorded in accordance with the safeguards of the Uniform System of Accounts [535] are costs reasonably incurred." [536] We take a different view.

In these intrafamily transactions buyer and seller are one and the same. Such transactions are not necessarily wrongful. They often save the ratepayer money. Frequently, they are proper and laudable.

But they are suspect. Their abusive potential is obvious. Moreover, the transactors (the pipeline and its affiliates) normally know far more than a complaining shipper can about the adequacy of the consideration that moved to the pipeline and about the overall fairness of the arrangement. Hence the burden of justification should be on the pipeline, not on the complainant. That is the rule in corporation law when transactions with insiders are challenged. [537] And it should be the rule here. We hold that it is. [538]

What of the "safeguards" in the Uniform System of Accounts? [539] They seem formidable. Hence the industry's contention that compliance with them should be deemed to establish the prima facie propriety of whatever transpired between the pipeline and its corporate relatives has considerable appeal.

But the appeal is superficial. For routine transactions in things that the seller sells to unaffiliated as well as to affiliated customers and for which price lists are readily available (for example, fuel), a showing of compliance with our accounting requirements may well be enough to carry the day for the carrier. But that is beside the point. It is beside the point, because those are not the relationships that shippers are likely to question. [540]

The probable bones of contention will relate to the fair market value of such things as managerial services and office space. [541] Questions in those areas cannot be answered from accounting records. True, those records are important. Their weight will often be considerable. In our view, however, that weight is insufficient to foreclose further probing by an intervenor who wants to delve deeply into a material transaction between a pipeline and its parent.

These inquiries turn on estimates and guesstimates of fair market value. [542] The people who make those estimates and guesstimates and who see to it that the Uniform System of Accounts is complied with are not wholly disinterested. So we cannot presume that they will always see these matters in exactly the same way that a complaining shipper or a neutral arbiter would see them. Hence those shippers and those arbiters must be given a fair chance to do some skeptical exploring. [543]

Another Intrafamilial Problem—Should the Tax Component of the Cost of Service be Calculated on a Consolidated or on a Stand-Alone Basis?

For Federal corporate income tax purposes, groups of affiliated corporations are free to treat themselves as though the entire group were a single taxable entity. [544] In tax jargon they are free to file "consolidated returns." And that is what they do whenever they can save money that way. [545]

The regulatory question is, who should get the benefits of those savings? The ratepayers? Or the shareholders? Take the following set of facts, for example:

(A) The X Pipeline Company earned a million dollars in 1981.

(B) But because of exploration and development activities that receive favorable tax treatment and because of unfavorable conditions in the petroleum market, the pipeline company's parent, the X Oil Company, lost a million dollars.

(C) Since gain and loss were equal to each other, there was no net taxable consolidated income.

(D) So no tax was actually paid.

(E) But if the pipeline company's links to its losing parent are ignored, *i.e.*, if the regulators look at the pipeline as a wholly independent entity on a so-called "stand alone" basis, it is obvious that:

(i) Such a stand-alone pipeline would have had to pay corporate income tax at the statutory rate; and

(ii) That tax would be a reimbursable cost of service.

On this question we have recently said:

> Our policy in the past has been that "a utility [546] should be regulated on the basis of its being an entity; that is a utility should be considered as nearly as possible on its merits and not on those of its affiliates." [547] Our present view remains the same, based on our conviction about the proper way to set rates for a regulated company. Evidence of a particular company's circumstances is not needed to make this policy determination. [548]

As was noted in the order from which we have just quoted, "the validity of our 'stand alone' policy" must now be reexamined. [549] But that issue has not been raised in this case. Here no one urges that the savings derived from consolidated returns be flowed through to the ratepayers. Accordingly, our traditional stand-alone approach to the consolidated tax problem governs. After we have reconsidered the validity of that approach on a generic basis, we shall take a fresh look at what the rule on this subject ought to be in oil pipelining.

A Last Word on Depreciation and Taxes—Normalization or Flow-Through?

For regulatory purposes, depreciation is almost invariably computed on a straight-line basis. [550] The Federal income tax rule is different. [551] It permits depreciation to be accelerated. [552] This means that during the early years of the facility's life its owner's depreciation deductions for Federal tax purposes are far in excess of the amounts that the regulators will permit in the depreciation component of the cost of service.

Suppose, for example, that a piece of equipment which cost a thousand dollars is assumed to have a useful life of 20 years. The regulators will allow $50 of depreciation expense during each and every one of those twenty years. [553] The Internal Revenue

Service will permit the owner to deduct double that or $100 in the facility's first year, $90 in its second year, et cetera. [554]

Hence during the first year in which it uses that equipment its owner has a $100 depreciation deduction. This means that the owner's Federal corporate income tax is $46 less than it would have been had the equipment not been purchased. [555] But if tax depreciation accounting were in perfect tune with regulatory depreciation accounting, the depreciation deduction would be $50 instead of $100. And the tax benefit would be $23 instead of $46.

Now what of the tax component in the regulatory cost of service? Should the regulators proceed on the assumption that the company received a tax benefit of $46, which in fact it actually did? Or should they reason that the $46 is a tax peculiarity designed to promote certain broad economic objectives, [556] that those objectives would be frustrated were the taxpayer compelled to pass the tax incentives that Congress gave it through to its customers, that all that is involved is a "tax timing difference" irrelevant to the regulatory function, and that the first year's tax benefit should therefore be reduced to the $23 that it is *"really"* worth under applicable regulatory doctrines?

The first approach is called "flow through." Its advocates emphasize the "actual taxes paid" test. They focus on the evils of what they style "phantom taxes."

The second approach is called "normalization." Its followers emphasize the social importance of the taxing statute's pro-investment objectives and the temporary and self-reversing character of the discrepancies involved. They also place much stress on what they regard as the inequities that flow-through engenders. They say that giving the tax benefits of accelerated depreciation to the ratepayer *does not help ratepayers.*

What it does is to help earlier ratepayers at the expense of later ones. The industry puts that point this way:

> Regulatory commissions allow only straight line depreciation for revenue purposes because this is assumed to fairly apportion an asset's useful life . . . Flowing through the tax benefits of accelerated depreciation would depart from this cost allocation pattern and result in charges, relative to actual costs, which are too low in early years and too high in later years. Future ratepayers would therefore bear a disproportionate share of the costs of pipeline assets and subsidize early-year ratepayers. [557]

The Court of Appeals gave a lucid summary of the controversy in this very case. It said:

> In figuring its tax costs, Williams used the "normalization" method. Under this method, a regulated business accelerates its depreciation schedule for tax purposes, but figures its tax costs for ratemaking purposes as if it were paying the higher taxes required by a straightline depreciation schedule. The difference between the two amounts is placed in a deferred tax reserve account, out of which the taxes are eventually paid, but on which the business in the meantime collects interest. See 26 U.S.C. § 167 (1)(3)(g). Alternatively, Williams could have reflected its present tax savings from accelerated depreciation in lower current costs for ratemaking purposes. This latter method allows current tax savings to "flow through" to current ratepayers, *while burdening future ratepayers with the deferred taxes when they come due. Normalization, on the other hand, allows the*

current benefits and future burdens to be shared more equally by current and future ratepayers. [558]

This stress on "intertemporal equality" or "intergenerational equity" among ratepayers is sound. We think it basic to good regulatory policy. Hence we have in our gas and electric work opted for normalization. [559] We reach the same result here.

Though the result is the same, the reasoning is not identical. In this, as in other areas, oil pipelining is by no means on all fours with gas and electricity. For one thing, it can fairly be assumed that the composition of the ratepayer group is more constant here and that it varies less over time than in the utility field. [560] In our view, however, that does not nullify the argument. Intergenerational equity is not quite so compelling a consideration here as it is elsewhere. But it is by no means wholly without force. It retains impressive validity.

A second variation stems from the "front end load" factor peculiar to oil pipelining. [561] When we discussed that, we expressed considerable concern about a regulatory system that would make for high rates at the outset and for lower ones as time progressed. Now we are worried about the opposite of that. Isn't there an inconsistency here?

We think not. Our concern is with stable rates. That is what we consider the prime desideratum here. Accordingly, we are loath to embrace *any* methodology (with respect to taxes, with respect to rate base, or with respect to anything else) under which temporal differences among groups of customers become central and crucial.

Matters become more troublesome and much less clear when we move from legalisms to basic policy considerations. [562] When one cuts through all the words to what is really at stake, it becomes much too plain for argument that what is at the bottom of the whole business about accelerated depreciation and tax normalization is the allocation of the national income between investment, on the one hand, and consumption, on the other. What we have here is an effort to use the tax system to tilt the balance in favor of investment and to raise the shamefully low American rate of saving. We believe that, in general, it is appropriate public policy for us to implement rather than frustrate the purposes of the tax statutes. Nothing in our regulatory charters *requires* otherwise.

In oil pipelining, however, we have a very special situation. There are no "consumers" here. The lines are used solely by business enterprises. Hence the clash between shipper and carrier differs fundamentally from the clash between utilities and their customers.

When an electric utility or telephone company is required to flow the money it saves on its tax bill by using accelerated depreciation through to its ratepayers, the odds are that most of the money will go to consumption rather than to investment. If the utility gets the benefit of the tax timing difference, it will invest. If the customers get that benefit, they will almost certainly elect to consume. [563]

In oil pipelining, however, the tax savings are almost certain to be invested. That will be so whoever gets the benefit of them. Should those benefits be "normalized," the pipelines' parents will have funds available for investment that they would not otherwise have. Should the benefits be flowed through, the independents in the oil business will have the funds. And they'll make the investments. That makes the case for normalization somewhat uneasy here.

Moreover, oil pipeline regulation deals at bottom with equity among *competitors*. The shipper-owners compete with their own customers. Normalization compels those customers to reimburse the shipper-owners for taxes that the latter are not *now* paying.

True, those taxes will be paid later. But competition functions in the here and now. Hence the notion that it is just as well for the independent shipper to reimburse the shipper-owner in 1982 for the taxes that the latter will not pay until 1992 is a bit troublesome. There is much to be said on both sides. This is a difficult question. It is easier to discuss than to decide.

But we must decide it.

In doing so, we opt on balance for normalization. The essential reason for that is that normalization facilitates the comparable earnings analyses basic to the determination of appropriate rates of return on oil pipeline equity investments. Throughout the economy rates of return on equity are reported on a normalized basis.[564] This means that after-tax earnings are computed as though the "deferred taxes" had actually been paid. Hence the taxpayer's actual after tax rate of return is higher than the version of that return given in its financial statements, reported to the Securities and Exchange Commission, and used by the financial community.[565]

So a flow through rule for this field will make for mismatched rate of return comparisons between oil pipelines and other industries. Were we to insist on actual cash basis, after tax rates of return here, elaborate adjustments would be needed in order to compare those returns with actual cash basis, after tax rates of return elsewhere. That would be administratively difficult. And those difficulties would be pointless. Nothing of substance would be accomplished.

Accordingly, we conclude that oil pipelines *may* elect to normalize. But they need not do so. Compulsory normalization would, we think, be most undesirable here.

Competitive considerations may lead some pipelines to prefer lower rates that they can actually collect right now to higher rates that we would permit but which market forces preclude them from collecting. Lines in such circumstances will want to take less now in return for more later.[566] We see no reason to preclude them from doing that.

When regulated entities "normalize" their income tax timing differences, their customers reimburse them for taxes that were not actually paid. We disagree with those who label those unpaid taxes "phantom taxes." They are not phantoms. They will be paid in the future. That is why accountants call them "deferred taxes."

The salient features of this deferred tax business are that:

(1) Ratepayers send money to the regulated entity to enable it to pay its taxes.

(2) But those taxes will not actually be paid for many years.

(3) Until they actually are paid, the regulated entity has access to and dominion over the funds that the Treasury will later collect.

Is the regulated entity entitled to a return on those funds? The carriers insist that it is. We take a different view. The fund in question comes from the ratepayer. Why should he be required to pay the carrier a return on money that came from him, not from it?

As the Court of Appeals for the District of Columbia Circuit said not long ago on this point in a case arising under the Interstate Commerce Act:

> As this court has recognized on more than one occasion, the principle of excluding a deferred tax reserve from the rate base, as such reserve comes into existence, is *an essential component of an agency's election to normalize taxes for ratemaking purposes.* Otherwise the rate payer who has paid higher taxes reflecting normalization accounting would be paying the carriers for earnings on the tax differential even though it was the rate payer who contributed the differential in the first place. [567]

The carriers maintain that this rule deprives them of the benefits of accelerated depreciation. There are several answers to that. One is that they should make this argument not to us but to the courts or to the Congress. Another is that normalization coupled with a "no return on deferred taxes" rule enhances the regulated entity's cash flow. Most people prefer money now to money later. Are oil pipeline companies an exception to that general rule? We doubt it.

And if some of them are, they need not normalize. Nobody is *forcing* normalization on them. They are perfectly free to flow the tax benefits stemming from accelerated depreciation through to their ratepayers. [568]

What About the Investment Tax Credit?

Like accelerated depreciation, the investment tax credit is a device adopted by Congress for the purpose of giving a pro-investment tilt to the taxation of business income. Hence the regulatory questions raised by the existence of this special credit for new investment seem essentially the same as those discussed in the preceding section. In that section we held that the tax savings engendered by accelerated depreciation must be shared with the ratepayers through appropriate deductions from the rate base.

Why not treat the investment tax credit in exactly the same way? After all, from a *regulatory* perspective there is no real analytical difference between the credits of concern to us here and the speedy depreciation writeoffs with which we have just dealt. There is much to be said for this position. Were we free to adopt it, we might well do so.

But we are not free to do that. Congress has spoken clearly in this area. It has decreed that the full benefit of the investment tax credit belongs to the carriers. [569] Our analysis begins with Section 203(e) of the Revenue Act of 1964. [570]

It reads:

> TREATMENT OF INVESTMENT CREDIT BY FEDERAL REGULATORY AGENCIES.
>
> It was the intent of the Congress in providing an investment credit under section 38 of the Internal Revenue Code of 1954, and it is the intent of Congress in repealing the reduction in basis required by section 48(g) of such Code, to provide an incentive for modernization and growth of private industry (including that portion thereof which is regulated). Accordingly, Congress does not intend that any agency or instrumentality of the United States having jurisdiction with respect to a taxpayer shall, without the consent of the taxpayer, use—
>
> (1) in the case of public utility property (as defined in section 46 (c)(3)(B) of the Internal Revenue Code of 1954), more than a proportionate part (determined

with reference to the average useful life of the property with respect to which the credit was allowed) for any taxable year by section 38 of such Code, or;

(2) in the case of any other property, any credit against tax allowed by section 38 of such Code, to reduce such taxpayer's Federal income taxes for the purposes of establishing the cost of service of the taxpayer or to accomplish a similar result by any other method.

Oil pipeline property is not public utility property. [571] So Section 203(e)(1) has no direct bearing on our problem. The section that controls here is 203(e)(2).

Moreover, Section 203(e)(1) is no longer on the books. It has been replaced by Section 46(f). Why then do we bother with Section 203(e)(1)? We do so because we think that an analysis of what happened when § 203(e)(1) was replaced by § 46(f) is crucial to the interpretation of Section 203(e)(2). [572]

Section 46(f) generally provides for two alternative ways in which investment tax credits can be treated for ratemaking purposes. [573] The first is rate base reduction "if the reduction ... is restored not less rapidly than ratably." The second is cost of service reduction provided it "is reduced by [no] more than a ratable portion of the credit." The choice is between no return on or no return of the subsidy. Section 203(e)(1) specifically permitted the denial of return of the subsidy by pro rata reduction of cost of service. It said nothing specific about denying a return on the subsidy. Congress clearly changed the treatment of investment tax credits when it enacted Section 46(f). The question is, what was the change? Did Congress take away the right to *both* pro rata flow through and rate base reduction? Or, did Congress add the option of rate base reduction to the already existing pro rata flow through? It is our view that Congress was adding a new option.

Old Section 203(e)(1) did not allow both pro rata flow through and rate base reduction. It specifically permitted only the former. We believe it prohibited all other devices which would reduce a company's cost of service, including rate base reduction.[574] Section 203(e)(2) is subject to the same prohibition. It follows that we are powerless to exclude investment tax credits from oil pipeline carriers' rate bases. [575]

Other Matters—Test Periods, Throughput Variations, and Developmental Losses

The agenda with which we have been dealing was fixed by the administrative law judge who presided over the hearings held at this Commission after the Court of Appeals had remanded the case. Before those hearings began, the judge attempted to structure them by issuing a document that he entitled "INVITATION TO SUBMIT COMMENTS ON RATEMAKING PRINCIPLES FOR OIL PIPELINE RATE CASES." [576] Among the questions posed in that document were these:

(1) "What base period or test period should the Commission utilize to compute operating expenses and revenues? [577]

(2) "How should the Commission take account of variations in throughput in determining whether oil pipeline rates are just and reasonable?" [578]

Those are good questions. But we see no need to answer them. Rigid rules about test periods and about the way in which divergences between expectations and actualities should be treated seem out of place here. Rules about these matters are necessary in our electric utility and natural gas transmission work. But we think them unnecessary here.

Our views rest on the following considerations:

(1) Electric companies and natural gas companies have to make detailed filings with us whenever they want to change their rates.

(2) Those filings structure the subsequent inquiry.

(3) Indeed, the very first step in that inquiry is careful analysis of the filing by our staff.

(4) Moreover, there is lots of litigation about gas and electric rates. In our world that kind of litigation is the stuff of the daily round. It is as common for us as tort litigation is for trial courts in metropolitan centers. So there is an important place for rules. They supply valuable guidance to the litigants and to the judges who preside at our hearings.

(5) None of this is true in the oil pipeline field. There are no detailed filing requirements here. Nor do we intend to prescribe any. Moreover, there is no need for staff analysis. We view this as an essentially private law area in which the Commission is merely a forum. So there will be no occasion for staff studies. [579] Finally and perhaps most important, history shows that oil pipeline rate cases are rarities. There may perhaps be more of them in the future than there were in the past. But we see no reason to anticipate torrents of litigation in this field.

Accordingly, we leave these questions about who has to prove what and just when he has to prove it to the litigants, to their lawyers, and to our hearing officers. The carriers and their adversaries are better positioned than we are to assess the lines of proof that will best serve their causes. Moreover our administrative law judges are sharp enough and experienced enough to detect both insufficiencies in the proof and fallacies in the inferences that they are asked to draw from it. When they see a need for more evidence or better evidence, they can ask for it. And they should.

The Commission's Order

The Commission orders:

(A) The cause is remanded to Administrative Law Judge Isaac D. Benkin (or in the event that he is unavailable to another administrative law judge to be designated by the Chief Administrative Law Judge) for further proceedings in conformity with this Opinion.

(B) The judge shall:

(1) Set rates for the future;

(2) Determine what this carrier's rates should have been for each of the past periods involved;

(3) Determine whether any excess revenues were in fact collected;

(4) In the event that excess revenues are found, determine whether all or any part of them should be refunded and which of the reparation claims asserted, if any, should be allowed; [580] and

(5) Do such other acts, take such other evidence, and make such other determinations as he in his discretion deems necessary or appropriate in order to effect a just, speedy, and complete resolution of the controversy. 581

(C) The Commission's Oil Pipeline Board is directed to refrain from initiating any suspensions or investigations in cases where no aggrieved person requests such action.

Commissioner Sheldon *concurred* with a separate statement attached [page 61,716]. Commissioner Hughes *dissented in part* and concurred in part with a separate statement attached [page 61,719]. Commissioner Richard *concurred* with a separate statement attached [page 61,730].

— Footnotes —

[1] The industry maintains that "oil pipelines have by far the most unfavorable capital turnover of any industry group" (opening brief of the Association of Oil Pipelines [hereinafter cited as "ASSOCIATION BRIEF"] at 84), that each dollar of investment yields only 29¢ in gross revenue, and that an investment of $3.52 is required to produce a dollar in gross receipts.

[2] If the traffic is there, the substantial investment required to bring a pipeline into being is well worthwhile. That is so because the noncapital costs of a pipeline operation are extremely low. Pipelines use amazingly little labor. That gives them a great advantage over other forms of transportation that use less capital but much more labor, such as shipping or trucking.

[3] We recognize that pipelines are frequently built and owned by groups of oil companies. In that situation, the co-owners' interests may not always be harmonious with each other. Assume, for example, that the A Company and the B Company are equal partners in the A-B Pipeline. But assume further that A generates 75% of the pipeline's traffic. So A contributes 75% of the revenue. But it takes home only 50% of the profits. Hence A's interest as a *customer* is greater than its interest as an *owner*. That gives A an interest in low rates. Conversely, B has an interest in high rates.

Does anyone else have an interest in those rates? Should anyone else care about them? Are there public interest implications? If so, what are they?

[4] The Supreme Court thinks that there is something to this. In the *Trans Alaska Pipeline Rate Cases*, 436 U.S. 631, 644 (1978), a unanimous Court observed that: "[T]hose who will ship oil over TAPS [an acronym for Trans Alaska Pipeline System] are almost exclusively parents or co-subsidiaries of TAPS owners. Thus, to an indeterminate, but possibly large extent, excess transportation charges to shippers will be offset by excess profits to TAPS owners, creating a wash transaction from the standpoint of parent oil companies. Indeed, it is telling that no shipper of oil protested the TAPS rates. Instead . . . only the public perceives that it will be injured by the proposed TAPS rates and has objected to them . . . Therefore . . . unreasonable . . . rates - both generally and in these cases - . . . will almost certainly be passed along to 'a prior producer or . . . to the ultimate consumer.'" Quoting with approval from the late Professor I.L. Sharfman's well-known multi-volume treatise of the 1930's on the Interstate Commerce Commission, *The Interstate Commerce Commission: A Study in Administrative Law and Procedure*, 4 volumes in 5 (1931-1937), hereinafter cited as "SHARFMAN."

[5] G. S. Wolbert Jr., *U. S. Oil Pipe Lines 30-31* (1979). The author was formerly the Shell Oil Company's General Counsel. So few would accuse him of being biased against the oil industry. Nor are many likely to say that he underestimates the competitive hazards that the pipelines face. In fact, Dr. Wolbert's footnotes show that his text relies in large measure on the testimony of *industry witnesses* before this Commission. Moreover, we note that Wolbert's publisher was the American Petroleum Institute.

Dr. Wolbert wrote an earlier book on the subject. G.S. Wolbert, *American Pipe Lines* (1952). In this Opinion his first book is cited as WOLBERT I, and his second as WOLBERT II.

[6] Most people in the industry appear to concede that there may once have been some measure of truth to this allegation. But they insist that this is no longer so. As they see it, *intramodal* competition among pipelines coupled with the pipeline owner's self-interest in seeing to it that his very expensive facility is used to the fullest extent possible are potent market pressures that keep pipeline rates within an acceptable zone of reasonableness. The industry's critics are dubious about that. At this juncture, however, we are not concerned with the merits of the debate. We are trying to describe what the debate is about. We shall come to the merits in due course.

[7] That does not appear to be true of maritime carriage. The passage from WOLBERT II quoted in the text at p. 4, *supra*, concluded with a caveat about "ocean-going, long-haul supertankers." And that caveat is followed by this observation:

> There are, of course, special situations where other forms of transportation have a competitive advantage over pipelines. For example, heavier petroleum liquids or solids (*e.g.*, residual fuel oil, asphalt, and coke) while transportable by pipelines are more economically handled by other bulk carriers. Often market volume requirements make barge movement more attractive than by pipeline. In large volume markets having good port facilities, tanker shipments may offer the lowest transportation costs. This is especially true of crudes imported from far away foreign sources. The niche for trucking lies in situations where small volumes over short hauls with many different destinations are involved, such as gasoline movements from terminals to jobber plants and to private residences. WOLBERT II at 31.

[8] *Cf.* M. Ball, *This Fascinating Oil Business 73* (1940) "Oil in the field tanks is like a fat steer on the range; it needs to be taken thence and made into something useful."

[9] There is an element of fiction here. In the strict, literal sense independent producers very seldom "ship". Nine times out of ten (perhaps it would be more accurate to say 95 times out of 100) they sell their output in the fields. So they are rarely "shippers". WOLBERT II at 193-194. But independent producers generally sell at or near the point of production at the prices "posted" by some major oil company that owns pipelines. That "posted price" will normally be the world market price for oil of the grade and quality involved *minus the cost of carrying that oil over the pipeline from the well to the refinery.*

Moreover, some relate the independents' propensity to sell in the fields to the major companies at the latters' posted prices to the majors' ownership of the pipelines and to the majors' pipeline rate structures. Thus, for example, one student of the industry whose interests have since shifted from petroleum economics to world politics wrote back in 1948 that the pipeline rate structure *"is designed to persuade the independent producer of oil to sell his product in the oil fields at prices dominated by the major company, or the few major companies owning the pipe line or lines in that field. The pipeline rates are such as to discourage the seller from paying the costs of carriage on his oil in order to reach a wider market in the refinery area."* E. Rostow, *A National Policy for the Oil Industry 62* (1948). (Emphasis added.)

Some years thereafter Professor Rostow, who later became Dean of the Yale Law School, then moved on to the post of Under Secretary of State, and is now Director of the United States Arms Control and Disarmament Agency, amplified this view in a law review article in which he said:

> In the past at least pipe line ownership gave the major companies a powerful voice in the markets for crude. The level of pipe line rates in relation to field prices provided a distinct incentive for independent *producers* of crude oil to sell their oil to a major company pipe line owner in the field. Pipe line rates were so high as to discourage independent producers from transporting crude oil through the pipe lines in their own account, to be sold in markets containing more buyers than are available in any producing area. Similarly, the relation between crude prices and pipe line rates helped keep independent refiners located far from particular fields from purchasing oil advantageously in those fields, and transporting it to their own account via pipe lines. This effect was enhanced by high tender requirements, and other conditions imposed upon the carriage of oil by pipe line companies. Although the oil and gasoline pipe lines have been common carriers in form for many years, they have until recently transported very little except oil or gasoline produced by other branches of their own companies. Rostow and Sachs, *Entry into the Oil Refining Business: Vertical Integration Re-examined,* 61 Yale L.J. 856, 882 (1952).

[10] People who subscribe to this analysis weep copiously for the independent producers. They make much of the fact that 18 leading integrated companies control over 96% of the nation's crude oil pipeline network and that the lion's share of the oil that moves over that network belongs to those companies, *i.e.,* they either produce it themselves or they buy it in the fields from independents so that it already belongs to them when it enters their pipelines. Those concerned about what they deem excessive concentration in oil proceed to relate this state of affairs to figures that show that the independent producers' share of aggregate crude oil output role has declined over time. Thus, for example, the June 1978 Staff Report of the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee entitled "OIL COMPANY OWNERSHIP OF PIPELINES" (commonly referred to and hereinafter cited as the "KENNEDY STAFF REPORT") commented at pages 30 and 31 that:

> It is often argued that concentration in crude oil production is lower than it is in many other extractive industries in the economy; industry sources frequently claim there are 10,000 producers. Two considerations weigh against this argument. First, given the number of producers in the industry (in contrast to, say roughly a dozen each in copper, lead or zinc production), observed concentration rates in crude oil production are impressive. Secondly, there has been a disturbing increase in concentration rates over the past two decades or so.
>
> * * *
>
> The shares held by the thousands of producers outside the 20 largest ... declined sharply from 44.3 percent of the industry's output in 1955 to no more than 25.0 percent by 1975. This occurred in a period when production was rising, from 2.4 billion barrels in 1955 to 3.1 billion barrels in 1975. In other words, while output directly controlled by the major companies increased by 75 percent, from 1.3 to 2.3 billion barrels, that under the control of independent producers fell by 29 percent, from 1.1 billion barrels to 800 million annually.
>
> * * *
>
> It is possible ... that much of the increase in concentration reflected merger or the purchase of reserves located by smaller exploration and production companies.

The industry brands this sort of thing poppycock. It points out that:

(1) Many years have now elapsed since an audible outcry about the pipelines was last heard from the independent producers.

(2) There is no *contemporary* evidence that a statistically significant number of independent producers deem themselves victimized by the pipeline owners.

(3) The Independent Petroleum Producers Association of America, which claims to speak for thousands of independent producers, wholeheartedly endorses the pipeline status quo, insists that its members are happy about things as they are, denies that there is any exploitation by the majors, and maintains that proposals for "reform" designed by lawyers and economists who have appointed themselves counsel to the hapless independent producers frighten those gentlemen's involuntary clients to death.

[11] *But see* n. 6, *supra*.

[12] Even if he does not *actually* do so, some argue that he has the *power* to do so. And that is pernicious. One economist, whose study of the industry has become a classic and is cited with approval by all sides observes:

> There is nothing really unique about such criticism of the major oil companies. Alcoa, for instance, was accused of using a vertical integration squeeze based on its control of ingot production. It supposedly sold sheet to fabricators at a price lower than the sum of the price of ingots and the cost of rolling. This left competing sheet producers who paid the market price for ingots at a competitive disadvantage.
>
> There is no dearth of respectable economic reasoning to support the validity of such complaints, if not the justice of the remedies sought. Where one company (or small group) in an industry controls one vertical stage of that industry completely, it is in a position to abuse its less fortunate competitors in the earlier or later stages. Acting as a single or joint monopsonist it can exploit the earlier stages of the industry, and as a monopolist the later stages. Such can easily be the economic facts of life in a vertically organized industry; and such, it is said, have been and are the facts of life to the independent producers and refiners in the oil industry, *especially to independent refiners*. L. Cookenboo, Jr., *Crude Oil Pipe Lines And Competition in the Oil Industry 5-6* (1955). (Emphasis added.)

[13] Even persons friendly to the industry concede that the rates *used* to be high. Thus, for example, Dr. Wolbert says that "formerly pipeline owners charged initial rates as stiff as the traffic would bear, the amount being determined largely by comparable through rail rates. After the lines had paid themselves out, in the absence of regulation or adverse effects of tax laws, rates were maintained at an *unreasonably* high level, since the charging of rates to shipper-owners was only a bookkeeping transaction, a figurative shifting of money from one corporate pocket to another, *and the higher rates discouraged use of the lines by independents*." WOLBERT I at 20-21. (Emphasis added.)

[14] There is, of course, an enormous literature about industrial concentration. Some think concentration an unmitigated evil that will, if unchecked, subvert American democracy and destroy economic and eventually political freedom. Others consider it beneficent, a great engine of economic efficiency and social progress. Between those two extremes, one finds a host of intermediate views. We see no need for exhaustive citations. No one likely to read this document will need references to such treatments of the subject as the future Justice Brandeis's *The Curse of Bigness,* available in Osmond K. Fraenkel, ed. *The Curse of Bigness* (1934), Judge Learned Hand's opinion in *United States v. Aluminum Co. of America*, 148 F.2d 416, 428-429 (2d Cir. 1945) (expressing the belief that "great industrial consolidations are inherently undesirable, *regardless of their economic results*" [emphasis added], noting that "among the purposes of Congress in 1890 was a desire to put an end to great aggregations of capital because of the helplessness of the individual before them", and observing that the antitrust laws were intended "to perpetuate and preserve, for its own sake *and in spite of possible cost,* [emphasis added] an organization of industry in small units which can effectively compete with each other"), Professor (now Judge) Robert H. Bork's all-out attack on Hand's position in *The Antitrust Paradox* (1978), the late Professor Richard Hofstadter's famous historical essay on *What Happened to the Antitrust Movement* in his *The Paranoid Style in American Politics and Other Essays* (1965), Professor John McGee's *In Defense of Industrial Concentration* (1971), and much else that can be found with relative ease by looking at the footnotes in the law reviews, the antitrust treatises and casebooks, and the economic journals and by consulting the card catalogue in a good library.

These voluminous disputations are of only fleeting relevance. Our concern at the moment is with questions, not with answers. So the important thing about the concentration controversy is not with its rights and wrongs, but with its existence. People who look at industrial concentration either with delight or with equanimity are unlikely to be disturbed by the oil pipeline problem. They find the parade of horribles in the text so much stuff and nonsense. But those who look at concentration with a jaundiced eye have in the past tended to find the pipeline scene extremely disturbing. Historically, the oil pipeline debate has in large measure been a debate about the merits and the demerits of industrial concentration and about whether the oil business is or is not more concentrated than it would be in an ideal world.

[15] In a well-known treatise on the economics of oil, Professors Alfred E. Kahn and Melvin De Chazeau elaborated on this theme in the following vein:

> For the refiner not located in the field, crude oil availability is economically inseparable from access to pipelines; and the competitive margin within which he must live will be vitally affected by the tariff he has to pay for transit. Historically, there can be no doubt whatsoever that this crucial fact has been used by the majors to confine their independent rivals to secondary locations in producing fields and to harass those with the temerity to challenge this fate. M. De Chazeau and A. E. Kahn, *Integration and Competition in the Petroleum Industry at 512* (1959).

[16] This is one of the major counts in the many literary indictments of the status quo in oil from Henry Demarest Lloyd's *The Story of a Great Monopoly*, which appeared in the March, 1881 issue of The Atlantic Monthly and which observed, among other things, that "Standard Oil has done everything with the Pennsylvania legislature, except refine it" and Ida M. Tarbell's *History of the Standard Oil Company* (1904) (hereinafter cited as "TARBELL") down to Robert Engler's *The Politics of Oil: A Study of Private Power and Democratic Directions* (1961) and *The Brotherhood of Oil* (1977) as well as the late Professor John M. Blair's *The Control of Oil* (1976).

Blair says that "By its very nature the pipeline is a bottleneck invariably owned and controlled by the majors but of critical importance to the independents. Without the services of a gathering line, the independent producer cannot get his product to a refinery. And without the continuous, assured supply provided by a pipeline, a refinery, because of its high fixed costs, cannot operate efficiently. Even where his supply is provided by independent producers, the independent refiner using a major-owned pipeline is still not free from the influence of his larger competitors.

"The opportunities presented by the pipeline for securing monopoly control have long been recognized. When first incorporated in 1870, the Standard Oil Co. controlled only about 10 percent of the nation's petroleum refining capacity. Three years later, it began to gather and transport crude bought from others through pipelines. By 1879, less than a decade after the original incorporation, it had increased its control over refining capacity to 90 percent. This astonishing increase was achieved in large part through control over transportation-both pipelines and railroads." *Id.* at 137.

This excerpt is followed by a discussion that shows that Dr. Blair thought that the same basic forces are at work in the world of today, that only the form of the thing has changed, and that when it comes to substance, the oil pipeline world is one where the more things change, the more they remain the same.

Other versions of that point of view can be found in *America's Energy* (R. Engler, ed. 1980), an anthology of articles about energy that have appeared over the years in *The Nation*. As those familiar with that magazine's orientation might expect, the articles:

(1) Are almost invariably critical of big oil companies;

(2) Make much of the fact that those companies own most of the pipelines; and

(3) Stress the baleful effects that this has on consumers.

Finally, note should be made of a forceful and an elaborate presentation of this point of view by the General Accounting Office in its report to the Congress entitled *Petroleum Pipeline Rates and Competition—Issues Long Neglected by Federal Regulation and in Need of Attention* (July 13, 1979).

[17] One economist friendly to the industry finds that "The special 'squeezing' arguments are implausible because adoption of the hypothesized tactics would annually have cost the large oil companies (the alleged 'squeezers') billions of dollars to implement." Professor Richard Mancke in E. J. Mitchell, ed., *Vertical Integration in the Oil Industry 67* (1976). Professor Mancke's views rest on a number of propositions. One is that the "oil companies no longer possess observable monopoly power in any important energy market." Another is that "the economic structure of the key stages of the oil business is such that the successful exercise of monopoly power is virtually impossible unless the oil companies receive governmental assistance."

More specifically, Mancke points out that:

(1) The idea that the majors "squeeze" the independent refiner rests on the premise that the majors achieve that nefarious end by manipulating the price of the crude that they sell to the independents.

(2) The charge is that the majors keep the price of crude up.

(3) But the majors are not self-sufficient in crude. They buy lots of crude. In fact, they buy more crude than anybody else does. So why would they engage in all kinds of shenanigans and knock themselves out in order to raise the price of that which they *buy*?

Dealing in detail with the charge that the large integrated majors have had incentives to make their profits in crude and to arrange matters so that refining is unprofitable, Professor Mancke analyzes the Federal Trade Commission's 1969 estimates of crude oil self-sufficiency for the seventeen largest integrated refiners. He finds that:

> Except for Getty Oil, only the sixteenth largest, none of these integrated giants produced more than 93 percent of its total domestic needs. Hence, only Getty owned enough crude oil for profit-shifting to be profitable. The after-tax losses if any of the other firms had adopted this strategy would have ranged from a low of three cents on each dollar of profits shifted by relatively oil-rich Marathon to a high of 48.3 cents on each dollar of profits shifted by relatively oil-poor Standard Oil (Ohio). None of these sixteen integrated majors would choose to bear these high costs, which means that, even if it were possible, profit-shifting would never be practiced and thus that independent refiners would never be "squeezed. Mitchell, *op. cit. supra* at 66-67.

Of course, much has changed since 1969. Standard of Ohio is no longer "relatively oil-poor." It now has vast Alaskan reserves. Another and an even more significant change involves the Federal income tax treatment of crude oil extraction. In 1969 large-scale producers of crude had the benefit of the percentage depletion allowance. They don't anymore. In fact, they have been subjected to a windfall profits tax. That is important because the depletion allowance was basic to Professor Mancke's analysis. His calculations were based on the depletion allowance. Another pertinent change is the substantial post-1969 increase in the market power of the major exporting countries, of whom the United States long ago ceased to be one. Moreover, there is some reason to believe that those countries may now be somewhat more skillful in exploiting that power than they used to be. We are not unmindful of the recent softening of oil prices. Nor have we ignored recent evidence suggesting that all may not be perfectly peaceful and exquisitely harmonious within the house of OPEC. However, these developments are very recent. They may prove of brief duration. It is too early to tell. In any event, we do not believe that they affect the observations made in this paragraph.

But it is hard to see how these post-1969 changes invalidate the analysis. Indeed, they seem to strengthen it. We note in this regard that Professor Lester C. Thurow of the Massachusetts Institute of Technology, a well-known "liberal" economist (see his *Generating Inequality* (1975) in which he showed a strong egalitarian bias and took a dim view of the notion that rich people are rich because they are smarter than poor people and his *The Zero Sum Society: Distribution and the Possibilities for Economic Change* (1980) in which he again expresses great concern over economic inequality, discrimination, and unemployment and advocates a more progressive tax structure and income protections for the weak) and scarcely a passionate admirer of large oil companies, has recently told the readers of *Newsweek* that "Oil prices are set in a worldwide market dominated by OPEC where no American corporation, no matter how large, is going to have monopoly power." Thurow, *A New Era of Competition*, Newsweek, January 18, 1982, page 63.

But we are in an area in which there is a counter-argument to every argument. So those who take a jaundiced view of the majors and all their works would have an answer to Professor Mancke as well as a rejoinder to Professor Thurow. That answer-rejoinder would focus on the pipelines. It would probably go something like this:

(1) Of course, the integrated oil companies don't want to raise the prices that they have to pay for crude when they *buy* it from others. We know that. It was our basic complaint against the old Standard Oil Trust. And we never accused the Trust's successors of overpaying the independents for the crude that they bought from them. In fact, we maintain that the majors have historically used their control of the pipelines to *depress* the prices that the independent producers get.

(2) Today, however, "cheap crude" isn't all *that* important. In fact, it may no longer be important at all. The majors may not be "self-sufficient" in crude. But they have vast reserves of it. And the higher the price of crude, the more valuable those reserves become.

(3) For competitive purposes, what *really* matters is not the absolute price but the relative price. Whether crude is high or low, dear or cheap, you want to be able to buy it for less than your competitors have to pay for it. And the majors' control of the pipelines enables them to do just that.

[18] The authors of the KENNEDY STAFF REPORT concluded that it was. They said (at page 151):

> The integrated owners of pipelines have in fact exploited their advantages. Integrated company ownership of pipelines has had a substantial impact on the ability of nonintegrated refiners and marketers to compete with the pipeline owners in the market place for petroleum products. Control of crude oil pipelines has enabled these vertically integrated oil companies to gain control of crude oil production greatly exceeding their own refinery needs and has worked to prevent the formation of a domestic crude oil market. Their operation of petroleum pipelines allows them to control the distribution and flow—and consequently influence the price—of refined petroleum products. The lower real costs of pipeline transportation have not been translated into lower consumer prices but merely into higher oil company profits. Oil company ownership of petroleum pipelines has demonstrably failed to make petroleum pipelines a practical transportation alternative for many small refiners and marketers trying to compete with the pipeline owners.

[19] If the disease isn't too serious, the patient may be better off with it than he would be after a painful and an expensive "cure." Moreover, some cures don't work. But even those that don't work have to be paid for. And it is the patient who has to do the paying. In this case the patient is the American people.

Spokesmen for the oil pipeline industry maintain that there is nothing to cure. They argue that their critics "have a solution in search of a problem." The industry's favorite adage is "If it ain't broke, don't fix it."

[20] The KENNEDY STAFF REPORT's last sentence (at page 152) reads in pertinent part: "effective solution to the grave competitive problems inherent in oil company ownership of petroleum pipelines: to prohibit oil companies from owning petroleum pipelines and to require divorcement of existing pipelines from oil company ownership."

[21] But if the "natural monopoly" thesis be sound, those genuinely independent transportation companies will have enormous market power. That will enable them to exact monopoly profits. So the prohibition of shipper-ownership would not be enough in itself to resolve "the problem" in toto.

[22] Because of the factor alluded to in the preceding footnote there has long been a school of thought that advocates vigorous rate regulation *plus* a ban on shipper-ownership.

[23] Kerr-McGee is number 101 on *Fortune's* list of the 500 largest industrials. *See Fortune*, May 3, 1982, at page 265.

[24] In that area it is very much a maverick. Its view of the pipeline problem differs radically from that of its brethren among the major oil companies. When it comes to pipelines, Kerr-McGee stands alone. None of the other integrated companies agrees with its position.

[25] Indeed, it seems to be very much part of that establishment. Mr. Dean A. McGee, Kerr-McGee's co-founder and chief executive officer, recently received the American Petroleum Institute's Gold Medal for Distinguished Achievement. *Oil and Gas Journal*, November 16, 1981, page 29. The American Petroleum Institute is not known for its propensity to honor people whom it has reason to regard as enemies of the status quo in oil. Nor is the Institute known for its receptivity to unconventional ideas about oil and its role in the American economy.

[26] Kerr-McGee relies heavily on other people's pipelines. This suggests that Kerr-McGee's managers have decided that pipelines are not an especially attractive investment and that there are better places in which to put Kerr-McGee's money.

[27] They too are of substantial size. They are agricultural cooperatives with significant interests in oil.

[28] In view of the glacial pace at which the matter has moved, some may think the word "progress" ill-chosen.

[29] However, the Williams complex is appreciably smaller than Kerr-McGee. As previously noted, Kerr-McGee is number 101 among the nation's 500 largest industrial firms. Williams is much further down on the list than that. It is number 198. *See Fortune*, May 3, 1982, at page 266.

[30] It holds a 27.5% interest in the Peabody Coal Company.

[31] It owns large phosphate deposits and is also an important producer of anhydrous ammonia.

[32] Its subsidiary Edgcomb Metals Co. processes and distributes high-performance metals.

[33] Williams' real estate affiliate, Williams Realty Corp., is developing a major commercial real estate project in downtown Tulsa known as the Williams Center. The company also has other real estate interests.

[34] Williams' pipeline system covers a 12-state area extending from Oklahoma to North Dakota and Minnesota. The system has over 8,500 miles of pipeline and approximately 4,900 miles of right of way.

[35] Natural gas is also produced. These producing operations are conducted by the Williams Exploration Company and by two other subsidiaries called Louisiana Resources Company and Rainbow Resources, Inc.

[36] What Williams produces is crude. What it carries on the other hand, consists in the main of gasoline and other refined products.

[37] Kerr-McGee has at times suggested that Williams may not be quite so totally "independent" as it claims to be. But those questions are peripheral. They have no bearing on the points that we now have to decide.

[38] Williams is said to be the largest.

[39] That is a generalization. Most generalizations have their exceptions. And that may be so of this one.

[40] KENNEDY STAFF REPORT at 78-80. (Emphasis added; footnotes omitted.)

The shipper-owners maintain that these propositions rest on misconceptions. *See* WOLBERT II, at 296-298.

[41] *Cf. United States v. Rabinowitz*, 339 U.S. 56, 69 (1950): "It is a fair summary of history to say that the safeguards of liberty have frequently been forged in controversies involving not very nice people. And so, while we are concerned here with a shabby defrauder, we must deal with his case in the context of . . . the great themes expressed by the Fourth Amendment." Dissenting opinion of Frankfurter, J., concurred in by Jackson, J.

[42] *See Mid-Louisiana Gas Co. v. Federal Energy Regulatory Commission*, 664 F.2d 530, 535 (5th Cir. 1981), *cert. granted*, 51 U.S.L.W. 3219 (U.S. Oct. 4, 1982) (No. 81-1889): "The Commission's duty is to administer the law Congress passed in light of the purposes for which it was passed. It is not an agency's prerogative to alter a statutory scheme even if its alteration is as good or better than the congressional one."

[43] This sentence reflects the Commission's public-interest perspective. To the litigants, to Williams and to the complaining shippers the case-specific features of the matter are obviously all-important.

[44] *See* E. F. Schumacher, *Small is Beautiful* (1973).

[45] Recent events would seem to strengthen this position. They certainly show that oil prices can move down as well as up.

[46] Of course, John D. Rockefeller and his associates dissented from that consensus. They saw no problem. Some think that they were right. But history's locomotive was moving in the opposite direction.

[47] There were no Gallup polls in those days, so the statement in the text cannot be demonstrated mathematically. Most Americans were probably more worried about earning a living and about other private day-to-day problems than they were about the economics of oil. But the historical sources show that the better educated citizenry were much concerned about oil and that their concern had by 1906 seeped down to a broad segment of the less educated. Journalists, newspaper proprietors, and magazine proprietors thought that oil was "good copy." Statesmen looking for issues took the same view. That is pretty strong evidence that the public was interested. Of course, some would say that a clever propaganda campaign had led the populace to consider itself interested.

[48] He was Theodore Roosevelt. And he was then busily denouncing "the malefactors of great wealth."

[49] They were uppermost among the "malefactors" referred to in the preceding footnote. One recent historian notes that Roosevelt's "public relations campaign against Standard Oil was relentless." B. Bringhurst, *Antitrust and the Oil Monopoly*; *The Standard Oil Cases* 1890-1911 (hereinafter cited as "BRINGHURST"), p. 207 (1979).

[50] They were then reproduced in two volumes that bore that title. These appeared in 1904. There have been a number of subsequent editions. The book is still very much alive. It is available in a *Harper Torchbook* paperback edition edited by David M. Chalmers. As Tarbell's biographer says: "In the sole work for which she is now remembered, *The History of the Standard Oil Company*, the author, her subject, and the times had met to produce a masterpiece which has not declined into a period piece." M. Tomkins, Ida M. Tarbell 91 (1974) (hereinafter cited as "TOMKINS").

[51] Hence she was allergic to the point of view expounded by John D. Rockefeller, Jr. when he addressed the students at his alma mater, Brown University, on the subject of "Trusts" and told them that "The American Beauty Rose can be produced in its splendor and fragrance only by sacrificing the early buds which grow up around it." Quoted by Tarbell at the very outset of her *History of the Standard Oil Company*.

[52] Many had, of course, gone over the brink. In Miss Tarbell's view, pipelines had a lot to do with that. The penultimate paragraph of her great book reads:

> And what are we going to do about it? For it is *our* business. We the people of the United States, and nobody else, must cure whatever is wrong in the industrial situation typified by this narrative of the growth of the Standard Oil Company. That our first task is to secure free and equal transportation privileges by rail, pipe and waterway is evident. It is not an easy matter. It is one which may require operations which will seem severe, but the whole system of discrimination has been nothing but violence, and those who have profited by it cannot complain if the curing of the evils they have wrought bring hardship in turn on them. At all

events, until the transportation matter is settled, and settled right, the monopolistic trust will be with us, a leech on our pockets, a barrier to our free efforts. 2 TARBELL 292 (Emphasis added).

[53] Among Tarbell's articles was a series entitled *Crimes of the Standard Oil Trust*. These pieces appeared in *The New York American* in February 1905.

[54] Though proverbially meticulous, her journalism was not dispassionate. Her father was an independent oil man. So was her brother.

Her biographer comments:

> Tarbell . . . shared with the people of her native regions a deep hatred of Rockefeller, and it activated her study of him . . . Convinced that Rockefeller was of the species most despised on the frontier of her youth, a hypocrite of a peculiarly offensive kind, who taught the Bible version of the Golden Rule to his Sunday school classes and practiced the version of it allegedly taught him by his father, she set out to demolish the whited sepulcher. She left it in ruins. TOMKINS at 90.

At an earlier point Tomkins sums Tarbell's work up this way:

> Tarbell's history recounts the development of the oil industry from the early hawking of petroleum as a medicine guaranteed to cure everything prayer couldn't to its eventual use as a lubricant and fuel for internal combustion engines. The narrative follows the rise of the Standard Oil Company from its inception following the Civil War to the height of its unchecked power at the turn of the century. Tarbell's tone, a mixture of cold disdain and white-hot moral indignation controlled by excellent documentation and a facade of objectivity, seemed to hit the right note. An enthusiastic public followed her serial account in *McClure's* for two years as she tirelessly communicated to tens of thousands of readers "a clear and succinct notion of the processes by which a particular industry passes from the control of the many to that of the few." Tarbell nowhere leaves much room for doubt that she is a partisan of "the many." TOMKINS at 60 (with a footnote citation to Tarbell's own statement of her purpose in chronicling Standard Oil's saga at such length and in such elaborate detail.)

[55] 1 TARBELL at 36-37.

[56] *Id.*

[57] *Id.* at 154-160.

[58] Though none had done as successfully or as conspicuously as Tarbell, others had tilled this field before her. More than twenty years before Tarbell began to investigate Standard Oil, Henry Demerest Lloyd told the readers of the March 1881 issue of the *Atlantic Monthly* that "very few of the forty millions of people in the United States who burn kerosene know that its production, manufacture and export, its price at home and abroad have been controlled for years by a single corporation—the Standard Oil Company." Lloyd stressed Standard's control of the pipelines. He also delved into the way in which government had been manipulated so as to foster that control. That exploration led Lloyd to the conclusion about Standard Oil and the Pennsylvania legislature quoted in n. 16, *supra*.

[59] BRINGHURST, 69-70.

[60] Professor Arthur M. Johnson's monograph entitled *Lessons of the Standard Oil Divestiture* in E. J. Mitchell, ed., *Vertical Integration in the Oil Industry 194* (1969).

[61] *Standard Oil Company of New Jersey v. United States*, 221 U.S. 1 (1911). Standard contended that it could not be deemed a monopoly because the record "established that a very small percentage of the crude oil produced was controlled by the combination." The Court brushed that aside. It said: "As substantial power over the crude product was the inevitable result of the absolute power which existed over the refined product, the monopolization of the one carried with it the power to control the other . . ." 221 U.S. at 77.

[62] That question has been debated from 1911 until today. Economic historians and students of antitrust will probably continue to be fascinated by it for decades to come. For a skeptical evaluation see BRINGHURST. He concludes that the "requested remedies . . . were inadequate to achieve meaningful competition in the petroleum industry." He adds that "The Standard companies thus were able to operate as a closely coordinated unit for at least fifteen years after the decree took effect." BRINGHURST at 205.

A spokesman for the industry concedes that:

> While the company was indeed broken up, two factors were discouraging to Standard's critics who were primarily antibusiness.
>
> The first was that while the companies were now compelled to compete with one another, at first it appeared that this "competition" was on paper only.
>
> After all, the same people owned the same properties. One well publicized result of the dissolution was that one prominent Standard vice-president merely changed titles, and moved to a new office a few feet down the hall at 26 Broadway.
>
> The second disappointment to many critics of business was that while the management of Standard was broken up, and the dominant position of Standard was clearly gone, the owners, John D. Rockefeller among them, appeared to get even richer as a result of the decree. Dividends for holders of Standard's $100-par stock were reduced from $37 to $20 but the price of Standard stock and of the other Standard Companies soon began to rise, as dividends increased. Standard of New Jersey had paid its highest dividends, 48 percent in 1900 and 1901. The rates in the years before dissolution had ranged between 36 percent and 45 percent. During 1912, the first year following dissolution, 26 of 34 Standard Companies paid dividends amounting to 53 percent of the outstanding capital stock of the old Standard of New Jersey.
>
> During the 4-1/2 months of 1911 prior to the Supreme Court decision of May 15, Standard's stock had risen 61-1/4 points to 679-3/4 on the day of the decision itself. And the stock was 94-3/4 higher than at its lowest point in 1910. Mr. Hastings Wyman, Jr., an attorney on the staff of the American Petroleum Institute, writing on *"The Standard Oil Breakup of 1911 and Its Relevance Today"* in the Institute's *Witness for Oil: The Case Against Dismemberment* (Michael E. Canes, compiler) at pp. 71-72. (1976).

The incumbent Assistant Attorney General in charge of the Antitrust Division agrees. In a skeptical appraisal of what his legal specialty has done for the American people he wrote: "When the Standard Oil Trust was broken up many years ago, it was subdivided into a series of discrete regional enterprises that arguably had as much monopoly power as the prelitigation trust had had." R. Tollison, ed., *The Political Economy of Antitrust: Principal Paper by William Baxter 27* (1980).

[63] Mr. Wyman, the industry spokesman cited in the preceding footnote, has at pages 67 to 69 of the work there cited summarized those changes as follows:

Production

Standard's control over crude supplies ranged from 92% in 1880 to 70% to 80% of older fields and 10% to 30% of newer fields in the West in 1911. Standard Oil did not actually dominate production of crude oil; rather, because of its purchasing power, and its dominant position in pipelines, it was able to set the prices of the crude oil it purchased.

Today, (1974) the largest producer of crude oil produces just 9% of the total. And neither the top 4 companies (26%) nor the top 8 companies (42%) can match Standard's pre-1911 position.

Refining

Standard's share of refining capacity ranged from 90% to 95% in 1880 to 64% in 1911.

By comparison, the top refiner today accounts for only 8% of capacity.

The top 4, 31%; the top 8, 54%.

Transportation

Standard Oil had almost a total monopoly over pipeline transportation. Through its relationships first with railroads and then with pipelines, Standard was able to transport crude oil at a lower cost than its competitors.

The top company in pipeline ownership by volume has only 10% of interstate pipelines. The top 4, 34%; the top 8, 55%. And tankers are even less concentrated.

Marketing

At the peak of its domination, Standard sold 90% to 95% of kerosene sold in 1880. By 1911, Standard still sold 75% of the kerosene, and 66% of a relatively minor product called gasoline.

In the gasoline market today, the top company accounts for 8%. The top 4 sell 30%, the top 8, 52%.

Ownership

In 1900, John D. Rockefeller owned 42.9% of Standard Oil of New Jersey. Fifteen other individual stockholders accounted for an additional 39.5%. This meant that over 80% of the company which virtually dominated the petroleum industry was owned by only 16 individuals. In 1911, ten men still owned 37.7% of Standard's stock, with 24.9% held by Rockefeller. At the time of its dissolution all of the stock of the Standard Oil Company was held by only 6,000 stockholders.

In contrast, today the shares of just the six largest oil companies are owned by 2-½ million direct shareowners and another 11-½ million indirect owners. In other words, 14 million Americans, or about 6.5% of the population, are shareowners of just the six largest companies compared to 6,000, or only about $\frac{1}{10}$,000 of one percent of the population in 1911.

Profits

Economic historians have indicated that Standard Oil's profit rates were twice that of profit rates in general during the years leading to up 1911. Standard's profit as a percentage of net worth was 23.1% in 1906; 20.7% in 1904; 27.0% in 1902; 27% in 1900.

During 1975, the 25 leading oil companies had a comparable profit rate of 13.5, about half the Standard rates the decade prior to the breakup. For the ten years 1965-1974, the average profit as a percentage of net worth on petroleum companies was 13.4%. The ten year average for all mining was 14.7%, for all manufacturing, 13.0%. (Footnotes omitted).

[64] Mr. Nicholas Von Hoffman makes this point quite pungently in a recent commentary on the proposals for restructuring the American Telephone and Telegraph Company. He says: "The long-range results of earlier antitrust suits were probably much different from what any of the litigants had in mind when the suits were filed. The most famous of all, the turn-of-the century Standard Oil suit, had been economically moot long before it was legally settled. Since the Rockefellers disdained oil exploration in such unpromising places as Texas, their trust got busted by the competition before the courts got around to administering the *coup de grace*." Von Hoffman, *A Fool and His Money: Old Suits, New Ties, The New Republic*, February 3, 1982, at pp. 9-10.

That may be something of an oversimplification. But economic historians seem to agree. One of them says:

> Before public regulation became very effective, the oil industry generated its own counterreaction to Standard Oil's strength, a development which has broad significance in the history of the evolution of business. Even before the combination reached its full development as an integrated concern with world-wide operations competition arose and soon reduced Standard Oil's *relative* strength. It has been held commonly in the United States that the Supreme Court decision of 1911 broke the company's monopoly. This is obviously wrong, and it greatly over-simplifies and distorts what was a long-term development.
>
> * * *
>
> Before the Supreme Court decree of 1911 dissolved the Standard Oil combination, competition in the oil inudustry had established itself on the level of large-scale, integrated operations. No company had come to equal the strength of Standard Oil, but several were highly dynamic and were aggressively challenging it in many markets.

Professor Henrietta M. Larson of the Harvard Business School, *The Rise of Big Business in the Oil Industry* in *Oil's First Century at 29, 38* (1960), edited by the staff of the *Business History Review* (emphasis added).

Back in 1880 Standard owned 95% of the nations's refining capacity. Its share of that capacity fell to 87% in 1899, to 70% in 1906, and to 64% in 1911. Andreano, *The Emergence of New Competition in the American Petroleum Industry before 1911* at 282 (1960).

[65] In 1917 the Federal Trade Commission said: "An examination of the lists of stockholders of the various companies called 'Standard' shows that they are owned by bodies of stockholders which are so similar in membership as to justify the common usage." Federal Trade Commission, *Report on the Price of Gasoline in 1915* at 5 (1917). And as late as 1923, a Senate committee was of the opinion that "The dominating fact in the oil industry today is its complete control by the Standard companies." Senate Subcommittee of the Committee on Manufacturers, *High Cost of Gasoline and Other Petroleum Products*, Senate Report 1269, 67th Cong., 4th Sess. 48 (1923).

[66] Bringhurst concludes (at page 207) that "the explosive growth of the industry, new flush fields, and growing demand for new products were the leading factors."

[67] By the time it was decided, Roosevelt had been succeeded by Taft.

[68] Of course, the Supreme Court's decision meant that Jersey Standard had to divest itself of its pipeline interests. That created a number of nominally independent pipeline companies. But those companies were managed by former Standard personnel. In addition, the lines themselves had in most cases been designed to serve the old Standard system. Hence "ties of common ownership and functional interdependence continued to exist between Jersey and its disaffiliated pipeline companies." The quotation is from Professor Authur M. Johnson, the oil pipeline industry's Homer. Professor Johnson, who has been cited earlier in this document, has written two big books on the history of his favorite industry. His first volume was called *The Development of American Pipelines: A Study in Private Enterprise and Public Policy* (1956). The second, which appeared eleven years later, was entitled *Petroleum Pipelines and Public Policy*, 1906-1939 (1967). Professor Johnson's titles show that public policy has been intimately involved with pipelining from the industry's birth. The contents of his volumes drive that point home in exhaustive detail.

The quotation in the previous paragraph is from page 97 of Johnson's second volume, hereinafter cited as "JOHNSON". Professor Johnson does not view the 1911 antitrust decision as *totally* ineffective. He thinks that it had some impact on pipelining. The ties between the former parent and its disaffiliated pipeline children were still there. But "they were not so strong as they had been prior to 1911." JOHNSON, *id.*

Another writer describes the ultimate upshot as follows:

> History shows that almost all the independent pipeline companies created by the dissolution of the Standard Oil Trust were soon absorbed by the former members of the Trust. Furthermore, almost all new lines were constructed by those same firms plus a few well-financed non-Standard firms (e.g., Shell, Texas Company, etc.) which were growing rapidly and themselves becoming vertically integrated ... [T]he strategic reasons which occasioned Standard's original desire to control the network were ... still present. The only difference in the years immediately following 1911 was that there were several large firms instead of a single giant. Harman, *Effective Public Policy to Deal With Oil Pipelines*, 4 Amer. Bus. L. J. 113, 117-119 (Footnotes omitted), quoted in the KENNEDY STAFF REPORT at pages 106 and 107.

[69] Standard's control of the pipelines figured prominently in the litigation. The complaint alleged, among other things, "[T]hat the combination had obtained control of the pipelines available for transporting oil from the oil fields to the refineries." The meat of the complaint was its allegation "That the combination ... had obtained a complete mastery over the oil industry, controlling 90 percent of the business of producing, shipping, refining and selling petroleum and its products, and thus was able to restrain and monopolize all interstate commerce in those products." 221 U.S. at 33.

[70] During the Senate debates on the Sherman Act of 1890, Standard was singled out as the chief offender among the trusts. *See* 21 Cong. Rec. 2457 (March 21, 1890). Sixteen years had now elapsed. But the great combination was as yet unscathed by antitrust action.

[71] Tarbell and Lloyd had popularized this idea. The following passages from Tarbell are illustrative:

> [I]t [Standard] controls the great pipeline handling all but perhaps ten percent of the oil produced in the Eastern fields. This system is fully 35,000 miles long. It goes to the wells of every producer, gathers his oil into its storage tanks, and from there transports it to Philadelphia, Baltimore, New York, Chicago, Buffalo, Cleveland, or any other refining point where it is needed. This pipeline is a common carrier by virtue of its use of the right of eminent domain, and, as a common carrier, is theoretically obliged to carry and deliver the oil of all comers, but in practice this does not always work. It has happened more than once in the history of the Standard pipes that they have refused to gather or deliver oil. Pipes have been taken up from wells belonging to individuals ... working with independent refiners. Oil has been refused delivery at points practical for independent refiners ... It goes without saying that this is an absurd power to allow in the hands of any manufacturer of a great necessity of life. It is exactly as if one corporation aiming at manufacturing all the flour of the country owned all but ten per cent of the entire railroad system collecting and transporting wheat. They could, of course, in time of shortage prevent any would-be competitor from getting grain to grind, and they could and would make it difficult and expensive at all times for him to get it.
>
> It is not only in the power of the Standard to cut off outsiders from it, it is able to keep up transportation prices. Mr. Rockefeller owns the pipe system—a common carrier—and the refiners of the Standard Oil Company pay in the final accounting cost for transporting their oil, while

outsiders pay just what they paid twenty-five years ago. 2 TARBELL 275-77.

A few pages later, as she was nearing the end of her tale of crime and rascality, Tarbell said:

> In spite of the Interstate Commerce Commission, the crucial question is still a transportation question. Until the people of the United States have solved the question of free and equal transportation it is idle to suppose that they will not have a trust question. So long as it is possible for a company to own the exclusive carrier on which a great natural product depends for transportation, and to use this carrier to limit a competitor's supply or to cut off that supply entirely if the rival is offensive, and always to make him pay a higher rate than it costs the owner, it is ignorance and folly to talk about laws making it a crime to undersell for the purpose of driving a competitor from a market. You must get into markets before you can compete . . . So long as the Standard Oil Company can control transportation, as it does today, it will remain master of the oil industry, and the people of the United States will pay for their indifference and folly in regard to transportation a good sound tax on oil, and they will yearly see an increasing concentration of natural resources and transportation systems in the Standard Oil crowd." 2 TARBELL 283-84.

[72] *Cf.* L. Cookenboo, Jr., *Crude Oil Pipelines and Competition in the Oil Industry 2* (1955): "[T]he independent refiner helped drive himself out of business every time he used Standard's transportation facilities. If the independent refiner chose not to buy in the field, but to buy instead from Standard at the refinery site, he paid Standard's price for crude. That price was allegedly kept high; consequently, the profits from crude sales could also be used to drive the independent refiners and the dealers they supplied out of business."

[73] JOHNSON at 22.

[74] *See* Johnson's description of the Kansas uproar that led directly to Federal regulation of oil pipeline rates. JOHNSON at 22-23.

[75] 34 Stat. 584.

[76] *See* JOHNSON at 254-63.

[77] John D. Rockefeller always insisted that Standard derived no special benefit from these practices. In his *Random Reminiscences of Men and Events* (1909) he said: "After the passage of the Interstate Commerce Act, it was learned that many small companies which shipped limited quantities had received lower rates than we had been able to secure . . . I well remember a bright man from Boston who had much to say about rebates and drawbacks. He was an old and experienced merchant, and looked after his affairs with a cautious and watchful eye. He feared that some of his competitors were doing better than he in bargaining for rates, and he delivered himself of this conviction:

> 'I am opposed on principle to the whole system of rebates and drawbacks—unless I am in it.' "

Most historians take a different view. Even those of them who consider Rockefeller a genius whose triumph stemmed in the main from superior organizing ability think that railroad rebates plus control of the pipelines had a good deal to do with Standard's rise and progress.

[78] *See* n. 124, *infra*.

[79] That is also true of Tarbell, the mistress of the anti-Standard agitation. Her predecessor Lloyd was a radical. See C. Destler, *Henry Demarest Lloyd and the Empire of Reform* (1963). But Tarbell was not. Her hatred of Rockefeller was rooted not in a general hostility to the workings of the business system, but in moral indignation about Standard's specific, and in her view outrageous, ethical transgressions. Tarbell's laudatory biographies of such business figures as General Electric's Owen D. Young and the United States Steel Corporation's Elbert H. Gary show that. Indeed one reviewer found her biography of Gary so rose-colored that he ridiculed it in the pages of *The Nation* in a piece entitled *Saint Elbert and the Heavenly Trust*. So some may wonder what Tarbell would have thought of the United States Steel Corporation's recent acquisition of the Marathon Oil Company, known in her day and down until 1967 as the Ohio Oil Company and also a principal producing arm of the original Standard combine. Others may speculate about the view that she would take of the contemporary energy scene.

[80] *See* n. 124, *infra*.

[81] *See United States v. E. C. Knight Co.*, 156 U.S. 1 (1895).

[82] *See United States v. American Tobacco Co.*, 221 U.S. 106 (1911).

[83] *See United States v. International Harvester Co.*, 274 U.S. 693 (1927).

[84] *See United States v. United States Steel Corp.*, 251 U.S. 417 (1920).

[85] *See Swift & Co. v. United States*, 196 U.S. 375 (1905).

[86] True, the agitation about oil was paralleled by an agitation about meat. It is also true that both agitations came to a legislative head in 1906 and that the two cases have something in common. In meat, as in oil, a best selling book produced by a gifted writer with a flair for the dramatic had great influence. We refer, of course, to Upton Sinclair's classic *The Jungle* (1906) and to its role in the pure food and drug legislation of that year. 34 Stat. 768.

Nevertheless, we see nothing in the turn-of-the-century concern about meat that invalidates the statements made in the text. When the Congress of 1906 legislated about meat, it did so to foster health. It was not seeking to alter the economics of the meat business by statute. When that same Congress legislated about oil pipelines, it was concerned solely with the structure of the oil industry. Moreover, that concern went to the market power of a single dominant firm and to ways in which that power could be lessened. There was no *single* dominant firm in meat. Nor was there any legislation that sought to restructure the business.

[87] The passage of time has not made them any easier. Nor has the change in nomenclature from "Federal Power Commission" to "Federal Energy Regulatory Commission" had that effect.

[88] *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944).

[89] The industry is quite vehement about that. It maintains that its properties are "plant facilities," not "public utilities."

[90] 49 U.S.C. § 1(1)(b) says that one engaged in "the transportation of oil" in interstate commerce is a common carrier. But the cases show that the scope of this formulation is not quite so broad as the literal text suggests. One can carry oil from one state to another through pipes and still be immune from common carrier obligations. Whether he is immune or not depends on whether he is engaged in "transportation." Now what is "transportation" for this purpose?

The Supreme Court addressed that question in the famous group of cases that established the constitutionality of oil pipeline regulation. *The Pipe Line Cases*, 234 U.S. 548 (1914). One of the companies there involved was able to demonstrate that it used the pipeline for the sole purpose of "conducting oil from its own wells to its own refinery." The Court held that this was not "transportation" because "It would be a perversion of language . . . to say that a man was engaged in the transportation of water whenever he pumped a pail of water from his well to his house. So as to oil. When, as in this case, a company is simply drawing oil from its own wells across a state line to its own refinery for its own use, and that is all, we do not regard it as falling within the description of the act, the transportation being merely an incident to use at the end." 234 U.S. at 562. The fortunate company was the Uncle Sam Oil Company. So the doctrine that it succeeded in establishing has become known as the "*Uncle Sam Doctrine*." That doctrine's scope is limited. But the precise limitations are fuzzy. *See Valvoline Oil Co. v. United States*, 308 U.S. 141 (1939); *Champlin Refining Co. v. United States*, 329 U.S. 29 (1946); *United States v. Champlin Refining Co.*, 341 U.S. 290 (1951). The last two cases involved the same company. Hence they are commonly cited as *Champlin I* and *Champlin II*. The jurisdictional fog that these cases have spawned is of no moment for present purposes. We simply note its presence.

[91] Justice Black dissenting from the decision in *Champlin II* (cited in the preceding footnote); the quoted language is at page 314 of 341 U.S.

[92] The Department of Energy Organization Act of 1977 (91 Stat. 565) brought that change about. See Section 402(b) of that Act. 42 U.S.C. § 7172(b).

[93] Only one of them is still here. But we consider her a reliable informant. We also benefit from our advisory staff's institutional memory.

[94] The producer was seeking a better price for his product. He may have been entitled to that. The Congress of 1906 obviously thought that he was.

But it is hard to see how anyone could seriously have thought that dearer crude would mean cheaper kerosene for the ultimate consumer. The people who pressed for oil pipeline rate regulation thought the Standard Oil Company a monopoly. Moreover, they considered Rockefeller and his associates monopolists of a peculiarly heartless and vicious breed. Hence they could scarcely have thought that Standard, which bought most of its crude from independents, would pay its independent suppliers higher prices and altruistically refrain from attempting to pass those higher prices on to the consumer.

This raises a central problem about the anti-monopoly crusade at the turn of the century. Were the crusaders "consumerists" (a word then as yet uncoined), *i.e.*, were they primarily interested in bringing lower prices to the consumer? Or were they "producerists," if the reader will forgive a neologism, whose primary concern was higher prices and an easier life for the small businessman?

In oil and in oil pipelines the "producerist" motivation appears to have been paramount. Mr. Micheal McMenamin, a Cleveland antitrust lawyer, puts the point this way:

> Consumers were not an active or organized political force in the nineteenth century. It was businessmen and farmers who were organized, and they were the ones responsible for the antitrust laws. Those laws were born to protect these interest groups—not the consumer—and judges charged with interpreting the antitrust laws have intuitively sensed this and made their rulings accordingly.
>
> The fantastic success of John D. Rockefeller and the Standard Oil Company, as much as any other single man or company, was the principal factor behind the initial passage of the Sherman Antitrust Act in 1890. Yet in reading anew Ida Tarbell's classic 1904 muckraking book, *The History of the Standard Oil Company*, one detects scant concern on her part with injuries to consumers by Standard Oil. And with good reason: Standard Oil's efficiencies and innovations, which spurred on its fabulous growth, resulted in consistently lower petroleum prices to consumers during the latter half of the nineteenth century.
>
> The people for whom Ida Tarbell shed her tears were (a) the oil producers in Pennsylvania, a surly group of roughnecks who kept trying to fix prices and restrict output, all without success because Rockefeller kept playing one off against another, and (b) the oil refineries that were Standard's competitors (including the Pure Oil Company, whose treasurer was Ida Tarbell's brother), which were neither as efficient as Standard nor as eager as Rockefeller to eliminate the price-fixing schemes of the oil producers and the railroads that hauled the petroleum to the refineries. Special-interest groups like these did not like it that Standard paid the lowest price for oil and got price breaks from railroads that fixed prices against other refineries; and they are the ones that went crying to their state legislatures and to Congress for relief. McMenamin, *Busting Antitrust*, *Inquiry Magazine*, February 13, 1982, pp. 16-17.

One need not go all the way with Mr. McMenamin to realize that there is much to what he says. The idealogues and the muckrakers who wrote the books and the articles may have hoped that, in the end, the consumer would reap some benefit from their labors. The legislators who wrote the statutes probably shared that hope. So, we assume, did the judges who wrote the opinions.

But that putative consumer benefit was hypothetical and long-run. The people in the oil business who supplied the real impetus for the anti-Standard agitation were not bemused by vague abstractions about the beauties of perfect competition over the long run. Like businessmen since time immemorial, they were interested in money here and now. So the measures that they pushed were designed to cut down on Standard's take and to enhance theirs.

Few historians write as pungently as Mr. McMenamin. But their researches support his conclusions. Thus Bringhurst says: "[W]riters and investigators were not the prime movers in the antitrust crusade. The explosive growth of the oil business itself was the underlying source of the proliferating litigation. As oil became a central fact in the daily lives of the American people, the possibilities for economic conflict and the potential political rewards for those who could resolve that conflict in the public interest increased dramatically. In the first decade of the twentieth century, annual oil production in the United States more than tripled from 63 million to 209 million barrels. Most of the new oil came from virgin fields in widely scattered sections of the country. The old Appalachian and Ohio fields gradually declined in productivity, while Illinois, Kansas, Oklahoma, the Gulf Coast, and California provided vast new resources. These new areas provided opportunity for independent producers and refiners, who frequently clashed with Standard Oil and were more than willing to take their disputes to court. In Kansas, for example, agitation by independent oil producers led directly to a state antitrust suit against the oil trust." BRINGHURST at 70.

Those same independent Kansas producers played a crucial role in bringing a Federal presence to bear on oil pipeline rates. See JOHNSON at 22: "Standard oil policies and practices in Kansas brought public wrath and state legislation in their wake and led directly to federal action when Kansas oil production soared between 1903 and 1904, Prairie Oil & Gas, the principal purchaser [a Standard subsidiary], was unable to keep up with the flow. Accordingly, the price of oil dropped from $1.38 a barrel in late 1903 to 80 cents and less in 1904. Thereupon, producers, many of them newcomers to the business and overextended in the oil frenzy that Prairie Oil's initially high offering price had precipitated, concluded that they had been duped into exploration and production to save the combination that expense." At the end of his book, Professor Johnson concludes (at page 466) that "Most efforts to make pipelines more available to nonowners were initiated by elements of the nonintegrated oil industry."

[95] *Champlin II* at 297 (emphasis added).

Note that the Court did not mention "refiners". It spoke solely of "producers".

[96] Neither Justice Clark's majority opinion from which we have quoted nor Justice Black's dissent in which he took a dim view of the efficacy of oil pipeline regulation *(see* p. 61, *supra)* said a word about "consumers." This omission cannot be shrugged off as inadvertent. It appears historically sound. True it is that when the High Court dealt with the Trans Alaska Pipeline System, it suggested that consumer intersts were implicated. *See* n. 4, *supra*. But that was dictum. The concrete question before the Court in *Trans Alaska* was: Does the Interstate Commerce Act authorize the suspension of "initial rates," *i.e.*, rates filed by a new pipeline that is just about to go into service? The question of what good it all does, of precisely what social interests oil pipeline rate regulation serves, was far afield from that. Secondly, the *Trans Alaska* case is *sui generis*. The per barrel pipeline transit charges there involved are far, far higher than those in the Continental United States. Hence it is possible to view consumer interests as implicated in that most unusual situation. And it is also possible to deem those interests peripheral in oil pipeline rate regulation generally. Thirdly, law and legislation are complex. Our concern in the text is with the dominant political impetus for Federal regulation of oil pipeline rates. It seems clear to us that this impetus was *primarily* producerist. Obviously, that does not exclude secondary themes, and the historical record can be read as suggesting a secondary consumerist strand in the great oil pipeline agitation. Finally, statutes framed in terms of majestic generality often take on a life of their own after their enactment. Hence the fact that champions of the consumer's cause find some grist for their mills in a statute passed at the behest of producer interests is unsurprising. That kind of thing has happened often in legal history. The evolution of the Fourteenth Amendment is instructive in this regard. Its purpose was to help the ex-slaves. But corporations have found it a potent legal tool.

[97] Were this a normal case, it would be presumptuous and unseemly for us to sit in judgment on the ICC's performance. That agency is not subordinate to us. Nor are we a reviewing court with a roving jurisdiction to pass on the quality of rate regulation, wherever and whenever performed.

Even if we had some semblance of so anomalous a jurisdiction we should be loath to exercise it. We know the difficulties of the regulator's task at first-hand. And we are painfully aware of the flaws in our own work. Hence we generally guide ourselves by the biblical admonition, "Judge not that ye be not judged." *Matthew 7:1*.

But circumstances alter cases. Here we have a most unusual situation. A reviewing court has taken an extremely jaundiced view of the ICC's corpus of oil pipeline lore. That happened in the *only* case in which any court ever had a chance to look at that methodology. In that same case the court directed us, the statutory heirs to the ICC's oil pipeline rate estate, to take a hard, skeptical, searching look at the ICC's oil pipeline methodology, and we cannot shirk that duty.

[98] Professor Johnson, a pro-industry historian who believes that the oil pipeline trade has served the nation well and that it has been slandered and victimized by misconceptions, states that his "conclusions are basically favorable to integrated and pipeline company management." JOHNSON at 477. But he also says on that same page: "These conclusions do not argue that pipeline managers and those to whom they were responsible in parent companies pursued consistently enlightened policies. The fact seems to be that they fully recognized the advantages conferred by pipeline ownership and did not relinquish any of them except under pressure which in virtually all cases was more economic than governmental. By refusing to acknowledge a valid public interest in the reduction of pipeline rates before it was forced on them by overcapacity, . . . and by reacting rather than anticipating attack, pipeline management invited the investigations, the hearings and the criticism to which it was subjected."

[99] This observation would appear particularly applicable to producers. If they were being disadvantaged financially, one could hardly explain a Congressionally mandated "windfall profits" tax being levied on the industry. Crude Oil Windfall Profits Tax of 1980, 94 Stat. 229, I.R.C. §§4986-4998.

[100] We are mindful of the recent decline in oil prices and of the current softness in the demand for that commodity. Nevertheless, the price remains high by historic standards. We do not venture to predict the future course of oil prices. We profit by the example of those who have made such predictions in the past. Their track record has not been good. The deliberations of the Congress of 1978 on the Natural Gas Policy Act of that year (92 Stat. 3351 [1978], codified in 15 U.S.C. §§3301-3432 [Supp. IV 1980]) are instructive in this regard. Those deliberations appear to have been based largely on premises about the future price of oil that time quickly falsified. We note also that back in 1921 (more than 60 years ago) the late Professor Leo Wolman, a distinguished economist of those days, writing in the august pages of the *American Economic Review* asked: "What effect, if any, will the impending exhaustion of our natural resource of crude oil exert on the next estimate of the national wealth of the United States?" *The Theory of Production*, 11 Am. Econ. Rev. 38, 40 (1921). Fifty-three years later, an even more eminent economist, Professor Milton Friedman, a president of the American Economic Association and a Nobel laureate in the discipline, predicted the imminent demise of OPEC. And he did so with assurance. Writing in June of 1974, the professor told the readers of his *Newsweek* column that "the price of oil will return to a level much closer to its pre-October 1973 price than to the peak prices reached shortly thereafter." M. Friedman, *There's No Such Thing as a Free Lunch 307-308* (1975). It has taken eight years to see a glimmer of truth to his prediction. Some may be reminded of another great economist, the late Professor Irving Fisher of Yale. He thought what had happened on Wall Street during those crisp October days in 1929 a mere "technical reaction." *See* I. Fisher, *The Stock Market Crash and After* (1930).

The crystal balls employed by people in the Government have proved every bit as cloudy. Earlier in this footnote we spoke of the assumptions about oil prices that influenced the authors of the Natural Gas Policy Act. Another illustration of the hazards of prophecy in this field can be found in the report on the oil import question that a Cabinet Task Force submitted to President Nixon in February of 1970. That distinguished body, which included the Federal Power Commission's Chairman, concluded that "without import controls, the domestic wellhead price would fall from $3.30 per barrel to about $2.00, which would correspond to the world price." The Task Force's next sentence read:

> "Although we cannot exclude the possibility, we do not predict a substantial price rise in world oil markets over the coming decade." Cabinet Task Force on Oil Import Control, *The Oil Import Question: A Report on the Relationship of Oil Imports to the National Security 124* (1970). Pertinent in this regard is the recent comment of Mr. Warren Davis, the Gulf Oil Corporation's chief economist. He said: "The world oil situation is less predictable today than I ever remember having seen it. I can't remember another time when you'd ask me and I couldn't honestly tell you whether the price of oil would be up $10 or down $10 next year. I can conceive of situations fairly readily where it could go either way within the next year or even within the next month or two." The journalist who reported these observations observed that "These words . . . point to an oil industry fact of life. Like the tip of an iceberg, the current slip in world prices sits atop a lot of unknowns." Harsch, *Beyond the Oil Glut: What Experts Say, The Christian Science Monitor,* March 15, 1982, front page.

Nevertheless, we think it appropriate to note that we know of no informed observer who thinks that oil is going to be really cheap (as cheap in *relative* terms as it was in 1906 or at the nadir of the Great Depression) within the foreseeable future.

[101] At least as to the producers, they have told us they want no help. *See* n.10, *supra*.

[102] *See Permian Basin Area Rate Cases*, 390 U.S. 747, 776-777 (1968); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 602-603 (1944); *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942).

[103] A few impatient souls may already have reached that conclusion. Some of them doubtless did so many pages ago. It is not for us to say that they are wrong.

[104] That is not our view. Our decision to adhere to much of the methodology that we inherited, which is made with some misgivings, rests in the main on pragmatic considerations.

[105] Some would answer that "legal history still has its claims." *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 609 (1942) (concurring opinion of Frankfurter, J.)

[106] Had we thought them correct, we would have reached a different result.

[107] Quoted by Judge Walter R. Mansfield, who now sits on the bench of the very court that Hand adorned for so long, in *The Lesson of Learned Hand*, 68 A.B.A.J. 182 (1982).

[108] *Cf.* Easterbrook, *Criticizing the Court*, 95 Harv. L. Rev. 802, 828 (1982): "It is most unlikely . . . that the justices will be able to reach agreement on fundamental principles of constitutional interpretation. There is no agreement on such matters within the legal profession. Some would choose strict adherence to the language of a statute or constitutional provision, coupled with analysis of the legislative debates; others would choose a form of cost-benefit analysis; still others would choose some form of philosophical or natural law approach. There is no device for ruling any set of choices out of bounds and refusing to count the vote of justices who do not conform to these decisions."

The cat with which we have to wrestle here is of the same breed. Some seem to think that oil pipeline rate regulation was intended to and is capable of turning the economic clock back to Thomas Jefferson's day and of converting the oil business into an industrial paradise for the little man. They suggest that this would lead to a beneficent shower of competitive blessings in the form of lower prices for the consumer and to the deconcentration of economic power. They maintain that bureaucratic sloth, timidity and subservience to Big Oil are the villains of the piece. Others say that in broad terms the statute never made much sense because it was based on the erroneous premise that if only something drastic were done about the pipelines, independent producers and independent refiners would seek each other out thus creating a significant pool of oil outside of the control of the Standard Oil Company and its successors. They consider that premise wrong because in their view, independent producers are quite properly preoccupied by the search for oil and by the task of extracting it so that they have neither time nor energy to spare for the strenuous marketing effort that the militant anti-monopolists postulate. Accordingly, these skeptics maintain that though the statute expressly requires that these rates be "just and reasonable," the enactment really has nothing or next to nothing to do with rates. They think that the real purpose of the statute was to see to it that everyone who wanted to use a pipeline had access to it. Accordingly, they believe that it would be a great mistake for us to take oil pipeline ratemaking too seriously.

As the patient reader will learn in due course, we have arrived at our own conclusions about these historical issues. Of course, we think those conclusions correct. But we do not claim that ours is the only truth.

[109] *See* JOHNSON at 24-33.

In his concluding chapter Professor Johnson says: "In the heat of the excitement whipped up by Roosevelt against Standard Oil and the railroads in 1906, Congress precipitately placed pipelines under the Interstate Commerce Commission. The legislators made virtually no study of pipeline problems as such and no analysis of how those privately built carriers differed from other carriers with which they were lumped for regulatory purposes." JOHNSON at 464.

[110] Nothing in the historical materials that we have seen suggests that economists were consulted.

[111] Federal oil pipeline rate regulation stems directly from a furor in Kansas about the low prices that Standard was paying for crude produced in that state. *See* JOHNSON at 22 quoted in n.94, *supra*.

[112] The words "automobile" and "gasoline" are not to be found in Ida Tarbell's careful index.

[113] The exercise resembles an effort to determine what the Roman law of firearms would have been if the Romans had known about fireams.

[114] That was true only at the Federal level. The states had tried to regulate. *See* W. Beard, *Regulation of Oil Pipelines as Common Carriers* (1941).

[115] The shipper-owner phenomenon may make this course more complicated than it sounds when one first hears about it. Normally, there is nothing "discriminatory" about a rate that is very high. Such a rate may be "unjust." It may also be "unreasonable". But if everybody pays the same high rate, it is not "discriminatory."

When the supplier of the service is also his own best customer, matters may be on a different footing. It can be argued that in that situation a reasonableness requirement and a ban on discrimination meet and blend so that the difference between the two concepts is semantic rather than substantive. If the X Oil Company charges itself a lot of money for shipping its own oil over its own line, that is just bookkeeping. But suppose that X also charges Y, an unaffiliated shipper, that same high rate for the use of its line. For Y, that high rate is very real. So we now have something that some will undoubtedly view as undue discrimination of a perniciously anticompetitive type.

Problems of this type also arise in natural gas. There, however, the Natural Gas Policy Act of 1978 has done much to resolve them. *See* § 601(b)(1)(E) of that statute (15 U.S.C. § 3431(b)(1)(E)) providing that in certain situations any price paid by an interstate natural gas pipeline to its producing affiliate that does not exceed prices paid in comparable transactions between unaffiliated third parties shall be deemed "just and reasonable."

[116] We consider this the correct result under existing law and as a matter of policy. But we concede that the subject is enshrouded in a fog that precludes us from branding other views "clearly erroneous" or "frivolous."

[117] That, of course, is a very general statement. Many details with respect to such matters as to the precise meaning of "market power" for this purpose and burden of proof would have to be filled in. Would there be a presumption in favor of rate regulation with the burden on the carrier to show that it is unnecessary? Or would it work the other way so that the presumption would be in favor of the uninhibited market with the burden on the shipper to show that the circumstances of his situation are such that unrestrained market forces make (or may make) for exploitative and socially harmful results?

[118] As noted earlier, the friends of the status quo aren't really all that friendly to it. Though much enamored of the ICC's basic oil pipeline concepts, the industry, its lawyers, and its expert economic witnesses insist with great vehemence that the way in which those concepts have traditionally been applied is overripe for a drastic overhaul. This position may have been motivated in large measure by tactical considerations. Some of us suspect that it was.

The carriers were and are confronted by an assault. Their assailants charge that they have benefited for decades from a cozy, sweetheart arrangement between themselves and the ICC, under which that allegedly indifferent policeman permitted them to do whatever they wanted to do. In these circumstances astute tacticians on the industry side may well have looked to the old maxim that "the best defense is a good offense." Had they contented themselves with a militant defense of their old friends at the ICC, they would have been open to some damaging rejoinders.

Their adversaries could have responded that such passionate mutual admiration among the regulators and the regulated, such perfect concord between the cops and the robbers, was enough in itself to raise a presumption of regulatory inadequacy.

Had the industry's critics chosen to take that almost irresistible course, they could have drawn on a voluminous literature indicting the ICC for undue subservience to those whom it regulates. We express no opinion about the scholarly merit of that literature. The important thing is that whatever its merit, it exists. Illustrative is the following perhaps outmoded extract from Huntington, *The Marasmus of the ICC*, 60 Yale L.J. 467, 473 (1952):

> At times the railroads have been almost effusive in their praise of the Commission. The ICC, one subcommittee of the Association of American Railroads has declared, "is eminently qualified by nearly sixty years of experience to handle transportation matters with a maximum of satisfaction to management, labor and the public." Another representative of the same association has similarly stated that "what is needed for the solution of the tremendously important problems of transport regulation is the impartiality, deliberation, expertness, and continuity of policy that have marked the history of the Interstate Commerce Commission." Railroad officials and lawyers have commended the Commission as a "conspicuous success," a "constructive force," and as a "veteran and generally respected tribunal." The American Short Line Railroad Association has commented upon the "fair, intelligent treatment" its members have been accorded by the Commission, and the [now deceased] Pennsylvania Railroad has been lavish in its praise of the latter's policies. The ICC is probably the only regulatory body in the federal government which can boast that a book has been written about it by counsel for a regulated interest in order to demonstrate "how well" the Commission has "performed its duty." (Footnotes omitted)

Long before "deregulation" came into vogue (indeed, Professor Huntington was an advocate of vigorous regulation) the author concluded that *"The Interstate Commerce Commission should be abolished as an independent agency."* 60 Yale L.J. at 508. With respect to the ICC's oil pipeline performance see the scorching criticisms of the chummy relationship between the ICC and pipeline management by a committee of the House of Representatives back in 1959. Report of the Antitrust Subcommittee of the House Committee on the Judiciary on the Consent Decree Program of the Department of Justice, 86th Cong., lst Sess. (1959).

The industry may well have decided to avoid this trap by launching its own gentle but audible assault on the ICC. By interposing a counterclaim to its critics' complaint against it, the industry is able to appear as an aggrieved plaintiff in its own right rather than as a defendent intent on holding on to the allegedly cushy life of which its adversaries wish to deprive it. Besides, why not ask for more than you already have, if the opportunity to do so arises?

Of course, this is just speculation. We have no way of knowing whether it is correct or not. What we do know is that the industry has its own oil pipeline reform program. Indeed, it has two oil pipeline rate reform programs. The first is deregulation. But we have no power to give it that. So it asks us for its second choice. Verbally and conceptually that second choice is much more modest, much more conservative, and much more traditional than the program espoused by the industry's critics. But when one digs beneath the surface to the substance of the thing, it becomes apparent that the industry's program is every bit as drastic and every bit as radical as that of its critics. The industry's program may well have merit. But we do not consider ourselves at liberty to adopt it. The considerations that preclude us from legislating in the way recommended by the industry's critics also preclude us from legislating on the industry's behalf. As the Supreme Court once said of another matter, "this case boils down to an old adage about sauce and geese, which need not be given citation." *Midstate Horticultural Co. v. Pennsylvania Railroad Co.*, 320 U.S. 356, 367-68 (1943).

[119] We use the word "law" in the narrow technician's sense.

[120] Even the justices of the Supreme Court were once reminded by three of their brethren in one of the most famous dissenting opinions to be found in the annals of the law that "the only check upon our own exercise of power is our own sense of self-restraint." *United States v. Butler*, 297 U.S. 1, 79 (1936) (dissenting opinion of Stone, J., joined by Brandeis and Cardozo, JJ.). *A fortiori* should humbler tribunals, such as this one, be mindful of that admonition.

[121] That is for Congress, not for us. When it wants the world remade, it will tell us so.

[122] *Cf. Home Building & Loan Association v. Blaisdell*, 290 U.S. 398, 426 (1934): "While emergency does not create power, emergency may furnish the occasion for the exercise of power." Students of the Constitution will recall that this famous Depression-era case involving a Minnesota debtor-relief statute that allegedly impaired the obligation of contract in violation of Article I, § 10, of the Constitution was decided by a vote of 5 to 4 and that the division of opinion among the justices was sharp and hot. But there was no disagreement about the general proposition. Justice Sutherland's dissent conceded that "It is quite true that an emergency may supply the occasion for the exercise of power." 290 U.S. at 473.

[123] That statute dealt with lots of things besides oil pipelines. Its "basic import . . . lay in the explicit delegation of ratemaking power to the Commission and in the procedural reforms which . . . rendered the determinations of the Commission . . . effective and final." 1 SHARFMAN at 43.

Of course, the important thing about the Hepburn Act for present purposes is what it said about oil pipelines. From a broader perspective, however, the oil pipeline provisions were scarcely earthshaking. Johnson's review of the history leads him to conclude that "Except for members of the oil industry . . . or observers of the industry like Miss Tarbell, the pipeline aspect of the pending legislation was largely ignored, even in Congress. The railroad's role in oil transportation dominated the interest of both the public and government officials." JOHNSON at 26.

[124] The Congress of 1906 was not interested in pipelines. It was interested in oil. Its members knew about natural gas pipelines and about water pipelines. But they saw no need to regulate them. Hence carriers of natural gas and of water were expressly excluded. Seventy-six years have now elapsed. And carriers of those substances remain exempt from the Interstate Commerce Act.

Johnson tells why at page 26 of his opus: "Lodge reported that he had numerous complaints from producers against . . . Standard Oil pipeline practices . . . When Senators concerned about the possible inclusion of pipelines devoted to natural gas or irrigation water made their objections known, Lodge quickly quieted them and the language of the amendment was clarified. 'All I want to get at is the transportation of oil,' he said. With the way so smoothly cleared, the Lodge pipeline amendment rolled through the Senate by a 75-0 vote."

A generation elapsed before natural gas pipelines were regulated. When Federal regulation finally came to that industry as a result of the Natural Gas Act of 1938 (52 Stat. 821, *codified in* 15 U.S.C. § 717, *et seq.*), Theodore Roosevelt was long dead. His cousin, Franklin D. Roosevelt, was in the White House. When it addressed itself to natural gas, F.D.R.'s Congress did not use the common carrier concept that T.R.'s Congress had found appropriate for oil pipelines. Moreover, the political forces that led to regulation were not the same in natural gas as they were in oil. As pointed out earlier, oil pipeline regulation was sought by oil producers. While natural gas producers had some interest in natural gas pipeline rate regulation, the primary push for that innovation came from people who were interested in consumer protection. The consumerists were joined by "investorists" who were concerned about financial malpractices by the holding company groups that had come to dominate both electricity and gas during the 1920's. Compare Johnson's account of the legislative history of oil pipeline rate regulation with the natural gas story recently recounted in M. Sanders, *The Regulation of Natural Gas: Policy and Politics*, 1938-1978, at 17-58 (1981).

[125] *See* n.90, *supra*.

[126] Anti-rebate provisions had been added to the Interstate Commerce Act by the Elkins Act of 1903. 32 Stat. 847. That statute was passed at the behest of the railroads. After all, they were the principal victims of rebating. See 1 SHARFMAN 36 (Elkins Act "enacted on the initiative of the railroads themselves, as a means of conserving their revenues.") The Hepburn Act made the Elkins Act applicable to oil pipelines.

[127] The reference to "legal litmus paper" comes from Justice Holmes's dissent in *Abrams v. United States*, 250 U.S. 616 (1919). At page 629 of 250 U.S., Justice Holmes said: "Even if ... enough can be squeezed ... to turn the color of legal litmus paper; the most nominal punishment seems to me all that possibly could be inflicted ... "

[128] Justice Jackson wrote: "I must admit that I possess no instinct by which to know the 'reasonable' from the 'unreasonable' in prices." *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 645 (1944) (dissenting opinion).

We, too, lack that "instinct." And in our exposure to the regulatory process we have not found anyone blessed with it.

[129] The idea comes from the Church fathers. Back in the Middle Ages they talked about the *"justum pretium,"* the "just price." As Professor Bonbright says "The just price is basically ethical rather than economic. While not completely devoid of economic content, it recognizes no validity for economic activity as such nor independent economic norms. Its law is derived from theological doctrines and from the philosophy of medieval class society." Bonbright, *Principles of Public Utility Rates 121, n. 1* (1961) (hereinafter cited as "BONBRIGHT"), quoting with approval from Salin, *Just Price* in volume 8 of the Encyclopedia of the Social Sciences (1932).

[130] Those among them who will concede that they may sometimes be in a position to reap excessive returns are few. Even fewer are those who will concede that they have ever actually succeeded in raking in some really unjusted loot. When such confessions are made, they are made to investors to whom one wants to sell stock. In our experience they are never, never, ever made to legislators, to regulators, or to courts.

[131] How many buyers would rather pay a higher price than a lower price on the ground that the lower price would be unfair to the seller?

Here, however, we have that rare situation. There is a good deal of evidence that independent producers of crude oil (the class of persons that the Congress of 1906 sympathized with and wanted to help) are now either content with or indifferent to pipeline rates. We do not rely solely on the record before us as authority for that statement. Almost thirty years ago Professor Cookenboo noted that "Independent producers do not complain so much any more." He attributed the independent producers' acquiescence to the pipeline status quo, an acquiescence that was and is in sharp contrast to the frantic agitation at the turn of the century and at the bottom of the Great Depression to the fact that "their price [was] now protected against catastrophic declines by the state governmental agencies production control." L. Cookenboo, Jr., *Crude Oil Pipelines and Competition in the Oil Industry 6* (1955).

Unlike the independent producers, the independent refiners have not appeared before us to support the pipeline owners who allegedly exploit them. On the other hand, they have not mobilized to support *Kerr-McGee*. Though their interests would seem to be at stake, they show no stomach for a war against their putative exploiters. Save for Kerr-McGee itself and its two co-complainants in these proceedings, independent refiners who feel that the pipeline monopolists are choking them to death have failed to show up either in these proceedings or in other proceedings before us that raise basic questions about oil pipeline rate regulation. That is so even though those proceedings have been well-publicized and even though they offer the independent refiner a splendid opportunity to strike a blow for liberty. This opportunity has found do takers.

We think that the independent refiners are rational economic actors and that they have a better and a clearer conception of what is really important to them than we possibly can. Hence we attach considerable significance to their passivity in this struggle. We shall have more to say about this at later points.

[132] Unless there is reason to believe that the contract was imprudent or that borrower and lender did not deal with each other at arm's-length. Then the bargain will be scrutinized to see whether the borrower paid too much. Such scrutiny is unnecessary when the borrower got the benefit of an exceptionally good bargain. That benefit is flowed through to the consumer without ado.

[133] The figure stated in the text is on the high side. Actually, prime corporate bonds returned an

annual average yield of 2.45% in 1946. S. Homer, *A History of Interest Rates 352* (2d ed. 1977).

[134] As Judge Stephen Breyer of the Court of Appeals for the First Circuit has recently observed, "setting a rate of return [for common stock] cannot—even in principle—be reduced to an exact science. To spend hours of hearing time considering elaborate rate-of-return models is of doubtful value and suggestions of a proper rate, carried out to several decimal places, give an air of precision that must be false." S. Breyer, *Reforming Regulation 47* (1982).

[135] At the Federal level this has been the universal answer. Oil pipelining is the only exception to that statement of which we know. The word "unique" is often misused. It does not mean merely "unusual." It means "singular, the only one of its kind." See Webster's Third New International Dictionary 2500 (1967). But that much misused word fits here. Oil pipeline rate regulation is indeed unique.

[136] Since stock prices fluctuate, different holders have paid different prices. Looking at what each shareholder paid for his, her, or its piece of paper would be administratively impractical. Moreover, shareholders generally buy in the trading market from other shareholders. The prices paid in these transactions have no necessary relationship to the price that the company received when it issued the stock. That Mr. Jones paid Mr. Smith $20 for a share of Amalgamated Utilities on such and such a day tells us nothing about how much, if anything, the original buyer of that share contributed to Amalgamated's capital.

[137] BONBRIGHT at 173-174 (1961).

[138] *See Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 151 (1934); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 606-607 (1944) ("By such a procedure the utility is made whole and the integrity of its investment maintained. No more is required. We cannot approve the contrary holding of *United Railways Co. v. West*, 280 U.S. 234, 253-254 (1930)."); *Democratic Central Committee of D.C. v. Washington Metropolitan Area Transit Commission*, 485 F.2d 786, 802-804 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1974).

[139] There are exceptions and qualifications to that proposition. But in an exposition of the essentials, which this is, those need not detain us.

[140] BONBRIGHT at 177 (Emphasis in the original).

See also Judge Learned Hand's opinion in *Niagara Falls Power Co. v. Federal Power Commission*, 137 F.2d 787, 793 (2d Cir. 1943), *cert denied*, 320 U.S. 792 (1943) and the opinion of the Court of Appeals for the Ninth Circuit in *Montana Power Company v. Federal Energy Regulatory Commission*, 599 F.2d 295, 300 (1979).

[141] Of course, we assume that the allowed rate of return has in fact been high enough to compensate him adequately for anticipated inflation.

[142] *Cf. Federal Power Commission v. United Gas Pipe Line Co.*, 386 U.S. 237, 245 (1967): "[C]ases support the power *and the duty* [emphasis added] of the Commission to limit cost of service to real expenses."

[143] The problem is that postage costs and labor costs are easy to quantify, while the true cost of equity capital can only be guessed at.

[144] That fiction may have had something (indeed, it may have had much) to do with the methodology's origins. In no sense, however, does the methodology rest on that fiction. Nor does the manner in which the depreciated original cost methodology is actually applied in the world of today by careful regulators assume (either explicitly or implicitly) that a 1932 dollar and a 1982 dollar are really one and the same.

[145] We assume that their securities are not convertible into common stock. Moreover, even when fixed-dollar securities are convertible into common equity, so long as they remain *unconverted* their holders' claim on the issuer's current income is limited to the nominal dollar amount stated in the indenture and in their coupons.

[146] Justice Brandeis, whom some regard as the father of the prudent investment, depreciated historical cost approach and who was, among other things, a sophisticated and a successful investor, stressed this point in his seminal concurring opinion in *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission of Missouri*, 262 U.S. 276, 307 (1923). He said: "About 75 per cent of the capital invested in utilities is represented by bonds. [Because of the Securities and Exchange Commission's long and in large measure successful campaign against excessive leverage in utility capital structures and because of the costly lessons on that subject given by the Great Depression, that 75% figure is somewhat lower today. But in 1982, as in 1923, most utilities get most of their capital by selling bonds.] He who buys bonds seeks primarily safety . . . Through a fluctuating rate base the bondholder can only lose. He can receive no benefit from a rule which increases the rate base as the price level rises; for his return, expressed in dollars would be the same, whatever the income of the company."

[147] In most utilities he supplies considerably less than half of the total capital.

[148] It must also be remembered that the economic climate in which this system of thought was initially developed differed substantially from that of our era. Sixty years have now elapsed since Justice Brandeis wrote his *Southwestern Bell* concurrence (cited in n.146, *supra*). Brandeis and the other designers of the methodology that we have described in the text and that this Commission uses every day in its gas and electric work were concerned about undue favoritism to the equity investor in regulated enterprises. When we look at the context in which that concern was voiced, we see that it was one of ineffective regulation, high growth rates in the demand for the service, and great technological progress. Those factors enabled equity investors to reap gains that many found inappropriate and unseemly in industries that were supposedly regulated. The speculative frenzy of the 1920's in utility and utility holding company securities *(see* n.154, *infra*) reinforced that view. The people who bought those securities may not always have made out quite so handsomely as the investment bankers who sold them. Down until 1929, however, equity investors in utility securities did very well indeed. Leverage was working for them.

So was the price level. True it is that inflation was a wellknown phenomenon in the early 1920's. Then, as now, regulatory controversies turned in large measure on price level changes and on their regulatory consequences. Like other great wars, the 1914-1918 struggle had led to severe inflation. But that inflation was not protracted. And it was most assuredly not viewed as permanent. It was considered an essentially short-run by-product of wartime finance.

Hence Justices Brandeis and Holmes said in *Southwestern Bell* that "To require that reproduction cost at the date of the rate hearing be given weight in fixing the rate base, may subject investors to heavy losses when the high war and post-war levels pass-and the price trend is again downward." 262 U. S. at 302-303. To that sentence a long footnote (Justice Brandeis's n.16 at 303-304 of 276 U.S.) was appended. That footnote summarized American price level history. Its last sentence reads: "The chart shows that the peak price levels were practically the same during the War of 1812, the Civil War, and the World War; and it shows that practically continuous declines, for about 30 years, followed the first two wars. *The experience after the third may be similar*." (Emphasis added.)

Also pertinent to the temper of that time and to the bearing of that temper on our time is Justice Brandeis's next footnote. It warned that "a serious decline of the price level would subject the return on many utilities established earlier to . . . dangers. A collapse of public utility values might result. And the impairment of public utility credit might be followed by the cessation of extensions and new undertakings." After 1929, that warning, which is at the end of n. 17 on page 304 of 262 U. S., appeared prophetic. History seemed to vindicate it. And the belief that it had done so had much to do with the origins of the legislation on which this Commission spends most of its time.

Now, however, we have had more than 40 years of inflation. The Second World War was not followed by the great post-war deflation that seemed in the 1920's (and even more in the 1930's when Brandeis's views began their forward march to the total victory that they won in the 1940's) to be an immutable law of economic history.

Instead, we had and still have a worldwide outburst of seemingly perpetual and at least thus far apparently incurable inflation. That has had a material adverse impact on investors in utility equities. Their position today is far different from that of the people who held such securities in the 1920's. We note in this regard that Holmes, Brandeis and their contemporaries knew nothing of "stagflation." Nor had they ever heard of such a thing as an "inflationary depression."

In recent years, however, both phenomena have been prominent. So it has not been unusual to see the allowed return for utilities lag well behind prevailing short-term and long-term interest rates. This is no small risk. Secondly, the entire investment of the equity holder is subordinated to claims of the bondholders and preferred shareholders. This, also, is no small risk in the contemporary economic environment. Thirdly, the equity holder has the financial risk of not earning his allowed return if the utility does not perform as expected. Fourthly, pay-out ratios depend at least in part on the utility's cash flow needs, so more or less of the investor's earnings will remain "captive" to the prior claims of bondholders and preferred shareholders in the form of earned surplus or retained earnings (and subsequent investment). Finally, although leverage is both more common and greater in utilities than in unregulated industries, it is only in industries subject to traditional, original cost regulation that the equity investor is stripped of all its advantages. And that is done in the regulated industries without adequate allowance for the fact that the common shareholder's risk is appreciably greater than that of the bondholder or the preferred shareholder. But we are quick to point that this argues only for the use of an inflation-adjusted rate base, *not that and an inflation-adjusted rate of return also.* To give both, which the oil pipeline industry argues for in this case, is clearly to compensate the equity investor for inflation twice.

149 *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 91, 600-601 (1944).

150 Writing in 1961, Professor Bonbright said, "One standard of reasonable rates can fairly be said to outrank all others in the importance attached to it by experts and by public opinion alike-the standard of cost of service often qualified by the stipulation that the relevant cost is *necessary* [emphasis in the original] cost or cost reasonably or prudently incurred. True, other factors of rate making are potent and are sometimes controlling-especially the so-called value-of-service factor in the determination of the individual rate schedules. But the cost of service standard has the widest range of application. Rates found to be far in excess of cost are at least highly vulnerable to a charge of 'unreasonableness.' Rates found well below cost are likely to be tolerated, if at all, only as a necessary and temporary evil." BONBRIGHT at 67.

151 *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 602-603 (1944).

152 Section 5(a) of the Natural Gas Act (15 U.S.C. § 717d) provides, among other things, that "the Commission may order a decrease where existing rates . . . are not the lowest reasonable rate." There is no such express directive in the Federal Power Act. But history leaves no doubt that this is what its authors had in mind. *See* F. Fungiello, *Toward a National Power Policy: The New Deal and the Electric Utility Industry*, 1933-1941 (1973).

153 Brandeis and Holmes, JJ. concurring in *Missouri ex rel. Southwestern Bell Telephone Company v. Public Service Commission of Missouri*, 262 U.S. 276, 308 (1923) (such rates are among "[t]he prime needs of the community.") True, the statutes that we inherited from the Federal Power Commission were passed years after *Southwestern Bell*. But the people who wrote them worshipped Holmes and revered Brandeis.

The Federal Power Commission's rate jurisdiction was a child of the New Deal. And in that field the New Deal made the dissenting opinions of Justices Holmes and Brandeis the foundation stones of a new legality that tilted toward the consumer and that freed regulation from the costly and time consuming rituals imposed by the old idea that regulated entities had a constitutional right to a fair return on the "fair value of their properties." The leading case was *Smyth v. Ames*, 169 U.S. 466 (1898).

The Power and the Gas Acts were products of what historians call the Second New Deal. And it has long been a common-place among the historically minded that Justice Brandeis was the Second New Deal's spiritual father. *See* A. M. Schlesinger, Jr., *The Age of Roosevelt: The Politics of Upheaval* (1960). Chapter 17 of that book (at 302-324) entitled *"The Utilities on the Barricades"* is pertinent to our theme. So is Chapter 20 (at 362-384); its title is *"Power for the People."* At page 387 of his book Professor Schlesinger says: "The second New Deal was eventually a coalition between lawyers in the school of Brandeis and economists in the school of Keynes. But in 1935 [and that was the year in which the administration and the Congress addressed utility problems] the economists were still in the background; the neo-Brandeisian lawyers were at first the dominant figures in the new dispensation. As for the old Justice himself, he watched the events of the year with growing delight." See also the discussion of utility regulation in B. Murphy, *The Brandeis/Frankfurter Connection* 165-182 (1982).

[154] Moving oil through a pipeline is transportation. And though regulated (at times highly regulated), transportation enterprises have never been regulated in "public utility" fashion. Of course, it can be said that the transmission of electricity or gas is also "transportation." That type of transportation, however, is an integral part of a tightly regulated business. When the product arrives at its eventual destination, the maximum price at which it can be sold to the ultimate consumer is regulated. This is not true of oil. *See generally*, BONBRIGHT at 4-5.

[155] The quotation is from our order of December 24, 1980, directing that the duration of oil pipeline rate suspension orders be limited to a single day. *Buckeye Pipe Line Company*, 13 FERC ¶ 61,267. (Footnotes omitted.) That order dealt solely with suspension policy. In footnote 25 (13 FERC at ¶ 61,597) the Commission said: "All that we deal with here and now is suspension policy. That is not to be confused with and has no necessary bearing on the substantive content of the 'just and reasonable' standard." That, of course, was good juridical technique. The application before the Commission in *Buckeye* raised no substantive questions. So the Commission had no occasion to opine about the thorny issues with which we now grapple.

The nice distinctions in which law students are drilled and that they draw when they come to practice at the bar between dictum and holding and between that which is necessary to dispose of the precise question presented for decision and that which could have been left unsaid without necessarily altering the result have an important place in the legal order. But those distinctions can be pushed too far. In *Buckeye*, for example, the Commission had to formulate a rational suspension policy for oil pipeline rate increase filings that its Oil Pipeline Board found questionable enough to warrant suspension and investigation. To answer that narrow question about suspension policy, however, the Commission had to consider broader questions about the social function and the practical effects of oil pipeline rate regulation. The precise question posed was: "Should a procedural policy adopted for electric power and natural gas transmission be carried over to oil pipelines?"

So the Commission had to compare its oil pipeline role with its role under the statutes inherited from the former Federal Power Commission. That assessment was carefully made. We find it valid. We also find that its implications go much beyond the narrow question that the Commission addressed in *Buckeye*. Hence we reaffirm the *Buckeye* analysis. And we apply that analysis to the broader questions now before us.

[156] The "eccentricities" with which Justice Jackson was there concerned were those of natural gas production. The "eccentricities" that we have to study here are the eccentricities of oil pipelining. We see neither nexus nor analogy between those two sets of "eccentricities."

[157] 13 FERC at ¶ 61,594.

[158] The Commission was mindful of the Supreme Court's suggestion that unreasonable oil pipeline rates "will almost certainly be passed along to the ... consumer." *Trans Alaska Pipeline Rate Cases*, 436 U.S. 631, 644 (1978), discussed at some length in n.4, *supra*.

However, the Commission stressed the Court's use of the qualifying word *"almost."* The Court did not say that excessive oil pipeline rates "will certainly be passed along." What it said was that such rates "will *almost* certainly be passed along."

The Commission commented (n.22): "The presence of the word 'almost' is significant. Had the Court been speaking of wholesale electric rates or of natural gas pipeline charges, it would probably not have used that qualifying adverb. In those contexts the word 'almost' would be unnecessary. Indeed, it would be misleading."

[159] 13 FERC at ¶ 61,595.

[160] At this point, a footnote (n.31) was appended. It reads:

> We adduce no statistical studies to support this proposition. It is also true that we have no statistical studies at our fingertips to support the proposition that the senior partners in New York's 20 largest law firms have more discretionary income as a class and are, on the whole, in significantly better financial condition than a representative sample of working and retired New York City legal secretaries and legal file clerks. We recognize that there is a chance that there are a few insolvent senior partners and that some of the solvent members of that class may have been dogged by misfortunes that have rendered their financial situations somewhat less comfortable than they would otherwise be. We have also heard of rich legal secretaries. And we suppose that there may very well be a couple of retired legal file clerks in New York who have performed prodigious feats of thrift, who have also inherited money, and who have in addition done well in the stock market. Nevertheless, we have considerable confidence in the validity of both the generalization stated in the text and the generalization stated in this footnote. Neither proposition calls for an elaborate supporting demonstration. Both are truisms.

[161] Under the constitutional doctrines of that day there was a serious question, to say the least, about the power of either the states or the nation to regulate those prices.

[162] A quarter of a century elapsed before refined products lines appeared on the scene.

[163] In sharp contrast to the Hepburn Act's oil pipeline provisions, which appear to have been based solely on visceral reaction, the Power and Gas Acts were based on the exhaustive utility studies that the Federal Trade Commission had made between 1928 and 1935. Both of those statutes tell us that at their very outset. The Natural Gas Act begins: "As disclosed in reports of the Federal Trade Commission made pursuant to Senate Resolution 83 (Seventieth Congress, first session) . . . , it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest." 52 Stat. 821 (1938); 15 U.S.C. § 717(a). The corresponding statement in the Federal Power Act is harder to track down. One who looks for it in Title 16 of the United States Code, where the Federal Power Act is codified, will not find it there. But if he goes back to the Statutes at Large he will see it in the Public Utility Act of 1935. 49 Stat. 838. Title I of that statute is the Public Utility Holding Company Act, codified in 15 U.S.C. § 79, *et seq.*, and Title II is the modern Federal Power Act, *codified in* 16 U.S.C. § 792.

Section 1(b)(5) of the Holding Company Act reads in pertinent part: "Upon the basis of facts disclosed by the reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session), . . . it is declared that the national public interest . . . and the interest of consumers of electric energy and natural or manufactured gas, are or may be adversely affected—when in *any . . . respect* [emphasis added] there is lack of economy of management and operation of public-utility companies, or lack of effective public regulation, or lack of economies in the raising of capital." 15 U.S.C. § 79a(b)(5).

The Holding Company Act may be an anachronism today. Indeed, the Securities and Exchange Commission, the agency that has administered that statute for almost half a century, now recommends its repeal. Its members are unanimous about that. Accordingly, bills that would repeal or overhaul the Holding Company Act are now pending in Congress. Historically, however, it is clear that the Holding Company Act was the centerpiece of the New Deal's utility program and that in 1935 and for many years thereafter the Federal Power Act was the tail and the Holding Company Act the dog. See M. Parrish, *Securities Regulation and the New Deal 145-178* (1970); F. Fungiello, *Toward a National Power Policy: The New Deal and the Utility Industry, 1933-1941, page 63* (1976); *Report to Congress by Charles B. Curtis, Chairman of the Federal Energy Regulatory Commission on Decisional Delay in Wholesale Electric Rate Cases: Causes, Consequences and Possible Remedies 32-35* (January 22, 1980).

In Section 30 of the Holding Company Act (15 U.S.C. § 79 Z-4) the Congress of 1935 was very explicit about its utility aims. That section reads in pertinent part: "The Commission ["Commission" there means the Securities and Exchange Commission] is hereby authorized and directed to make studies and investigations of public-utility companies, the territories served or which can be served by public-utility companies, and the manner in which the same are or can be served, to determine the sizes, types, and locations of public-utility companies which do or can operate most economically and efficiently . . . , *and in furtherance of a wider and more economical use of gas and electric energy* [emphasis added]; upon the basis of such investigations and studies the Commission shall make public from time to time, its recommendations as to the type and size of geographically and economically integrated public-utility systems which, having regard for the nature and character of the locality served, can best promote and harmonize the interests of the public, the investor, and the consumer."

True it is that the S.E.C. never made the studies that the Congress of 1935 *"directed"* it to make. Many factors accounted for that. Among them were the S.E.C.'s determination that its primary duty in this field was to break up the holding companies as rapidly as possible which meant that the long-run studies contemplated by Section 30 were secondary and peripheral *(see North American Co. v. Securities and Exchange Commission*, 133 F.2d 148, 151 [2d Cir. 1943], *affirmed without discussion of this point* 327 U.S. 686 [1946]; *The Commonwealth and Southern Corporation*, 11 S.E.C. 364, 371-384 [1942]), the essentially self-liquidating character of the S.E.C.'s utility mission which meant that once the electric power and retail gas industries had been restructured by eliminating most of the holding company empires that formerly dominated them and by reorganizing and rationalizing the holding company systems that remained the S.E.C.'s regulatory jurisdiction over utilities extended only to about one-fifth of the industry and that even with respect to that minority segment the S.E.C.'s regulatory jurisdiction was so limited and so marginal a character as to render it unsuited to the task of remaking the nation's utility map, the S.E.C.'s preoccupation with other problems that had a closer nexus to its investor-protection mission, staffing limitations, and budgetary constraints.

But these things could not have been foreseen in 1935. We assume that the Congress of that year meant what it said in Section 30. And what it said there was that it wanted to foster *"a wider and more economical use of gas and electric energy."*

That is what the Power and Gas Acts were all about. "Wider use" so that the blessings of electricity and gas would be brought to the poorest in the land and to the most marginal of industries. That is the foundation, cornerstone, and walls of the Federal regulatory effort in electricity and gas. *See Securities and Exchange Commission v. New England Electric System*, 384 U.S. 176, 184, n.15 (1966); *Union Electric Company*, 45 S.E.C. 489, 510 (1974).

The reasoning involved was very simple. It ran like this:

(1) Rates as low as possible foster wider use.

(2) Wider use enlarges the scale of production.

(3) That means massive economies of scale.

(4) Those will make for constantly falling costs and, if the regulators are vigilant and assiduous, for constantly falling rates.

(5) So the scale of production will be further enlarged.

(6) The end result will be ever lower costs, ever lower rates, ever greater output, and an ever higher standard of living for all.

Thus, for example, the Twentieth Century Fund in its study of Electric Power And Government Policy (unpublished until 1948, because of delays incident to World War II, but based on the experience of and written during the New Deal period) said at page 747 that "assuming the availability of sufficient power at costs . . . low enough to permit the widest imaginable use of electricity in its adaptation to human needs and desires, those who supply such power have before them potential consumer demand which puts no easily conceivable limit upon expansion."

The turn of the century agitation about oil pipelines had nothing in common with all this. No studies were made. A bunch of lawyer-legislators wrote a statute. And that was it.

Nor have we found anything in the turn of the century historical record that suggests even by implication that pipeline rates were regulated in order to make oil cheaper and to widen its use. Indeed, the people who were pushing for oil pipeline regulation wanted to make oil dearer. So it is obvious that we are dealing with animals of different species.

[164] In statutory construction one must not only read the words, one must listen to their music as well. That was the message of a great judge who was also a distinguished legal philosopher and who in his prior incarnation as a member and later as Chairman of the Securities and Exchange Commission had much first-hand experience at the administrative level with the construction of broad and flexible statutory texts. We refer to the late Judge Jerome N. Frank's *Words and Music: Some Remarks on Statutory Interpretation*, 47 Colum. L. Rev. 1259 (1947).

[165] It is most assuredly not extinct today. It is alive and well. Its partisans remain fiercely loyal to their cause, which they continue to regard as a battle for elementary economic democracy.

[166] *See* Bonbright, *Public Utilities and the National Power Policies* (1940).

[167] *See* page 380 of the Twentieth Century Fund report cited in n.163, *supra*. *See also* D. D. Anderson, *State Regulation and Public Utilities*, in J.Q. Wilson, ed., *The Politics of Regulation 3-16* (1980).

[168] Our references to "gas" exclude the production of that commodity. Once again we note that special circumstances come into play there.

[169] It must be remembered that many otherwise quite conservative people who regard themselves as stalwart champions of the private enterprise system favor or have in the past favored the public ownership of utilities, if only for the purpose of prodding the investor-owned companies with so-called "yardstick competition." The Congresses that created the Tennessee Valley Authority and the Rural Electrification Administration were not dominated by Socialists. Nor was the New York Legislature bent on making society in general over when it created the Power Authority of the State of New York. Nebraska's case is very much in point. Whatever its politics may have been when William Jennings Bryan was its best-known citizen or when George W. Norris represented it in the United States Senate, Nebraska today is no hotbed of radicalism. It is generally regarded as one of the most conservative states in the Union. Yet it is the only all-public power state in the land. Historians may say that like its unicameral legislature (which is also unique), Nebraska's 100% public power set-up is a legacy from George W. Norris, for decades its most prominent statesman. But the Norris era ended four decades ago. And we detect no signs of a mass movement in Nebraska calling for a return to investor-ownership.

Writing during the period when the Power and Gas Acts were enacted and writing with special authority as one of the principal architects of those statutes, Professor Bonbright, no Socialist, said:

> [E]ven under what we call private ownership, public utilities are Government agencies in a very real sense. They enjoy legal powers ordinarily reserved for the Government itself. They are under a host of restrictions by public officials which interfere with the freedom of management and which keep them perpetually in politics. Too often, in the past, their efforts to maintain a profitable status have led them to corrupt city councils and state legislators. *They* are therefore on a very precarious borderline between business and government. Under these circumstances the future of private industry in America might possibly be brighter if business men were to withdraw from this dangerous borderland, leaving to public officials sole responsibility for the supply of utility service.
>
> I mention this possibility not by way of recommending any such action, but only in support of my view that public ownership in the utility field cannot wisely be condemned, even by economic conservatives as "an entering wedge for socialism." The case for and against this form of ownership should depend on the test of relative efficiency as judged by actual experience, not on a doctrinaire dispute as to whether the utilities belong in the sphere of business or in the sphere of Government. Indeed, if such a dispute becomes the controlling one, the winners are almost sure to be those who take the more radical position. Bonbright, *Public Utilities and the National Power Politics 59* (1940).

That is how a sophisticated observer saw the utility scene back in F.D.R.'s day.

[170] Utility executives once sang paeans of praise to regulation. The love affair between the carriers and the ICC that lasted for so many years and of which Professor Huntington took so jaundiced a view (*see* n.118, *supra*) had its counterpart in the utility field. Though allergic to the idea of *Federal* regulation, utility executives praised *state* regulation to the skies. Thus, for example, the editor of Pub. Util. Fort., then as now an industry publication, told the Academy of Political Science in 1930 that "commission regulation has functioned admirably." He added that "There has been no serious complaint as to the manner in which the service of the companies has been regulated" and that "If you will examine the charges that Commission regulation has broken down, or is halting and beating time, you will find that they are mostly based on a mere difference of opinion as to the reasonableness of rates." Spurr, *Have the State*

Commissions Fulfilled Their Intended Functions? 14 Proceedings of the Academy of Political Science 11, 15-16 (1930). Mr. Martin J. Insull, president of the Middle West Utilities, one of the great utility combines of those days, a former president of the National Electric Light Association, and the brother of the great Samuel, told that same group: "State regulation of the electric light and power industry, notwithstanding any criticisms that may be made against it, has an enviable record to look back upon." Insull, *Is Control of Operating Companies Sufficient? Id.* 81, 83. One who examines the volumes of Pub. Util. Fort. for the 1920's and the early 1930's will find more, much more, in the same vein.

In those days it was the industry's critics who were raising questions about regulation. Save for the most vehement public ownership partisans, those critics thought that utility regulation had a potential for doing some real good. But they also thought that this potential had not been realized. That was why so many of them wanted to bring a *Federal* presence to the regulatory scene. They hoped that Washington could show the states how the thing ought to be done.

[171] A quite conservative economist who has written much in recent years about the abuses of regulation and who is a stalwart champion of "deregulation" concluded that regulation had no significant effect on prices until the 1960's. P. Mac Avoy, *The Regulated Industries and the Economy 35-37* (1979).

Writing in 1934, the future Justice Frankfurter, then still a mere law professor who taught public utility regulation, among other things, said of regulation that "[the] whole process is fundamentally an elaborate fiction." He added that "in the end rates are fixed which reflect no other reality than that of compromise, reinforced . . . by the superior advantage of the utilities in litigation." Frankfurter and Hart, *Rate Regulation* in 13 Encyclopedia of the Social Sciences lst ed. (1934), *reprinted in* P. Mac Avoy, ed., *The Crisis of the Regulatory Commissions 1-17* (1970).

[172] That point is no mere historical curio. It is not discursive pedantry. It is basic to the issues that we have to decide in this case.

As long as regulation was dominated by the idea (according to the Supreme Court, which had and has the last word in these matters, it was a constitutional imperative) that regulated entities were entitled to a fair return on a mystical something or other called "fair value," it was almost impossible to tie rates to costs. That was so because the classical "fair value" of *Smyth v. Ames,* 169 U.S. 466 (1898), and of that great case's confused and confusing progeny was an artifact of the legal imagination that existed only in law books. Utilities did not pay "fair value" when they built plants. Nor did investors buy utility securities at their "fair value." They bought them at market prices determined by the calculations of people who did not waste their time worrying about the true, inner meaning of the Supreme Court's "fair value" essays. Hence the capital sums on which those people were allowed to earn a "fair return" were not real-world numbers. Indeed, they bore no relationship to any real-world numbers. In such an environment arriving at the cost of equity capital, always an inherently guessworky proposition even in the very best of circumstances, became an intellectual adventure that was straight out of Alice in Wonderland. And indeed one well known student of the subject called the whole thing a "merry-go-round." Hale, *The Fair Value Merry-Go-Round,* 33 Ill. L. Rev. 517 (1938), cited with approval in the concurring opinion of Black, Douglas, and Murphy, JJ., in *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 599 at 603 (1942).

Writing in 1940, when the fair value concept was already well past its prime save in those corridors of the Interstate Commerce Commission's building where oil pipeline problems were being pondered-but when the doctrine still showed certain signs of life and had not yet been definitively repudiated-one of the country's most distinguished students of utility problems said:

> As a result of this court-made "law of the land" legislatures or public service commissions have not been free to develop standards of regulation under which the rates are so adjusted as to yield an adequate return on actual capital investment, with or without any special premiums for efficiency. Nor have they been free to adopt any other measure of reasonable profits based on the amount of income necessary to attract capital and to maintain the corporate credit. On the contrary, they have been compelled to decide rate cases by reference to an almost meaningless engineering appraisal of the physical properties. In theory, this appraisal may result in a low valuation, justifying the fixation of rates at lower levels than would be set under other rules of rate making. And so it sometimes worked out in practice during the early history of regulation. But for many years, the valuations approved by the courts have seldom gone below original construction cost and have often exceeded this cost by a high percentage.
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> Partly, I suspect, because of its very tendency to *cripple* [emphasis added] effective public control over rates, the "fair value" doctrine has been strongly supported by utility officials and company attorneys. Indeed, the fear that it may be modified if not renounced by the present Supreme Court is one of the reasons why some of the newer members of that Court are not popular in the utility world. Bonbright, *Public Utilities and the National Power Policies 16-17* (1940).

Professor Bonbright proved an accurate prophet. The gloomy forebodings about the Supreme Court's probable direction entertained by the fearful "utility officials and company attorneys" to whom he referred turned out to be well-founded. The ink on Bonbright's pages was scarcely dry when the epoch-making decisions in *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942), and in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), knocked fair value out of the Constitution.

Why is all this historical lumber important? It is important because, as previously noted, we deal here with the only type of Federal economic regulation known to us in which "fair value" still survives, 38 years after *Hope*, 40 years after *Natural Gas Pipeline*, 42 years after Bonbright concluded that "the 'fair value' doctrine . . . has gone a long way toward bringing regulated private ownership into disrepute" and noted also that "even a few utility executives have shown signs of awareness that unless the doctrine undergoes drastic modification it may promote the recent movement toward outright public ownership," and 43 years after Justice Frankfurter (with whom Justice Black concurred) denounced "the mischievous formula for fixing utility rates in *Smyth v. Ames*, 169 U.S. 466" and went on to brand "that formula moribund," characterizing it as "useless as a guide for adjudication." *Driscoll v. Edison Light & Power Co.*, 307 U.S. 104 at 122 (1939).

We agree with that. We agree with Brandeis, with Frankfurter, with Bonbright, and with others whose opinions deserve respect—including everyone or practically everyone who ever served on the Federal Power Commission, our predecessor in title—that "fair value" is an inappropriate tool for the utility regulator. But that does not necessarily make it inappropriate here.

We think that the regulatory effort that the Congress of 1906 directed in this most unusual field has nothing (or almost nothing) in common with the much more strenuous regulatory efforts that later Congresses directed in electric power and in natural gas. As we see it, oil pipeline regulation is in a class by itself. We are also of the opinion that:

(A) The highly specialized variant of fair value regulation that the ICC developed in its oil pipeline work is reasonably well-suited to this singular area of regulatory activity—where else do regulators deal with regulated entities that are their own best customers?

(B) No showing has been made that any other oil pipeline rate base methodology would be *so* much better, *so* much fairer, and *so* much more equitable as to enable us to say confidently that such other method would be clearly worth both the social cost of drastic regulatory change and the institutional cost to this Commission and to the legal order of a headlong drive into the deep and muddy waters of administrative legislation.

[173] Consider, for example, the famous 1923 case of *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679. That was a "fair value" case. The opinion was written by Justice Butler. He was generally regarded as friendly to utilities and carriers. No one could possibly have regarded him as insensitive to the investor's interest. Nor are we aware of anyone who ever accused him of tilting too far in the ratepayer's favor.

Yet Justice Butler's *Bluefield* opinion insisted that: "A public utility . . . has . . . no right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures." 262 U.S. at 692.

In electricity, in gas, and in telephones everybody considers that principle axiomatic. In theory, at any rate, every electric company, every natural gas pipeline company, every rate of return witness and every advocate who appears before us starts from that axiom.

But it may not be axiomatic at all in oil pipelining. Indeed, it may produce pernicious results. We shall have more to say about that.

[174] The public policy controversies of recent years about aviation and about trucking show how important this factor can be. The utility field is somewhat different from transportation. Transportation generally involves oligopolies. Retail gas, retail electric power, and local telephone service generally involve monopolies.

The important thing for present purposes about those monopolies is that any company that sought, as so many such companies did, to become the sole supplier of gas, electric, or telephone service to a particular market had to accept rate and profit constraints in exchange for that status. The people who managed those enterprises were astute and politically sophisticated. So they knew that unregulated legal monopoly was sociologically unfeasible. People just wouldn't stand for it. *See* the quotation from former Chairman Curtis in the very next footnote.

[175] Some think that the house has now outlived its usefulness and that it ought to be remodeled or demolished. That is a big subject. And though of some relevance to our present concerns, it does not impinge on them directly.

Even today, however, many still believe that in electric power and in both the transmission and the distribution of gas the only real choice is between public ownership, on the one hand, and rigorous regulation on the other. When he was here, this Commission's first Chairman took that view. He said:

[I]nvestors in public utility securities and the people who manage the properties that belong to those investors have a real and a keen interest in effective regulation. That is so because there is no real prospect of "deregulation" in your industries. To Mr. and Mrs. John Q. Public and to their legislative representatives, gas companies and electric companies look like monopolies. Hence there is an inevitable demand for regulation. Some economists may write learned papers demonstrating that this demand is silly. Those papers are of little real-world moment. Deregulation is a non-starter here. There are two-and only two-sociologically viable options in this field. One is regulated private ownership. The other is public ownership. And history shows that in public utility services, as distinguished from commodity production and from transportation, regulation that seems ineffective and meaningless never leads to tidal waves of laissez-faire sentiment. Ineffective utility regulation leads only to strong pressures for public ownership. Curtis, *A Regulator Reflects on Rate Regulation—Yesterday, Today, and Tomorrow*, Pub. Util. Fort., June 19, 1980, page 73 at 75, n.16.

[176] True, their cause evoked widespread sympathy from people who thought that:

(A) Rockefeller's oil monopoly raised a moral issue; and

(B) Pipeline transit was a strategic point at which the monopoly could be attacked and its obscene wrongdoing curbed.

Now moral issues are very potent. Tarbell's enormous popular success shows that. Essentially, her hundreds of pages were a richly documented sermon on John D. Rockefeller's sins. We have already quoted from the next to last paragraph of her very long book. *See* n.52, *supra*. However that paragraph's last sentence bears repetition. It reads: "At all events, until the transportation matter is settled, and settled right, the monopolistic trust will be with us, a leech on our pockets, a barrier to our free efforts." Then came Miss Tarbell's final words in her very last paragraph. They were:

> As for the ethical side, there is no cure but an increasing scorn of unfair play—an increasing sense that a thing won by breaking the rules of the game is not worth the winning. When the business man who fights to secure special privileges, to crowd his competitor off the track by other than fair competitive methods, receives the same summary disdainful ostracism by his fellows that the doctor or lawyer who is "unprofessional", the athlete who abuses the rules, receives, we shall have gone a long way toward making commerce a fit pursuit for our young men. 2 TARBELL 292.

That is powerful stuff. But its power is of a quite different order from the power of a direct appeal to the electorate's self-interest by asking its members to consider their monthly gas and electric bills, to contemplate how much lower those bills would be if only gas and electricity were publicly owned or "properly regulated," and to think about how much easier and pleasanter life would be if only electricity were cheaper. The power of the anti-utility appeal was of the second sort. So far as its pipelines were concerned, Standard was never confronted by a propaganda campaign of that type.

[177] Proposals for public ownership have been made from time to time. We know that. But those suggestions did not surface until long after the enactment of the Hepburn Act. Hence they are not part of the *statutory* background. So they shed no light on our problem which is what did the Congress of 1906 have in mind?

Turning to that question, we find no reference to public ownership in the Hepburn Act's legislative history. Nor do we find any mention of it in Tarbell's many pages. The first proposal for public ownership of which we are aware was the one made by Senator Robert L. Owen of Oklahoma in 1914. *See* JOHNSON at 107-110. The next round of proposals for Government ownership did not come until the 1940's, by which time hardly anyone in any way connected with the enactment of the Hepburn Act was still alive. *See* WOLBERT II at 474-475.

[178] Socialism has never been of appreciable political consequence in this country. At the national level, it never attracted much support. But people who described themselves as "Socialists" were more numerous in the America of 1906 than they are in today's America. This is sometimes forgotten. At various times the Socialist Party dominated the politics of such cities as Milwaukee, Wisconsin; Reading, Pennsylvania; Bridgeport, Connecticut; Schenectady, New York; and Minneapolis, Minnesota. Socialists and Socialism were also of some significance in New York City. That is relevant to the formative era of utility regulation. And it is immensely relevant to the history of urban mass transit. Moreover, trollies, subways, and elevated rapid transit lines used electric power long before it was widespread in homes. So there was a nexus between urban mass transit and electric power. Both industries were ideal for experiments in what the nineteenth-century British statesman Joseph Chamberlain styled "municipal socialism" when he began his political career as a "Radical" at the municipal level in the city of Birmingham before rising to fame at Westminster where he ended this career as a great Conservative and where his son Neville rose to the prime ministership that had eluded his sire. The corruption in which franchise grants were often mired added much fuel to this fire. *See* E. W. Clemens, *Economics and Public Utilities 78-80* (1950). *See also* J.Q. Wilson, ed., *The Politics of Regulation 4-12* (1980). For case studies on two of the nation's largest cities *see* F. McDonald, *Insull* (1962) (Chicago); N. Wainwright, *History of the Philadelphia Electric Company, 7-8, 27-29, 57, et seq.* (1961) (Philadelphia).

None of this has any bearing on oil pipelines. It would be difficult to think of any industry as little suited to municipalization as this one. If there was to be Government ownership, the "government" in question had to be the national government.

And though Socialists and Socialism were of some moment in a number of City Halls, they amounted to nothing on Capitol Hill. Moreover, Socialists had no reason to interest themselves in the pipelines. They were in favor of nationalizing oil. But they had no special reason to pick on the pipelines. From their Marxian perspective, the great oil pipeline battle was a ridiculous war between Rockefeller and a bunch of smaller "exploiters" who were every bit as bad as he was but not quite so smart and much less efficient. The point here is that the Progressive Era's anti-monopoly wars in which oil pipelines were a battleground were middle-class, and to a large extent upper-class, wars fought by and on behalf of entrepreneurs who deemed themselves menaced by the trend toward concentration. *See, e.g.*, T. McGraw, ed., *Regulation in Perspective: Historical Essays* (1981), where Professor McGraw of the Harvard Business School points out (at page 31) that "the net effect [of vertical integration] over time, might well be the reduction of prices and the enhancement of consumer welfare." His next sentence reads: "But this complex mixture of effects was not at all clear to Brandeis and other contemporary observers, who naturally paid more attention to the ruthless methods of such companies as Standard Oil (methods made possible because of Standard's much lower unit costs) and the gradual disappearance of small autonomous oil refiners than to long-term trends in the price of petroleum products."

At pages 43 and 44 Professor McGraw returns to the attitude of Brandeis and of those who thought as he did toward the oil business and toward other industries in which concentration appeared to be proceeding apace. McGraw points out that in Standard's way of doing business, "Brandeis saw the disappearance of the independent wholesaler and retailer of oil. If something were not done to stop this trend, he added, there would evolve 'the substitution of agents' arrangements for the ordinary barter and sale which in most respects leave the citizen . . . a free man.'" McGraw then adds "that Brandeis's chief goal was not consumer welfare through productive efficiency—which . . . he seems to concede to the center firm—but instead individual identity. He was concerned about the loss of identity as the individual jobber or retailer was metamorphosed into the mere agent of a vertically integrated corporation."

Of course, McGraw is speaking of Brandeis before his ascent to the bench. His Brandeis is in large measure Brandeis, the Boston lawyer whose clientele consisted largely of retailers, wholesalers, and small manufacturers confronted by economic changes that were "inherently threatening to the atomistic commonwealth of Brandeis's imagination." McGraw, *id.* at 53. What is relevant for present purposes about McGraw's discussion of Brandeis' concerns is that the concern for the small businessman that he showed in the unregulated sphere of the economy, a concern that led him at times to subordinate the consumer's welfare to the welfare of the entrepreneur, was altogether different from his concerns in the utility field. There "atomization" was obviously impossible. So there Brandeis, as we have previously noted, stressed the community's interest in rates "as low as possible." He was not alone in that.

Nor is this mere antiquarianism. Even today the very same people who are most vociferous in demanding vigorous antitrust action with respect to oil or other industries that they deem overconcentrated tend to be the most militant champions of either public ownership or a rigorous version of cost-based regulation when it comes to "utilities"-natural gas pipelines, retail gas service, electric power, and local telephone service.

[179] In 1900 Standard owned about 90% of the pipelines. JOHNSON 3. Around that time new firms began to go into pipelining in the Mid-Continent area (the very area involved in the case with which we are now concerned) and in the Gulf area. *Id.* 19. However, Standard remained overwhelmingly preponderant. And we find no suggestion in the historical record of significant competition among pipelines at the turn of the century. We see nothing, absolutely nothing, that even hints that the Standard Oil Company of 1906 was worried about competing *pipelines.* John D. Rockefeller had eliminated all of the competing pipelines that really bothered him. And he did that long before 1906. Hindsight shows that even "in 1906 . . . , its [Standard Oil's] position . . . was *potentially* [emphasis added] vulnerable to pipelines built . . . from the Gulf, where new companies were being established." JOHNSON again at 19. But there is no evidence that Standard was bothered about this. It sought no legal protection from these Gulf interlopers. And the legislators certainly were not bothered by the threats to Standard's dominance. They thought that Standard owned all of the pipelines that counted. And at the time, they were probably right.

But the industry was changing as Congress was legislating. After 1906, pipelines owned by Standard's competitors became more numerous and more important than they had been when Congress was considering the Hepburn Act. Professor Johnson explains that:

> A major development of the period 1906-1911 . . . was a continuing and growing challenge to Standard Oil based on aggressive exploitation of new discoveries in Oklahoma and Kansas by both large and small, old and new firms. Many of them owned pipelines, primarily to assure a supply of crude through a low-cost transportation medium over which they themselves could exercise control. Since the discovery and output of flush fields was unpredictable, the construction and investment in trunk pipelines was feasible only when a quick "payout" seemed reasonably certain. No more than Standard Oil did the new concerns want outsiders to pre-empt or benefit from lines built to serve their own integrated operations. Even where state or federal law required pipelines to be operated as common carriers, high rates and minimum tender requirements proved obstacles to use of the lines by outside shippers. JOHNSON 53.

The foregoing extract shows that Standard had no monopoly of the idea that pipelines were competitive weapons which could be used to make things difficult for people in the oil business who depended on pipelines owned by others. Everybody who was in a position to put this operating principle into practice seems to have done so. The second striking feature of Professor Johnson's summary of the initial stages of the long process by which Standard Oil's formerly near-total dominion over the pipelines was slowly eroded is the absence of any reference to competition among pipelines. Each line seems to have had what was for all practical purposes a virtual monopoly. That, of course, was an economic environment in which abuses could flourish. Eventually competition among pipelines did appear. But decades went by before that happened. *See* JOHNSON 387.

[180] The utilities objected to particular things that particular regulators did in particular situations. But they had no quarrel with the general idea of regulation. Indeed, some claim that they invented it. *See, e.g.*, F. McDonald, *Insull 113-123* (1962). Not until very recently when inflation became virulent and the regulatory lags that used to work for them began to work against them, did some people in the utility business become disenchanted with the regulatory *principle.* From a historian's perspective, it was only yesterday (indeed, it was only a few minutes ago) that the notion that something like electric power (the traditional *locus classicus* of cost-based regulation) could be deregulated without damage to the public interest and without fueling a strong drive for public ownership first began to spread from the economics departments of universities to certain industry circles.

[181] *See* JOHNSON at 69-81.

[182] Cynics no doubt will say that it could not possibly have told posterity what it had in mind because it had nothing at all in mind other than a politically expedient gesture. It is hard to say that they are wholly wrong. There seems to be a good deal more than a germ of truth to their position. That is one reason why we plead so earnestly for a fresh and a searching legislative look at this subject. Until that look is made, we and the courts must work with the foggy materials that history supplies. That may mean that we have to guess about what the Congress of 1906 would probably have thought about justice and reasonableness as applied to oil pipeline rates had it given some attention to the point. Sometimes there is no escape from guesswork. In the words of the great Cardozo we must ask ourselves, "which choice is it the more likely that Congress would have made?" *Burnet v. Guggenheim*, 288 U.S. 280, 285 (1933).

183 Early in the history of American law, Chief Justice Marshall said "where the mind labors to discover the design of the legislature, it seizes everything from which aid can be derived." *United States v. Fisher*, 2 Cranch 358, 386 (1805). And 142 years later one of Marshall's successors on the Supreme Bench quoted and lauded that observation. He said that "[w]ith characteristic hardheadedness, Chief Justice Marshall struck at the core of the matter" and lamented what had happened under some of Marshall's successors when "This commonsensical way of dealing with statutes fell into disuse and more or less catchpenny canons of construction did service instead." Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527, 542 (1947). We are of like mind.

184 *See* 3-B SHARFMAN 32 (the "guiding principles [were] tentative in character".) And that was still true decades later. Writing in 1936 about the ICC's ideas concerning the justice and the reasonableness of the general rate level, Professor Sharfman spoke of "anomalous, if not inconsistent, declarations" and of "tangled threads" that had to be "unraveled discriminatingly, against the varying background of changing circumstances and conditions to reveal the quality of the Commission's performance during the long period of its regulatory activity." *Id.* at 291. Those are kind words. Professor Sharfman was an indulgent historian. And the ICC was his favorite agency. Moreover, he was writing at the bottom of the Depression when people of all shades of opinion hoped that maybe regulation could help so that regulation and regulators had a friendlier press than they do today when the old Progressive-New Deal idea of philosopher-kings (or at least philosopher-dukes) sitting in disinterested judgment on the propriety of prices is less appealing than it used to be. Today neither this agency nor other regulatory bodies can expect contemporary academicians and dissertation writers to throw them kisses of the kind that Sharfman threw so liberally at the ICC. When appropriate allowances for Sharfman's long love affair with the ICC are made, it becomes apparent that Sharfman, a lawyer as well as an economist, was confessing that after studying the ICC for year after year he was unable to make any real sense out of its doctrines and that he found it impossible to derive any consistent general criteria of justice and reasonableness from its welter of precedent. That confession was made when the Hepburn Act was celebrating its thirtieth birthday. So we find it hard to imagine that the Congress of 1906 expected theoretical elegance or analytical rigor from the ICC's oil pipeline work. Nothing in that agency's past (it was already 19 years old, having been created in 1887) held out any promise of that.

185 Of course, the Federal Power Commission did not invent those concepts. It merely followed a path that had already been blazed by the best state Commissions, by Justice Brandeis, and by such academics as Bonbright, Hale, and the future Justice Frankfurter.

186 The Congress of 1906 was legislating in a regulatory vacuum. The Congresses of 1935 and 1938, on the other hand, were legislating against the rich background of theory and controversy referred to in the preceding footnote.

187 Once again we exclude natural gas production, a very special case. There the nature of the industry made the individual firm an inappropriate regulatory unit. *Permian Basin Area Rate Cases*, 390 U.S. 747, 756-767 (1968), *rehearing denied*, 392 U.S. 917. It seems to us that *Permian* is worth another word. That is so though the precise questions tendered for decision there had little, if anything, in common with those that confront us here. When details and particulars are put to one side, we see that *Permian* sanctioned a radical break with traditional notions about the way in which gas and electricity should be regulated. It did so for two reasons. The first was "that the breadth and complexity of the Commission's responsibilities demand that it be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties." 390 U.S. at 790. The second was that the traditional criteria of cost-based regulation "scarcely exhaust the relevant considerations." *Id.* at 791. The Court then elaborated on that second point. It said: "The Commission cannot confine its inquiries either to the computation of costs of service or to conjectures about the prospective responses of the capital market; it is instead obligated at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection by Congress. Accordingly, the 'end result' of the Commission's orders must be measured as much by the success with which they protect those interests as by the effectiveness with which they 'maintain . . . credit and . . . attract capital.' " *Ibid.* (Footnote omitted.)

What do these excerpts from *Permian* mean here? In our view, they mean that:

(1) When we till the oil pipeline field, one with which our predecessor, the Federal Power Commission, had no connection, we are not free to slumber on concepts, traditions, and approaches developed by that agency for other fields with a different legal and historical evil.

(2) We must look hard at the particulars of this industry and at the special features of its legal and economic history.

(3) If that look convinces us that the gas and electric model is inappropriate to "the needs to be served" *(General Stores Corp. v. Shlensky*, 350 U.S. 462, 466 [1956]) in this industry under the particular statute here involved, we have both the power and the duty to regulate oil pipelines in a way quite different from the way in which we deal with the jurisdiction inherited from the Federal Power Commission.

188 "Ratemaking . . . is but one species of price-fixing." *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 601 (1944).

189 *Rate of return* is something else. When it comes to that, the New York Commission looks, and must look, at the rates of return allowed to and at those actually earned by other utilities whose situation is more or less similar to Consolidated Edison's. But consumers do not pay rates of return. They pay rates. And rate of return is but one of many elements in the total rate.

[190] In those days the Pennsylvania Railroad Company was regarded as a veritable Rock of Gilbraltar. See E.D. Baltzell, *Puritan Boston and Quaker Philadelphia 224-225, 229, 235* (1979). The idea that the Pennsylvania would one day marry its arch-rival, the New York Central, would have seemed outlandish. Such a combination would under the doctrines of that time have been of dubious legality. *See Northern Securities Co. v. United States*, 193 U.S. 197 (1904). That so unlikely a marriage would be consummated, that it would prove disastrous, that the couple would wind up in the bankruptcy courts, that its railroad interests would be acquired by two Government-owned entities called Amtrak and Conrail, that the couple's *non-rail* interests would prove substantial enough and remunerative enough to give it a new lease on life as a diversified enterprise that has nothing to do with railroading, and that a thriving oil pipeline company (the Buckeye Pipe Line Company acquired by the old Pennsylvania Railroad Company back in 1963) would figure prominently in the reorganized entity's portfolio was then unforeseeable.

[191] The Erie's history was troubled. And the Baltimore and Ohio was scarcely in the same financial league with the Pennsylvania and the New York Central.

[192] Sharfman comments: "The concept of adequacy of income has no practical meaning except for individual roads: the average return of groups of carriers is a mere statistical concept; it is the financial performance and credit standing of particular lines which mold the character of the service rendered. But competitive considerations preclude the fixing of rates separately and distinctively for each individual company with sole reference to its particular revenue requirements. The difficulty is basic; when Congress in 1920 directed that rates be so adjusted as to yield a fair return to the carriers as a whole or in rate groups, it but gave this difficulty express statutory recognition. In order that extremes of dearth and affluence among the carriers should not, under rates so adjusted, work their harmful effects upon the traffic and communities served, means were necessary of mobilizing financial strength for the good of the railroad system in its entirety." 3-B SHARFMAN 301-302.

The "difficulty" adverted to in the foregoing extract is no difficulty at all for utility regulators. They deal with "extremes of affluence" (which really shouldn't exist in the utility sphere in the first place, if regulatory practice is in accord with regulatory theory) by trying to pass a fair share of the utility's affluence on to its customers in the form of lower rates. And they do what they can about "extremes of dearth" by giving appropriate rate relief. Unlike transportation regulators, they have no occasion to "average" the two sets of extremes.

The reason for that becomes crystal clear when we compare local telephone service, a natural monopoly, with taxicab service. In most large cities there are a number of competing taxicab operators. Some of those operators are in good financial condition. Others are up against it. Some have new vehicles. Others have old ones that have been fully depreciated on their books. Yet the fares have to be uniform. To permit one cab company to charge more than another would make neither regulatory nor economic sense. Moreover, it would be self-defeating. The low-fare companies would wind up with the lion's share of the business. The high-fare companies, which would be left only with the overflow that their low-fare brethren were unable to handle at peak times, would find the preferential fares designed for their benefit a one-way ticket to extinction.

A local telephone company, on the other hand, need not worry much about other local telephone companies in other places. Few of its customers are likely to move elsewhere in order to save on their telephone bills. Hence the public officials who regulate that telephone company's charges are in a position to concentrate on its affairs. It is quite true that those officials will, if they are diligent, look at other telephone companies for comparative purposes. That is the so-called yardstick factor. But they do not look at those other companies as closely and as directly as a taxicab regulator must. Therein lies the essential difference between the Interstate Commerce Commission's regulatory tradition and the regulatory tradition that we inherited from the Federal Power Commission. For most of its history the Interstate Commerce Commission was in a position akin to that of our hypothetical Taxicab Commission. The Federal Power Commission's ratemaking chores, on the other hand, were very much like those of our suppositious Telephone Commission.

The only significant exception to that generalization grew out of *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), which held the commodity price of natural gas subject to the Natural Gas Act's "just and reasonable" standard. That meant that the Commission had to regulate the prices charged by thousands of firms who were selling a fungible good. Experience showed that this could not be done on the firm-by-firm basis traditional in the utility field. See *Permian Basin Area Rate Cases*, 390 U.S. 747, 756-757 (1968). But this was one of those exceptions that proves the rule. As the Supreme Court said at page 756 of its *Permian* opinion, "Producers of natural gas cannot be usefully classified as public utilities."

[193] Some support for this view can be found in the Mann-Elkins Act of 1910. 36 Stat. 539. That statute gave the ICC jurisdiction over interstate telephone and telegraph service, a jurisdiction that it retained for almost a quarter of a century until the creation of the Federal Communications Commission in 1934. One can argue that it defies common sense to maintain that Congress intended that the ICC turn a blind eye to monopolies in communications and that it directed the agency to treat the American Telephone and Telegraph Company as though it were a facsimile of the Pennsylvania Railroad Company and Western Union as though it were a carbon copy of the Southern Pacific. The problem with the argument is the inherent weakness of inferences drawn from a different statute passed by a later Congress than the one that passed the statute under examination.

[194] This also argues, obviously, that the point about telephone companies and telegraph companies made in the preceding footnote is beside the point. Telephones and telegrams had no intimate links with railroading. Neither Western Union nor American Telephone and Telegraph competed with the

railroads. Nor, so far as we know, was either of those companies ever alleged to have been a recipient of rebates from the railroads.

[195] Senator Lodge said: "I can see no possible reason why the men controlling these great trunk lines of pipes should not make a carrying business and be content to carry oil for all producers at a reasonable rate. We make the railroads do it . . . " 40 Cong. Rec. 9104 (June 26, 1906). This suggests that he wanted to place the railroads and the pipelines on the same footing. It gives no basis for the inference that he intended to subject the pipelines to a regulatory scheme more onerous than that applicable to traffic by rail.

[196] This is not to say that we think history wholly unilluminating in the area with which we have been dealing. The view suggested in the preceding footnote is strengthened by the statement Lodge made when he introduced his pipeline admendment. At that time, he said: "My object, I state frankly, in this amendment is to bring the pipe lines of the Standard Oil Company within the jurisdiction of the Interstate Commerce Commission." 40 Cong. Rec. 7000 (May 17, 1906).

[197] Four centuries ago, in words that have often been quoted since, Lord Coke said that the essential steps in interpreting a statute are to ascertain "[w]hat was the mischief and defect for which the common law did not provide," "[w]hat remedy Parliament hath resolved and appointed to cure the disease of the Commonwealth," and "[t]he true reason of the remedy; and then the Office of all the Judges is always to make such construction as shall suppress the mischief, and advance the remedy." *Heydon's Case*, 76 English Reprint 637, 638 (Ex. 1584).

[198] Differences of roughly the same order of magnitude appear when we compare the oil pipeline story with the regulatory stories of other kinds of common carriers. Let us begin with railroads. That is where it all started. And what started it there was vociferous agrarian protest in the South and in the West about actual or alleged exploitation by the railroads whose principal owners were Easterners or foreign investors. Sharfman's treatise points out in this connection that "as early as 1872 President Grant had recommended that an investigation be made of the 'various enterprises for the more certain and cheaper transportation of the constantly increasing Western and Southern products to the Seaboard.'" 1 SHARFMAN 17, n. 13. So sectional conflict and the interregional distribution of income were important factors. Moreover, the railroads were at that time the principal arteries of commerce used by everyone who wanted to move himself or his wares from one place to another. They had no significant competitors. Hence many believed that they should be publicly owned. In support of their position they pointed to the important role that public funds drawn from Federal, State, and local treasuries had played in financing many of the roads. Public ownership of the railroads was a key plank in the Populist platform. And it remained a lively political issue for decades after that party's demise. So the socio-political origins of railroad rate regulation are not all that different from the constellation of forces that led at a later date to utility regulation. For a conventional account of the railroad background see 1 SHARFMAN 1-70. For an unconventional and a controversial view of the subject by a "revisionist" historian who stresses the railroads' self-interest in the right kind of regulation and their awareness of the way in which regulation could shelter them from the blasts of competition, *see* G. Kolko, *Railroads and Regulation 1877-1916* (1965). Hotly disputed though Kolko's railroad thesis is, there is little doubt of its essential correctness in the motor carriage and civil aeronautics cases with which Kolko does not deal because he concentrates on the Populist-Progressive period during which neither airlines nor motor trucking amounted to anything. It was not an outcry from indignant consumers that led to the regulation of air carriers and motor carriers. The demand for regulation came from the carriers themselves. They wanted Government to protect them from market forces. As previously noted, the oil pipeline story has nothing in common with this. So far as his pipeline interests were concerned, John D. Rockefeller did not need, did not seek, and did not want any aid from the Federal Government. He was doing very nicely on his own.

[199] In none of those industries was the seller also its own best customer. When it came to pipelines, however, John D. Rockefeller was his own best customer. The charge against him was that he wanted to be more than that, that he wanted to be his own *sole* customer, and that he had in fact attained that objective by depriving others of access to his transportation facilities or by giving them purely formal access at sky-high rates that they could not possibly pay. Standard Oil's rejoinder to this attack highlighted the issue. It also added fuel to the fire. Standard maintained that it had built its own pipelines with its own money to serve its own purposes and that this meant that those lines were "plant facilities" rather than "public utilities." It followed that an independent operator had as much right to use John D. Rockefeller's pipeline as he did to use the tycoon's horse and carriage or his shirt and tie. *See* JOHNSON 26-27, 74-81. Accordingly, Congress was as powerless to meddle with Mr. Rockefeller's pipelines as it was to meddle with his haberdashery. The old Commerce Court took this view. Hence it held the Hepburn Act's oil-pipeline provisions invalid. *Prairie Oil & Gas Co. v. United States* 204 F.2d 798 (1913). But the Supreme Court reversed. *The Pipe Line Cases*, 234 U.S. 548 (1914). Speaking through Justice Holmes, a jurist normally allergic to populistic rhetoric, the Supreme Court found the pipelines a subject of legitimate public concern even under the constitutional doctrines of that day. Justice Holmes explained: "Availing itself of its monopoly of the means of transportation the Standard Oil Company refused . . . to carry any oil unless the same was sold to it . . . on terms more or less dictated by itself. In this way it made itself master of the fields without the necessity of owning them and carried across half the continent a great subject of international commerce coming from many owners but, by the duress of which the Standard Oil Company was master, carrying it all as its own." 234 U.S. at 559.

[200] *See* the May 17, 1906 *Report of the Commissioner of Corporations on the Transportation of Petroleum*, a document that seems to have had much to do with the Congressional decision to

regulate. At page 37 of his report, the Commissioner said:

> The Standard Oil Company has all but a monopoly of the pipelines in the United States. Its control of them is one of the chief sources of its power . . . The Federal Government has not as yet exercised any control over pipelines engaged in interstate commerce. *The result is that the charges made by the Standard for transporting oil through its pipelines for outside concerns are altogether excessive and in practice largely prohibitive. Since the charges far exceed the cost of service, the Standard has a great advantage over such of its competitors as are forced to use its pipelines to secure their crude oil.* (Emphasis added.)

[201] *See* preceding footnote.

[202] *See* the quotation from *The Pipeline Cases,* 234 U.S. 548, 559 (1914), in n. 199, *supra.*

[203] Senator Lodge told his colleagues: "Those well owners are absolutely at the mercy of the pipe lines . . . A small well owner is compelled to take the price . . . offered by the controller of the trunk line." 40 Cong. Rec. 6366 (May 4, 1906).

[204] Senator Knute Nelson of Minnesota put the point this way: "The Standard Oil Company purchases oil from the independent shipping oil . . . and holds a monopoly of the use of the main line; and unless it is put under the control of the Interstate Commerce Commission, it can . . . practically destroy all independent dealers . . . " 40 Cong. Rec. 7001 (May 17, 1906).

[205] Theodore Roosevelt's message about the problem to the Senate said: "Standard Oil profits *immensely* [emphasis added] by . . . rates . . . arranged to give it an *overwhelming* [emphasis added] advantage over its independent competitors." 40 Cong. Rec. 6358 (May 4, 1906).

[206] We draw once more on Learned Hand's wisdom. He said that regulatory statutes "should be construed, not as theorems of Euclid, but with some imagination of the purposes which lie behind them . . ." *Lehigh Valley Coal Co. v. Yensavage,* 218 F.2d 547, 553 (2d Cir. 1914).

[207] We note in this regard that the Congress of 1906 was legislating in a regulatory vacuum. No coherent body of ratemaking theory was available for that Congress to adopt. The Congresses of the 1930's that addressed themselves to electric power and to natural gas were working in a wholly different climate. The background of theory and controversy about rates and ratemaking against which they legislated was rich and detailed. *See* n. 185, *supra.*

[208] Then, as now, those who favored drastic action insisted that regulation was bound to be futile unless the pipelines were severed from other phases of the oil business and turned over to genuinely independent transportation companies.

The climate of 1906 was favorable to their cause. For a time, it looked as though they would succeed. But they failed in the end. Congress decided against divestiture. *See* JOHNSON 27-29; KENNEDY STAFF REPORT 99-102. This suggests that nothing really radical was envisaged and that there was no legislative consensus for anything stronger than a mild dose of regulatory constraint. True, Rockefeller was detested by the populace. Nevertheless, the Standard Oil Company was not wholly without influence. It had its friends on Capitol Hill. In its final form the statute reflects this balance of forces in the legislative halls.

Standard was looking out for its interests. And no doubt it had ways of doing so that were not altogether ineffective. But other forces were also at work. Those stemmed from the ambivalence of Standard's independent adversaries. They wanted "something" done about the pipelines. But not all of them wanted that something to be drastic. Some independents were afraid that the pipelines would be unviable if severed from Standard and that they, the independents, would be left without a dependable means of transportation. Their voices were heard. And that had a bearing on the outcome. See the sources cited earlier in this footnote.

The divestiture controversy has remained lively. Bills to divorce the pipelines from their oil company parents were introduced at every session of Congress from 1931 to 1945. WOLBERT I at 4, n.4. None passed. That seems to us of some significance. Our reading of the relevant history suggests that an important factor that made Congress reluctant to decree mandatory divestiture even at the height of Progressivism and even at the zenith of the New Deal was its awareness of the fact that the independents prefer a high-cost pipeline that is really taking them over the hurdles to no pipeline at all. In 1906 many independents were afraid that divestiture would mean no pipelines or at least fewer pipelines.

Three-quarters of a century later that fear is still there. Moreover, the Independent Petroleum Association of America tells us that its producer-members also fear hard-nosed, tunnel-visioned regulation that would reduce both the remunerativeness of the pipelines and the major integrated companies' incentive to build them. That fear may be ill-founded. It may be exaggerated. It may be stimulated in large measure by the majors themselves. After all, they have much to gain from it. But both the historical record and the record made before us in this very case show that the fear exists. Moreover, the historical record shows that this fear has influenced the course of legislation. Hence we are not free to disregard it.

The fact that a significant number of independents are not now and never have been in complete accord with their self-appointed friends, the all-out oil pipeline regulatory hawks, is an important strand of the fabric with which we have to deal. That would be so even if we thought the fear in question ludicrous. As it happens, however, we do not think it ludicrous. We proceed on the premise that the independents in the oil business know their own interests far better than we do and that their attitudes toward radical regulatory proposals that purport to rescue them from their oppressors are rational.

[209] The carriers insist with great heat that they have a vested right to lenient regulatory treatment. But they do not ground that claim on the Hepburn Act. They rely on legislative actions subsequent to 1906.

The argument has two prongs. The first involves an obscure Progressive-era statute remembered only by specialists in transportation history, by students of the career of its distinguished sponsor, Senator Robert M. ("Fighting Bob") La Follette, Sr., by the West Publishing Company's editorial staff, and by lawyers who represent oil pipeline companies. This is the Valuation Act of 1913 (37 Stat. 701), now codified in Section 19a of the Interstate Commerce Act. It directs us to collect and publish information about the value of the carriers' properties. The original cost of those properties is one of the things that we are supposed to look at. But we are also required to examine other kinds of "value." The statute refers to "the cost of reproduction new." It also speaks of "the cost of reproduction less depreciation." Finally, there is a vague catch-all reference to "other values and elements of value." The carriers maintain that this mandates the application of traditional fair value concepts to this field.

The argument is flawed. To begin with, the Court of Appeals has rejected it. *Farmers Union Central Exchange v. Federal Energy Regulatory Commission*, 584 F.2d 408, 413-422 (1978) (hereinafter cited as *"FARMERS"*). All future citations to and quotations from *FARMERS* are referenced to the page numbers in 584 F.2d without repetition of the number of that volume.

That happened in this very case. Moreover, the Supreme Court denied Williams' petition for certiorari. *Williams Pipe Line Co. v. Federal Energy Regulatory Commission*, 439 U.S. 995 (1978). That is the end of the matter. For us, it is "the law of the case" that the Valuation Act is wholly devoid of the significance that the carriers attribute to it. No more *need* be said. Nevertheless, we think it appropriate to note that we find it hard to see how the Valuation Act could possibly have done the industry much practical good, even if the Court of Appeals had been willing to read that statute as the industry reads it. *See* n. 306, *infra*.

The second prong to the industry's legal argument revolves in essence around the inaction of Congress. The legislators have known for a long time that the Interstate Commerce Commission was regulating oil pipelines in a manner so relaxed as to be altogether without parallel in the world of regulation. Yet they never amended the statute. They never directed the ICC to show more vigor. Ergo, the classical ICC methodology must be "the law."

This argument has more to it than the first one does. Indeed, we attach considerable weight to it. But we do so as a matter of statesmanship, not as a matter of law. *See* pp. 84-87, *supra*.

The industry goes much further than that. It claims that passing references to oil pipelines in certain committee reports and floor colloquies during the 1970's (all of them digressions because the central topic being examined in each instance had nothing to do with pipelines) make a mysterious body of uncodified statutory law about the subject.

These "secret statutes" are said to read as though they had been drafted by the industry's lawyers. We do not see how that can be so. The Constitution prescribes the way in which laws are to be made. Its text gives no sanction to the idea that a 1906 statute can be amended or "clarified" by casual remarks seven decades later in committee reports about other statutes dealing with other matters. Accordingly, we find the industry's reliance on the legislative histories of the Railroad Revitalization and Regulatory Reform Act of 1976 and the Department of Energy Organization Act of 1977 misplaced. Far stronger contentions of that type were rejected by a unanimous Court in *Securities and Exchange Commission v. Sloan*, 436 U.S. 103 (1978). The justices said there that they were "extremely hesitant to presume general congressional awareness . . . based only on a few isolated statements in the thousands of pages of legislative documents." Their next sentence observed "[t]hat language in a Committee Report, without additional indication of more widespread congressional awareness, is simply not sufficient . . . " 436 U.S. at 121. True it is that the construction of the statute said to have been embraced by subsequent Congresses in *Sloan* was "at odds with the language of the section in question and the pattern of the statute taken as a whole." 436 U.S. at 121. That is not so in this case. But what is true in this case is that the propriety of the very methodology that Congress is said to have approved, ratified, and silently enacted or re-enacted into law was being hotly litigated before the Interstate Commerce Commission and before the Court of Appeals for the District of Columbia Circuit. That was happening in this case. And it was happening at the very time that Congress is supposed to have embraced the ICC's corpus of oil pipeline common law.

Thus the argument is that the relatively recent Congresses of 1976 and 1977 told us and also told reviewing courts how to decide the essential issues that this case presents about the construction of a 1906 statute. Of course, Congress can do such things. But it almost never does. No showing has been made that it followed that extremely unconventional course in this instance. Nothing that we have seen persuades us that the Congresses that passed the Railroad Revitalization and Department of Energy Organization Acts can be presumed to have realized that they were also voting at that time on the substance of oil pipeline rate regulation and that they were voting in favor of the carriers' views.

210 That is a possibility. But there is also another possibility. Astute lawyers on both sides may have decided to steer clear of 1906. Tactical motivations for that are not lacking. From the industry's perspective the oily controversies at the turn of the century are sordid and embarrassing. The less said about them the better. The industry also argues for the best of all worlds—a valuation rate base *plus* rates of return calculated under contemporary regulatory standards. Since contemporary standards are far different from those of 1906, let alone the 1940's when the ICC fashioned its peculiar rate of return methodology, the industry is precluded by consistency from looking too hard at what the Congress of 1906 intended. The industry's critics are in about the same shape. We know of no turn of the century support for their public utility conceptions, which would, we think, probably have sounded extreme and a bit peculiar to the Congress of 1906. And we doubt that they know of any such support. If they did, why wouldn't they tell us about it? Since such support appears to be absent, the critics have an obvious incentive to ignore 1906 and to talk instead of the many post-New Deal authorities about electric power, about gas, and about telephones that tell us nothing at all about what the Congress of 1906 had in mind about this subject but that support their ideas about what ought to be done with oil pipelines in 1982.

That is legitimate advocacy. We do not censure it. But we are certainly not limited by it, either. When questions of law and policy are involved, the strategic judgments made by the advocates do not confine the disinterested tribunal's range of inquiry. Suppose, for example, that counsel on both sides present a nice constitutional point without reference to the debates at the Constitutional Convention, because neither side finds sufficient succor for its position in those debates. Does it follow that the judges are precluded from looking at what the Framers had to say about their own handiwork? The question answers itself.

[211] *Cf.* Brest, *The Misconceived Quest for the Original Understanding*, 60 B.U. L. Rev. 204, 238 (1980): "To put it bluntly, one can better protect fundamental values and the integrity of democratic process by protecting them than by guessing how other people meant to govern a different society a hundred or more years ago."

[212] *Brown v. Board of Education*, 347 U.S. 483, 492 (1954). However, that observation was preceded by a careful study of what had happened in 1868. Indeed, the Court's interest in "the understanding of the framers of the [Fourteenth] Amendment" was so great that it put a series of pointed historical questions to counsel and also ordered a reargument at which those questions were ventilated. *Gebhart v. Beolton*, 345 U.S. 972 (1953). Of that reargument the *Brown* opinion said: "Reargument was largely devoted to the circumstances surrounding the adoption of the Fourteenth Amendment in 1868 ... This discussion and our own investigation convinces us that, although these sources cast some light, it is not enough to resolve the problem with which we are faced. At best, they are inconclusive ... What ... Congress and the state legislatures had in mind cannot be determined with any degree of certainty." 347 U.S. at 489.

Thus the Supreme Court's problem in *Brown* had something in common with our problem in this case.

[213] The Constitution is hard to change. The Act is easy to change. Congress has changed it many, many times. *When it came to oil pipelines, however, Congress never chose to make any change of substance*. Indeed, it has shown itself loath to tinker in even the slightest degree with the words that its predecessors of 1906 wrote about oil pipelines. Thus when the Congress of 1978 recodified the Interstate Commerce Act (92 Stat. 1337) it expressly excluded "those laws ... related to the transportation of oil by pipeline" from the scope of the recodification. 92 Stat. 1470. As a law professor who recently became a judge observes, "if courts misinterpret a statute, the legislature can nullify their misinterpretation rather easily through an amending statute ... Courts have much more leeway in interpreting the Constitution, not only because the Constitution is so costly to amend, but also because its antiquity makes it unlikely that the same political forces that procured its amendment are still around to nullify departures from it." Posner, *Economics, Politics, and the Reading of Statutes and the Constitution*, 49 U. of Chi. L. Rev. 263, 291 (1982).

[214] The inaction may indeed be much more significant than the action.

[215] That many of these seem of doubtful wisdom today when the notion that every form of "transportation" must be tightly regulated is no longer deemed axiomatic and when there is less faith in the regulators' unerring wisdom than there used to be is beside the point. That is so because we are inquiring into the intellectual climate of an earlier day when economic regulation was in fashion.

[216] These developments are reviewed in 1 SHARFMAN at 86-292.

[217] Control over abandonment is an important subject. It deserves some comment. To begin with, it is fairly obvious that a regulatory scheme that permits the regulatees to abandon service whenever they find the regulators' decisions about prices unpalatable isn't worth very much. That kind of regulation gives the regulatees a veto power over the actions of the regulators. It is as full of holes as a Swiss cheese and is arguably tantamount to no regulation at all. *South Carolina Generating Co.*, 16 FPC 52, 58 (1956). *See also* the report of that same case in 16 FPC 1365 *(rehearing denied)*. With respect to this phase of the matter, the Federal Power Commission's decision was affirmed by the Court of Appeals for the Fourth Circuit in *South Carolina Generating Co. v. Federal Power Commission*, 249 F.2d 755, 762 (1957), *cert. denied*, 356 U.S. 912 (1958).

Because control over abandonments is so central a cornerstone of effective regulation (see 1 Priest, *Principles of Public Utility Regulation 380-403* [1969]), we are loath to confess that we lack it here. Yet it seems clear that we do lack it. That the statute contains no express restraints on the carriers' freedom to abandon is not necessarily controlling. A look at the Federal Power Act shows that this is so. That statute does not use the words "abandonment," "termination," "cessation," or "halt." Nevertheless, wholesale electric service that falls within the Federal Power Act's ambit cannot be halted without our consent. *Pennsylvania Water & Power Co. v. Federal Power Commission*, 343 U.S. 414 (1952).

We are strongly tempted to hold the reasoning of that case as applicable to oil pipelines as it is to wholesale electric power. Such a holding would, of course, give us the control over pipeline abandonments that we think essential to meaningful regulation. However, formidable obstacles stand in the way.

To begin with, the Interstate Commerce Commission never claimed that power. Now that agency may not have done a great deal in the concrete with its regulatory powers over oil pipelines. But it was seldom bashful about asserting those powers in the abstract. Yet it never claimed regulatory jurisdiction over pipeline abandonments. Nor did any of the vociferous critics of the Interstate Commerce Commission's oil pipeline performance censure the agency for its laissez-faire tack on abandonments.

We conclude that the ICC was right. We find that the Power Act analogy suggested earlier in this footnote fails.

Unlike the Power Act, the Interstate Commerce Act confers *express* regulatory control over abandonments. But that control added to the statute by the Transportation Act of 1920 (see 1 SHARFMAN 239-240, 283) applies only to "carriers by railroad." 49 U.S.C. § 1(18), now § 10903 of the recodified 49 U.S.C. We can conceive of no tenable basis on which Congress could be deemed to have created two kinds of control over abandonments, an explicit control over "carriers by railroad" and an implicit control that came to the same thing over carriers by pipe.

We should add that our study of this point leads us to believe that "through routes" and "joint routes" are on a special footing and that our approval is essential before service on any such route can be discontinued. *See* 49 U.S.C. § § 1(4), 3(4), and 15(3).

218 An argument to the contrary can be made. It usually can. Here one can reason that the fact the powers conferred on the Interstate Commerce Commission after 1906 were not extended to oil pipelines tells us only that such powers were deemed unnecessary in this industry. The argument would, we suppose, run something like this:

(1) *ABANDONMENTS* - Why bother to regulate oil pipeline abandonments? The carriers are their own most important customers. So it is altogether unlikely that they would abandon service to *themselves* without good and sufficient reason for so doing.

(2) *QUALITY OF SERVICE* - What has just been said of abandonments is also true here. Why would the Standard Oil Company have wanted to serve itself inadequately? It may, of course, have had a motive for serving *independents* inadequately. But the prohibition of discrimination would, if enforced, have been an effective check on that. Nothing more was needed.

(3) *SECURITY ISSUES* - These were regulated to protect investors and to shield both the investor and the consumer from the baneful effects of the torrents of watered stock and the sweetheart deals between investment bankers and issuers that marred the financial history of the railroads and of the utilities in the bad, old pre-S.E.C. days. But oil pipelining was free from these evils. For one thing, there weren't many oil pipeline investors. Then, as now, the public invested in integrated oil companies, not in oil pipeline enterprises. Secondly, neither the old Standard Oil Company nor the host of subsidiaries theoretically released from its control by the decision in *United States v. Standard Oil Company*, 221 U.S. 1 (1911), was guilty of mistreating investors. John D. Rockefeller may have been a "robber baron." If so, he "robbed" his competitors and his customers. His investors he treated well. Rockefeller was not a Jay Gould, a Daniel Drew, or a Samuel Insull. He had begun life as a bookkeeper. And he remained a good bookkeeper to the end. He may indeed have been history's greatest and most gifted bookkeeper. Investors who put their trust in him had no cause for regret. So why regulate something that was working so splendidly?

(4) *STATUTORY INSULATION FROM COMPETITION* - Here again there was no need for controls. In fact, the business was a monopoly. And everybody knew it. The Standard Oil Company never maintained that its oil pipeline operations faced much competition. To superimpose a legal monopoly on a pre-existing actual monopoly would have been pointless and silly. This line of argument has something to it. But there is also much that cuts against it. True it is that there is little danger that an integrated oil company will mistreat itself. But Congress obviously wasn't worrying about that. It was worrying about the integrated companies' power to mistreat the independents. That power could be exercised by abandoning service on routes crucial to a group of independents but relatively unimportant to the shipper-owners and by refusing to extend lines to sites more significant to the independents than to their major, integrated rivals. It could also be exercised by routing a new line in a way that favored its integrated owner and that disfavored that integrated owner's independent competitors. It is hard to see how anyone could have considered such conduct unnatural or unlikely. Yet Congress never did anything to curb it. We do not deem ourselves free to shrug that failure off as inadvertent or inconsequential.

219 That was *FARMERS*. There have been other cases. But all of them turned solely on jurisdictional points.

220 *FARMERS* at 413. (Emphasis added.)

221 Certainty is elusive in those matters.

222 What precedents would we parse? The only case in point is *Farmers*. It raises provocative questions. But it does not answer time.

223 The legal literature that we think in point tells us not to look at legal literature. The citation that we have in mind is Holmes, *The Path of the Law*, 10 Harv. L. Rev. 457, 469 (1897), where we are advised that history "is a part of the rational study [of law], because it is the first step toward an enlightened skepticism, that is, toward a deliberate reconsideration of the worth of . . . rules? and the future Justice Holmes goes on to say: "For the rational study of the law the blackletter man may be the man of the present, but the man of the future is the man of statistics and the master of economics." Those words were written 85 years ago. It is high time to put them into practice. And we can think of no better occasion on which to do so than this one.

224 Our predecessors seem to have taken the same view. In an interlocutory order occasioned by a squabble about the precise scope of the inquiry to be made in the instant case they said: "What are the numbers? That is what we want to know." The quotation is from footnote 5 to the Commission's order herein of August 6, 1979 [8 FERC ¶ 61,139], which referred a motion to exclude certain issues from the scope of these proceedings to the administrative law judge.

225 For reasons that we are about to explain, the very large amounts collected by the Trans Alaska Pipeline System have been excluded. As we have said several times, the Alaskan situation may be special. Were Alaskan pipeline revenues to be included in the calculation, the 61 cents per barrel stated in the text would become $1.11 per barrel.

226 *See* pp. 188-89, *infra*.

227 The relevant calculations are explained in the Appendix. For reasons there stated we think our estimate conservative. That is why we say "at least $240 billion."

228 *See* pp. 188-89, *infra*.

229 The heated controversy about the propriety of the system's rates stems in the main from the fact

that the royalties and the severance taxes due the State of Alaska are computed on the value of the oil at the wellhead. That wellhead value is the world market price minus the cost of transportation. So the higher the pipeline charge, the lower the State's oil revenues. Hence Alaska wants the pipeline charge to be as low as possible. Conversely, the shipper-owners have an obvious self-interest in paying themselves as much for pipeline transit as they can possibly get away with. Every time they shift a dollar from one pocket to the other in order to pay themselves for shipping their own oil over their own pipeline they save 27.5 cents in royalties and severance taxes that would otherwise fall into Alaska's coffers.

The United States also has an interest. Its interest is dual. The United States wears two hats in the Alaskan affair. One of those hats is that of a landed proprietor. The United States owns Alaskan lands capable or believed to be capable of producing commercial quantities of oil. The revenue stream that the Federal Treasury can expect to derive from those properties is affected by the level of pipeline rates. So State and Nation have a common interest in doing all that they can to keep Trans Alaska's rates down. The United States's second interest stems from the antitrust laws and from the national policy in favor of competition. The theory here is that:

(1) Though high pipeline rates that they pay to themselves do not deter the shipper-owners from looking for Alaskan oil, they do discourage non-owners from embarking on expensive Alaskan adventures.

(2) Excessive rates on TAPS therefore run afoul of the fundamental national public policy in favor of competition and of the dispersion of economic power by concentrating Alaskan production in the hands of the group of major companies that owns the pipeline.

230 In due course we shall have to decide whether it does.

231 *See* n. 4, *supra*.

232 *See Trans Alaska Pipeline System*, 20 FERC ¶ 61,044 (July 12, 1982).

233 As noted earlier and as every attentive newspaper reader knows, there is a great debate about exactly how competitive the oil business is. We need not enter that debate. Nor do we propose to do so. Nevertheless, we think it appropriate to note that the industry's most ardent economist-defenders do not assert that it is perfectly and purely competitive. Nor, so far as we have been able to ascertain, do the industry and its friends assert that it is one in which selling prices are always precisely attuned to the cost of production.

234 Magnitudes are relevant here. A fall in the cost of crude is almost certain to be passed along, because that cost bulks so large in total cost. A fall in the cost of paper clips or in safe deposit box rentals, on the other hand, would almost certainly be drowned out by other factors. Pipeline transit would appear to fall somewhere between these two extremes. Just where we don't know.

235 *See* pp. 108-110, *supra*.

236 The assumption about expense is based on what we know about litigation costs and on the fact that Kerr-McGee does not normally litigate *in forma pauperis*.

237 That Kerr-McGee's managers are such zealous consumerists seems just a wee bit unlikely. We note in this connection that the consumerists themselves appear oblivious to Kerr-McGee's affection for their cause. Thus, for example, all of the many references to Kerr-McGee in Professor Robert Engler's *The Politics of Oil* (1961) are critical. And some of those references are scorching. We, of course, express no opinion as to the correctness of Engler's criticisms. That is not our sphere.

But we do think it appropriate to note that the oil pipeline rate alliances between some of those who purport to speak for the consumer and certain independents in the oil industry are strange, strained, limited, transitory, and uneasy. The two factions may at times join hands and voices in denouncing the pipeline owners' outrageous tyranny. On other matters, however, they seldom see eye to eye. When it comes to the price of natural gas, to controls on oil prices, and to the tax treatment of oil and gas, the two groups are in different camps. Indeed, they have been known to turn on each other furiously. Since those other subjects have for the past 40 years been of appreciably greater moment for the oil industry, for its critics, and for society in general than oil pipeline rates, the oil pipeline rate reform alliance has been a feeble and a tepid affair since the end of the Second World War.

On Capitol Hill it has won a few friendly legislative reports (the KENNEDY STAFF REPORT is one and the so-called Celler Report *[Report of the House Committee on the Judiciary on the Consent Decree Program of the Department of Justice*, 85th Cong., 1st Sess. (1959)]) is another. But that is all it has won. The oil pipeline rate reform hawks have had to content themselves with legislative documents that never led to legislation. These documents make pleasant reading for those who agree with what they say. But save for the salaries collected by the Congressional staff members who wrote them and for the remuneration received by the people who replied to them on the industry's behalf, they have yet to put a nickel into anybody's pocket.

Now this does not mean that *nobody* cares about these rates anymore. The carriers obviously care. They are quite passionate on the subject. That is why their defense of the status quo (or of their version of the status quo, a version that differs substantially from ours) is so ardent. It is also why they are now beseeching Congress to deregulate.

Some of the carriers' adversaries also care. But they do not care *that* much. Other matters are more important to them. And since they disagree heatedly with each other about those other matters, they have never been able to mount a really formidable legislative effort to alter (or as some of them would have it to update) the Great Oil Pipeline Compromise of 1906. The oil pipeline rate coalitions that the carriers' adversaries have formed from time to time have been coalitions without consensus. Up to now, at least, these teams of strange bedfellows have not been notable for political effectiveness.

[238] The agricultural cooperatives allied with Kerr-McGee in this case are consumer-owned. Hence we think it fair to assume that they do speak for the consumer. Now those cooperatives are very substantial entities. Their assets run to the hundreds of millions. We are not talking about a handful of weavers banding together to run a small store in Rochdale, England. But oil is a very big business. And on an overall, industry-wide basis, cooperatives do not bulk large in the oil business. Were rural cooperatives as much of a force in oil as they and their municipally owned cousins are in electric power and were the cost of pipeline transit to figure as prominently in the cost of gasoline and home heating oil as the cost of purchased power does in the electric bills of people served by utilities that buy all or most of their energy from others pursuant to arrangements subject to the Federal Power Act, an altogether different situation would be presented. Our view of the instant case would also be different.

[239] We do not suggest that it should have been. Kerr-McGee is a business enterprise. It is not the Consumer Federation of America.

[240] Once again we note that what we say here may be inapplicable to the Trans Alaska System. We do not say that it *is* inapplicable. We say only that:

(A) It *may* be inapplicable;

(B) An inquiry will have to be made in order to determine whether it is applicable or inapplicable; and

(C) A further inquiry will be needed to see whether the difference between the Alaskan pipeline and the pipelines in the lower 48 is a difference that makes a difference.

[241] Sounds absurd. *But see United States v. United Shoe Machinery Corp.*, 247 U.S. 32 (1918); 258 U.S. 451 (1922); 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam* 347 U.S. 521 (1954); 266 F. Supp. 328 (D. Mass. 1967), *rev'd.*, 391 U.S. 244 (1968). Moreover, we may be dealing here with something of that sort. Suppose that some Victorian tycoon had begun by acquiring a stranglehold on the shoelace trade and had then made astute tactical use of that to acquire a preponderant position in shoes. This could well have led to an outcry from the independents in the shoe business. It could also have led to widespread popular concern about a "shoe trust" and about the strategic importance of laces. In such circumstances Congress might have perceived a problem and might have experimented with a regulatory "solution."

[242] In Christopher Columbus' time spice prices were a burning issue. In the intervening five centuries their importance had dwindled.

[243] But much of the spice that we use comes from abroad. So it is not altogether clear how the regulatory scheme would work or how much real effect it would have even on the price of spice, let alone the cost of food.

[244] This is, of course, a variant of our earlier hypothetical case about shoelaces. True, no one has ever contended that the apparel trade is monopolistic. Far from it. Garment production is generally regarded as the most competitive type of manufacturing, as *the* competitive industry par excellence. Suppose, however, that through patents or otherwise some of the larger apparel manufacturers acquired a firm grip on the button trade. Their smaller competitors would then probably consider themselves the victims of a "squeeze." And the odds are that they would be right. Sympathy for the "squeezees" might lead Congress to try to do something for them. That something could easily take a regulatory form. But it would not follow from all this that button prices were of anything like as much moment to people who merely wore clothes as they were to people who made clothes. Our supposititious case about buttons turns on the misuse of a patent. Such things happen. Analytically, conduct of that sort has much in common with the "squeeze plays" said to have been practiced by the oil pipeline industry for the past century. Hence we think it significant that when wrongdoing patentees are ordered to issue patent licenses and to grant licensees options to buy on reasonable terms, it is not public utility reasonableness that supplies the applicable standard, but something much looser and far more permissive. *See, e.g., Besser Manufacturing Co. v. United States*, 343 U.S. 444 (1952).

[245] Many of them are businessmen.

[246] They might serve valuable ritual functions. They might remind the populace of historical points that it should bear in mind. But it is hard to see how they could do anything of substance for pragmatically minded, materialistic *consumers*. They might, of course, do quite a bit for pragmatically minded, materialistic *lawyers*. That, however, is another matter. On second thought, however, it may well be that some matter. Over the long run the burden of those handsome legal bills would probably fall on the consumer. So would the Government's out of pocket regulatory costs.

[247] That proceeding was initiated by the Interstate Commerce Commission back in 1974. At the ICC it was called *Ex Parte 308*. When it came here on October 1, 1977, it was renamed RM78-2. The carriers found it of great interest. So did the Antitrust Division. But, apart from the complaining shippers in this case and the State of Alaska, nobody else did. The small and select circle of oil pipeline rate fans spent a great deal of time on that rulemaking. Its members spilled rivers of ink on the mysteries there investigated. But nary a word was ever heard from anyone who claimed to be a consumer or a consumer advocate.

[248] For a history of the bizarre rulemaking proceedings and for an account of the factors that led the Commission to terminate them on January 9, 1980, *see Association of Oil Pipelines*, 10 FERC ¶ 61,023.

[249] Might there not be something to both hypotheses?

[250] *See* pp. 112-18, *supra*.

[251] However, we have not heretofore presented the statistical support for our views. Previously we asked the reader to accept those views on faith. We no longer do so. We now offer evidence that we think "substantial."

[252] True, propositions are not proved by repetition. But, as Holmes once observed, there are times when it is more important to keep the obvious well in mind than it is to elucidate the obscure.

[253] *See* pp. 1-15, *supra*.

[254] *See* p. 12, *supra.*

[255] *See* pp. 63-67, *supra.*

[256] That axiom binds us in the way that Euclid's axiom about parallel lines never meeting binds a high school class in plane geometry.

[257] *See* n.17, *supra.*

[258] No independent pipeline owner would have any motive for that.

[259] *See* the 1978 University of Oklahoma doctoral dissertation by Johnnie K. Piercey, *The Pipeline Segment of the Domestic Petroleum Industry: Structure and Conduct 19-26* (1978), hereinafter cited as "PIERCEY."

Writing in 1931 Professor Sharfman who was not prone to deprecate either the extent or the significance of the ICC's work, brushed the pipelines off with a cursory "The Commission's powers over pipe lines ... have remained in most respects unexercised." 2 SHARFMAN at 96. A few pages later (at 99-100) Sharfman said: "Significant data [about pipelines] have ... been made available, but no regulatory action has followed."

[260] Numbers for 1906, when pressure from the independent producers led to the enactment of the statute, were roughly the same as for 1931.

[261] These questions reflect the views of the industry's critics. However, those views may have been more conspiratorial than the evidence warrants. Professor Johnson thinks that high pipeline rates were traditional in the industry, that management followed tradition, and that this was not necessarily sinister. JOHNSON at *278*.

[262] Two extracts from Professor Johnson's history capture the spirit of the times. One reads: "In March 1933 the domestic petroleum industry was overwhelmed with crude oil. Prices had dropped steadily since the preceding fall; flush production continued despite state efforts to curb it." JOHNSON at *222*. The other observes that "Distress in the oil industry as a result of overproduction and federal investigations of pipelines in connection with proposed remedial legislation bore a high correlation with each other ... [N]ew interest was displayed at the national political level where the benevolence of the 1920's toward business was being replaced by growing hostility." *Id.* at *217*.

[263] In East Texas oil sold for as little as 10¢ a barrel. Independents attributed that level to manipulation by the majors, who were said to be "seeking to wipe out independents in East Texas." R. Engler, *The Politics of Oil* (1961), at page 135 of the 1976 paperback edition.

[264] However, that interest was not nearly so intense as it had been at the turn of the century. Franklin Roosevelt's America was far different from that of his namesake. And history seldom repeats itself precisely. In 1906 the agitation against the Standard Oil Company attracted lots of interest from people who were not in the oil business. In 1933 most Americans had other more pressing things to worry about. To people who were not directly involved with oil, collapsing banks and disappearing jobs seemed more important than recondite debates about who should and who shouldn't own the pipelines. *Cf.* JOHNSON at *222*: "Events were moving fast in Washington during the spring of 1933, and the question of pipeline divorcement was a minor matter compared to the banking, agricultural, relief, and other emergency measures that concerned the administration."

[265] Section 9(b) of the National Industrial Recovery Act of 1933, 48 Stat. 200, invalidated by *Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935), the so-called "sick chicken case."

No action was ever taken pursuant to this grant of authority.

[266] "The integrated oil industry was stunned by the ease with which opponents of integration had found support in the White House. The immediate industry tactic ... was to point out that pipelines were already regulated by the ICC ... " JOHNSON at *223*.

[267] JOHNSON at *229*.

[268] *See* JOHNSON at *236-304*.

[269] The industry had two answers to its critics. One was that "rates had been high but were being reduced." The other was that "in the absence of outside business, [rates] were of little significance in any event." To make its first answer plausible, the industry had to lower rates. It was on the defensive. And part of its defensive strategy was to "stress the fact that change was taking place which would correct any abuses of the past [and to] emphasize the fact that public policy had already provided a regulatory agency for pipelines." The quotations are from page *278* of JOHNSON.

[270] Though rates fell, earnings did not. Earnings were remarkably stable. That was true both of the dollar amounts earned and of the rates of return on net investment. *See* L. Cookenboo, Jr., *Crude Oil Pipelines and Competition in the Oil Industry, 97-102.*

[271] *See* Engler, *op. cit. supra* at 136-143.

[272] For reasons previously explained *(see* pp. 166-68, *supra*), we exclude TAPS.

[273] This change began to manifest itself after the close of the Second World War. In part V of his book entitled *"The Transformation of Pipelining, 1946-1959,"* Professor Johnson says: "[T]he large-diameter lines required full loads to realize their maximum operating efficiency and this fact encouraged new interest in common-carrier business ... In the new era outside business was welcomed ... [T]here was a downward trend in rates stimulated by competitive building of large-diameter systems." JOHNSON at 387.

[274] When the industry's critics speak of "oligopolies" and "shared monopolies" in oil, this is what they are saying. As noted earlier, one of the best-known and sharpest critiques of the industry is entitled *The Brotherhood of Oil.* But even in ferociously competitive businesses the competitors engage in concerted activity to advance common interests. For example, restauranteurs vie with each other for the expense account trade. But they unite to preserve the income tax deduction for the business lunch. Hence we draw no sinister inferences from the fact that save for KerrMcGee, the industry is maintaining an essentially united front on oil pipeline issues.

[275] This case can be viewed as an exception to that generalization. And in this case Kerr-McGee is not squabbling with a brother oil company. It is squabbling with an independent pipeline operator.

[276] For us, however, those rates are central. Rates and access are the only things that we have the power to influence.

[277] *See* the American Enterprise Institute's 1979 symposium on *Oil Pipelines and Public Policy* edited by Professor Edward J. Mitchell. *See also* WOLBERT II at 375-402.

[278] This is one of the many situations in the law in which relevance does not depend on truthfulness. *See* 6 Wigmore, *Evidence* § 1766 (Chadburn rev. 1976); McCormick, Handbook of the Law of Evidence § 249 (2d ed. revised by E. W. Cleary, *et al.*, 1972).

[279] A quarter of a century ago the Assistant Attorney General then in charge of the Antitrust Division told a legislative committee that "Throughout the entire history of oil and antitrust, the pipeline problem has run a continuous thread." Mr. Victor R. Hansen testifying in 1957 before the Antitrust Subcommittee of the House Judiciary Committee on the Consent Decree Program of the Department of Justice, Hearings before the Antitrust Subcommittee of the Committee of the Judiciary of the House of Representatives, 85th Cong., lst Sess. (1959) at 33.

[280] Undersizing costs the shipper-owner money. When their lines are overtaxed, they are not at liberty to devote them solely to their own purposes and to bar non-owners from them. Their common carrier obligations preclude that course. They must ration or pro-rate capacity equitably among shippers. This practice known in the trade as "prorationing" forces shipper-owners to send some of their own oil over other means of transportation that cost more than pipelines do.

[281] During the New Deal years, the ICC was more active. But that was a long time ago.

[282] That is none did after the 1940's. There were a few earlier cases.

[283] Both Commissioners and staff were mindful of the rebuke that the Court of Appeals for the Second Circuit administered to the Federal Power Commission in *Scenic Hudson Preservation Conference v. Federal Power Commission*, 354 F.2d 608, 620 (1965), *cert. denied*, 384 U.S. 941 (1966), where it said: "In this case, as in many others, the Commission has claimed to be the representative of the public interest. This role does not permit it to act as an umpire blandly calling balls and strikes for adversaries appearing before it; the right of the public must receive active and affirmative protection at the hands of the Commission."

[284] *Buckeye Pipe Line Company*, 13 FERC ¶ 61,267 (December 24, 1980), discussed and quoted from pp. 108-113, *supra*.

[285] It also seems to us that they read *Scenic Hudson Preservation*, from which we quoted two footnotes earlier, much too broadly. They forgot two things about *Scenic Hudson*. The first was that it impinged on the human environment. The hydroelectric project there involved was "to be located in an area of unique beauty and major historical significance. The highlands and gorge of the Hudson offer one of the finest pieces of river scenery in the world. The great German traveler Baedeker called it 'finer than the Rhine.'" 354 F.2d at 613. Accordingly, the court found "that the Commission must take these factors into consideration." That holding was based on the historical record, which shows that the Federal Water Power Act of 1920 (now Part I of the Federal Power Act) was a planner's statute, a conservationist's statute, encompassing "the conservation of natural resources, the maintenance of natural beauty, and the preservation of historic sites." *Id.* at 614. When the Commission licenses a project under that statute, it gives part of the nation's heritage to a private developer. To carry the concepts and the standards fashioned for that setting over to pipeline rates deemed oppressive by our staff but unobjected to by the shippers is to think words, not concepts. *Scenic Hudson* involved a statute that "seeks to protect non-economic as well as economic interests." *Id.* at 615. The Hepburn Act, on the other hand, deals solely with economic interests. Nothing in *Scenic Hudson* precludes the Commission from drawing distinctions between these two situations. Neither that case, nor any other case known to us, nor any sound principle of public administration with which we are familiar requires the Commission to convert itself into an assiduous guardian ad litem for shippers of oil who are unwilling to fight their own battles. The second thing that seems to have been forgotten about *Scenic Hudson* was that it did not involve the initiation of proceedings sua sponte. The people who thought that the project was going to ruin the Hudson were not sitting back passively. They were active. They had intervened. The Court of Appeals thought that the Commission had treated them cavalierly. The moral of that is that intervenors should be taken seriously, treated respectfully and given every fair opportunity to air their grievances. And that is exactly what we propose to do in our oil pipeline work. However, we do not propose to permit our staff to appoint itself counsel to every shipper of oil in the United States who would in its view complain about pipeline rates were he as knowledgeable and as public spirited as our staff is. It seems to us that the staff can easily find more constructive outlets for its energies.

[286] *Securities and Exchange Commission v. Ralston Purina Co.*, 346 U.S. 119, 125 (1953).

[287] *See* the favored treatment of independent producers with respect to the depletion allowance in the Tax Reform Act of 1975, 89 Stat. 47, I.R.C. § 613A and with respect to the windfall profits tax in the Crude Oil Windfall Profits Tax of 1980, 94 Stat. 235, I.R.C. § § 4986, *et seq.*

[288] 15 U.S.C. § 751, *et seq.*

[289] *See, e.g., Texaco Inc. v. Department of Energy*, 663 F. 2d 158 (8th Cir. 1980); *Lundy-Thagard Oil Company*, FERC Appeals Decisions (CCH) ¶ 46,035 (November 16, 1979); *Young Refining, Corp. Id.* ¶ 46,098 (March 21, 1980); and *Sabre Refining, Inc., Id.* ¶ 46,122 (November 10, 1980).

[290] We refer to oil pipeline *rate* cases. Cases involving allegedly discriminatory denials of access to the lines or other alleged breaches of the common carrier obligation are clearly on a different footing.

[291] There are many such dockets. So it is conceivable that a few of them present special circumstances that warrant special treatment. Our staff should bring situations of this type, if any there be, to our attention with appropriate recommendations. And it should do so with dispatch.

[292] During the past decade he has endured a great deal of pinching.

[293] The late Mr. Martin Dooley, Chicago's turn-of-the-century saloonkeeper philosopher, once observed that John D. Rockefeller had converted himself into a one-man "Society for the Prevention of Cruelty to Money." We gather that in the view of the oil industry's critics that Society, though no longer a one-man affair, is still alive and well. As for the industry's friends, do they maintain that it is allergic to money?

We are mindful of the prudence issues raised in the *Trans Alaska* proceeding. The owners of that facility are alleged to have been profligate in its construction. But those are mere allegations on which this Commission may in due course have to pass. Secondly, even if those allegations should be found true, *Trans Alaska* involves a most unusual situation. We know of no one who contends that oil pipeline construction in the Continental United States has been extravagant or that the oil companies' pipeline affiliates have failed to watch costs.

[294] That is even truer of the independent pipelines. They have little or no oil of their own to carry. Williams, Buckeye, Mapco, Kaneb, and the other independents sell transportation services to others. Should that business become unremunerative, they will leave it. Hence rigorous rate regulation would probably lead to the decline and eventually perhaps the demise of the oil pipeline industry's independent sector. That is scarcely the "reform" which the industry's critics favor.

[295] The formula is:

$$V = \left[\left[\left(\frac{R_1}{R_1 + O_1}\right)\left(R_1\right) + \left(\frac{O_1}{R_1 + O_1}\right)\left(O_1\right)\right]\left(\frac{R_2}{R_1}\right)\right](1.06) + \left\{L_1 + L_2 + W_1\right\}$$

Where:

V = single-sum value
R_1 = cost of reproduction new
R_2 = cost of reproduction new less depreciation
O_1 = original cost to date
L_1 = present value of lands
L_2 = present value of right of way
W_1 = working capital

[296] That slowing down is progressive. Eventually it becomes glacial. Compared to straight-line depreciation, the ICC's rate base depreciation methodology:

(A) Accelerates depreciation during the facility's earlier years;

(B) Decelerates it in later years; and

(C) Always leaves an undepreciated residue so long as the property remains unretired—if inflation has been substantial, that undepreciated residue may also be substantial.

[297] The precise numbers depend on the type of property involved. The 37% figure given in the text applies to pipe and fittings. Had another kind of asset been selected for illustrative purposes, the precise proportion remaining in the rate base would have been different. But the general principle is the same with respect to all kinds of depreciable property.

[298] At first blush it also seems important for large, multi-route pipeline networks whose capital equipment consists of a mixture of old plant, new plant, and middle-aged plant. However, it is impossible to generalize about that. Much depends on the particular system's age mixture. What is clear, however, is that from the ex ante perspective of one who builds a pipeline the ICC's rate base methodology means that the pipeline will be an income-producing asset down until the time of abandonment. Thus, if things go well, the line will continue to produce a substantial stream of income for its owner or owners long after its depreciated book value has fallen to a very low figure or even vanished altogether.

[299] The case is hypothetical. But it is not fanciful. Much of Williams' plant dates back to 1931, when a group of oil companies built the system that Williams bought in 1966.

[300] In practice an allowance for salvage value sometimes leaves a small residual rate base.

[301] The term "condition percent" sounds odd today. But it is a classical fair value term. There is (or at least there used to be) nothing in the least esoteric about it. *See, e.g., City of Cleveland v. Hope Natural Gas Company*, 3 FPC 150, 167-168 (1942), and the Supreme Court's comments on the point in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 596-597 (1944).

[302] Once again we draw from the numbers used for pipe and fittings. *See* n. 297, *supra*.

[303] In an inflation-free world our 50-year-old oil pipeline property with an original cost of $1 million and an estimated useful life of 40 years would have an ICC rate base value $160,000. But save for its first decade, the last half century has been an era of inflation. And the ICC's rate base methodology is inflation-sensitive. So the actual contribution of our 50-year old property to the rate base would be far in excess of $160,000.

[304] For example, neither the rationale for the going concern value allowance nor the reason for the 6% weight assigned to that factor has ever been explained. The methodology for calculating reproduction cost also seems a bit peculiar. Assume, for example, that a pipeline was built in 1960. Its reproduction cost would be calculated as follows:

(1) The actual 1960 expenditures would first be trended back to 1947. In other words, the initial inquiry would be, had this pipeline been built in 1947 instead of in 1960, what would the cost of construction have been in 1947 dollars?

(2) The 1947 base prices are then trended forward down to the present.

[305] Neither the industry nor the ICC used the term "fair value." They seem to have wished to avoid the stigma that had attached itself to that concept. Hence they preferred to speak of "valuation."

[306] The industry disagrees. As noted earlier it insists that valuation is required by the Valuation Act of 1913. *See* n. 209, *supra*. But the Court of Appeals rejected that idea. And even if it had not done so, nothing in the Valuation Act requires that the elements of "value" referred to therein be blended into a single sum by means of a formula. There is certainly no statutory basis for the particular formula employed. Nor do we know of any legal mandate in the Valuation Act or elsewhere for the mismatch between cost of service depreciation and rate base depreciation.

[307] So said a prominent teacher of public utility law. His name was Felix Frankfurter. F. Frankfurter and H. M. Hart, *Rate Regulation*, 13 Encyclopedia of the Social Sciences 104-112 (1934), reprinted by Professor Paul W. MacAvoy in his *The Crisis of the Regulatory Commissions* (1970) with the comment that "[t]he essay remains as basic now, as when published." The quoted language is at page 11 of the MacAvoy reprint.

[308] The Supreme Court retreated from this as early as 1933. In a case decided in that year it held that "when rates themselves are in dispute, earnings produced by rates do not afford a standard for decision." *Los Angeles Gas & Electric Corp. v. R. R. Commission of California*, 289 U.S. 287, 305 (1933). Eleven years later the Court made the same point in the famous *Hope* case where it said that "The heart of the matter is that rates cannot be made to depend upon 'fair value' when the value of the going enterprise depends on earnings under whatever rates may be anticipated." *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 601 (1944).

[309] In *Smyth v. Ames*, 169 U.S. 466 (1898), which held, among other things, that "the amount or market value of . . . bonds and stocks" was pertinent to the rate base question, a classical bit of circular reasoning.

[310] *See* p. 98, *supra*.

[311] The practice stems from "the . . . disasters of the 1920's, when many accountants had been tarnished by the scandals of unjustified write-ups." H. Kripke, *The SEC and Corporate Disclosure: Regulation In Search of a Purpose 182* (1979). Chapter 17 of Professor Kripke's book entitled *"How Original Cost Came to American Accounting"* summarizes the relevant intellectual history and also highlights the bearing that utility malpractices had on that history.

[312] It has been vastly overdone in this case and in related proceedings.

[313] Kripke, *op. cit. supra* at 184. (Emphasis added.)

[314] Those rates may prove aberrational and short-lived. We realize that. Nevertheless, they make an important regulatory point. So does Wall Street's current affection for bonds.

[315] Many of them are said to be doing that at the moment.

[316] Does the SEC's failure to insist on that caveat at the outset of those prospectuses show that it has been remiss in this area?

[317] Were we to agree with the industry's contentions about the inherent deficiencies of the original cost method, we should have to concede that our treatment of investors under the Power and Gas Acts is fundamentally and inherently unfair. We are not inclined to make that concession.

[318] *See also* n. 331, *infra*, on the Securities and Exchange Commission's interpretation of "reasonableness."

[319] This standard is an inadequate guide to regulatory decisionmaking. As Professor Bonbright says: "The price at which the service may be sold is the very point at issue in a rate case." BONBRIGHT at 86. In footnote 8 on that page Professor Bonbright quotes the following from 3B SHARFMAN at 321-322: "The 'value of service' principle, as a basis for ratemaking, provides at best a vague and indeterminate formula, rather easily construed as justifying any system of rates found expedient by the carrier. Taking the words in their most obvious sense, no rate can exceed the value of the service and still be paid by the shipper." Nevertheless, Bonbright notes that value of service considerations were traditionally looked to in railroad ratemaking. *Id.* at 83. Since we are dealing with the Interstate Commerce Act and since the regulatory scheme here involved is a child of traditional railroad rate regulation, that is an important point.

It is one thing to say that "value of service" controls. It is quite another to say that "value of service" is a factor to be considered. The first proposition makes regulation otiose. Nobody can ever collect more from consumers than they are willing to pay. So undeviating adherence to "value of service" reduces regulation to the status of a ritualistic rubber stamp. The second proposition, on the other hand, leaves much to the discretion of the regulators. It also mimics competition where "value of service" is reflected in the buyers' demand schedules and therefore counts for a good deal in the pricing process.

[320] The real regulatory justification for an original cost rate base is that it facilitates rate of return analysis.

[321] That practice is in sharp contrast to the conservative financial policies generally followed by major oil companies. It is a by-product of a consent decree that the Antitrust Division obtained back in 1941 against all of the major oil companies and their pipeline affiliates. That decree encourages debt and discourages equity financing. *See* pp. 312-15, *infra*.

[322] In the past that entity was usually a single company. Thus we have such entities as the Exxon Pipeline Company, the Mobil Pipeline Company, and the Marathon Pipeline Company. Today, however, it is common for two or more parents to be involved. Such jointly owned pipelines are often built and

managed by jointly owned corporations. Thus, for example, Kerr-McGee itself has a wholly owned pipeline subsidiary and also owns an interest in the White Shoal Pipeline Company. Another technique used in collaborative pipeline ventures is the undivided interest system. There the parent oil companies or their pipeline subsidiaries are tenants in common. Each of the various tenants is deemed to be operating a common carrier system of its own. The *Trans Alaska Pipeline System* is organized that way. *See* WOLBERT II at 174-227; PIERCEY at 176-316.

323 Sometimes the parent's commitment is an ordinary guarantee, *i.e.*, a simple promise to answer for its subsidiary's debt. In other instances the same basic objective is achieved by a somewhat more complicated mechanism called a "through-put and deficiency agreement." Those agreements "are instruments whereby each shipper-owner binds itself to ship, or cause to be shipped, through the pipeline its pro rata share of enough oil so that the pipeline will generate sufficient gross cash revenue ... to service the interest and principal repay of the debt and service all operating expenses and other costs of the operation during the entire period of the loan. These obligations are not mere agreements to use the line, although they do require the shipper-owners to commit specific volumes of oil for transportation through the system. They go well beyond that, by virture of the deficiency agreements, or deficiency paragraphs in the throughput agreements, which contain clauses frequently referred to as 'hell or high water' clauses. Under these obligations, if for *any* reason whatsoever, even if the line is inoperable, or the inability to ship is due to causes which under normal commercial dealings would provide a *force majeure* escape, the pipeline does not have sufficient cash on hand to pay the principal and interest on the debt and discharge all its other obligations, the shipper-owners are required to make up the difference by a cash 'deficiency payment.' This obligation continues as an ever-present possibility for the entire 20-40 year life of the debt." WOLBERT II at 243-44. (Emphasis in the original.)

324 Williams' history is illuminating in this regard. Williams did not create its pipeline system. Like practically every other major pipeline network, the one that Williams now owns was conceived and planned by a group of major oil companies. Those companies formed an entity called the Great Lakes Pipe Line Company to build one of the pioneer product lines. That happened back in 1930. Operations began early in 1931. *See* WOLBERT II, at 18-19, 130, 173, 201, 210. *See also* JOHNSON at 256, 264-67.

Great Lakes was the first jointly owned products line. Thirty-five years later Great Lakes' owners sold the system to Williams. At that time Great Lakes' depreciated net investment in carrier property was $83.4 million. Its ICC valuation was $167.6 million. But Williams, which purchased at competitive bidding, paid $287.6 million for the property. That raises some regulatory questions, which we shall later discuss. Our concern at the moment is not with those problems, but with how Williams raised the $287.6 million purchase price. It borrowed *all* of it. Since Williams was then a small construction company with assets of about $30 million and earnings of about $3 million annually, it is plain that the lenders were lending against the pipeline. This feat of leverage, this amazing reliance on the lifting power of other people's money, evoked admiration in some financial circles. See the laudatory account of the transaction in Stott, *The Changing Face of Corporate Finance*, The Morgan Guaranty Survey 3 (October 1967), commenting that "The construction company came out of the deal with a highly leveraged capital structure-with only 12% of its capital accounted for by common equity. *The heavy orientation toward debt appeared to be justified, however, because of the stability characterizing the pipeline's earnings and because cash flow was ample in relation to debt-serving requirements.*" (Emphasis added.) The editors of a widely used corporate finance casebook use the Williams-Great Lakes situation to introduce law students to the leverage phenomenon. Brudney and Chirelstein, *Cases and Materials on Corporate Finance 355* (1972).

325 An all common stock structure also imposes unacceptably high-tax costs on consumers. That is so because each dollar paid out in interest to a bondholder is a deduction from the regulated entity's taxable income. When there are no bondholders and when all of the capital is equity capital, there are no such deductions. Hence taxable income is higher than it is when a judicious measure of debt financing is used. The higher income tax to which that income leads is paid in the last analysis by the ratepayer.

326 *Communications Satellite Corp. v. Federal Communications Commission*, 611 F.2d 883, 902 (D.C. Cir. 1977) (Federal Communication Commission's use of a hypothetical structure in lieu of COMSAT's actual 100% equity capitalization sustained.) (Footnotes omitted from the quotation.)

327 Of course, it isn't really a "just the facts" approach. It ignores the guarantees. And the guarantees are facts.

328 Some may see an analogy to the commitment fee charged by a commercial bank under an agreement to commit funds to a borrower.

329 We are even more dubious about the validity of the underlying concept in this context. Hypothetical capital structures are constructed for the purpose of shielding consumers from the detrimental consequences of financial structures that are overly conservative. The regulatory need for that is plain. Even the Securities and Exchange Commission, an agency that has in its utility work been much concerned about excessive leverage, has pointed out that: "Common stock is an expensive source of capital. Essential though it is as a cushion for the senior securities, common stock financing imposes special burdens on consumers . . . To insist on huge further issues of common stock ... would be most unfair to customers." *Metropolitan Edison Company*, 45 SEC 751, 756 n.19 (1975). Here, however, the idea is being turned on its head. What we are asked to impute is not *debt*, but *equity*. And we are told that this is the proper course because the capital structures that the regulated entities have designed for themselves and that actually exist are *too favorable to the ratepayer*. Hence, it is said that those actual financial structures should be replaced by hypothetical ones that will be more favorable to the regulated entities. The idea seems bizarre. And we know of no precedent for it at the Federal level.

330 Since the industry is so heterogeneous, we should probably have to do so over and over again. Hypothetical model capital structures for "normal" oil pipelines could undoubtedly be developed. But that would take time and effort. We doubt that this expenditure of energy would be worthwhile. What we have seen of this industry suggests that carriers would seldom concede that they were "normal" or "low-risk" and that most of them would have little difficulty in finding arguments and expert testimony demonstrating that they were much too hazardous to carry any appreciable amount of debt on a stand-alone basis. So the capital structure issue would, if permitted to become an issue, probably prove a prolific mother of litigation. And, as we hope is now evident from the reader's labors with this Opinion, there is little reason for us to engage in the exercise.

331 The Securities and Exchange Commission used this phrase in *Christiana Securities Company*, 45 SEC 649, 668 (1974), *aff'd sub nom. E. I. Du Pont De Nemours & Co. v. Collins*, 432 U.S. 46 (1977). That case seems in point here. *Christiana* involved a transaction between affiliated corporations. Under the Investment Company Act of 1940 that transaction could not be entered into unless the SEC approved it. Such approval can be given only if the transaction were found fair, reasonable, and free from overreaching on the part of any person concerned. *See* 15 U.S.C. § 80-17. Several minority stockholders of one of the affected corporations contended that this standard had not been met. They pointed out that the benefits to be received by their class were slight when compared to those to be reaped by others. They also stressed the fact that the lion's share of the total benefit would go to members of the Du Pont family rather than to the ordinary public stockholder. The SEC agreed. It said: "The objectors are clearly right when they say that the merger will be a very good thing indeed for Christiana's stockholders." 45 S.E.C. at 656. The Commission also found an "imbalance of benefit." *Id.* at 660. It characterized the benefit to the public shareholders as "far from awesome." *Id.* at 661. At another point, the SEC spoke of "the striking disparity between the substantial benefits to be received by Christiana and the far more modest ones inuring to Du Pont." *Id.* at 669.

However, the Commission found the statutory standard satisfied because "the Act's requirement that the transaction be reasonable, fair, and free from overreaching, does not mean that the benefits to the parties must be nicely balanced." *Id.* at 661. The Supreme Court agreed. 432 U. S. at 54-57. *Christiana* thus shows that there are situations in which a statutory requirement that a price be "reasonable" can be satisfied by a look at the broad picture for evidence of exploitation and gross overreaching without the nit-picking inquiries into every aspect of the price characteristic of public utility regulation. As we have seen, those laborious inquiries are made to protect *consumers*. *Christiana* found them unnecessary and inappropriate to the protection of investors. And we now find them unnecessary and inappropriate to the protection of oil companies that ship petroleum products over pipelines owned by others. Moreover, we see something of an analogy between the Investment Company Act and the Interstate Commerce Act's oil pipeline provisions. One was intended to protect investors against gross overreaching by strategically situated control groups. The other was intended to protect independents in the oil business against gross overreaching by the major integrated oil companies' pipeline affiliates. Neither was intended to usher in a reign of perfect justice. Both statutes are to be interpreted pragmatically in light of their history.

We return to the SEC's phrase about "ventures into the unknown and unknowable" that we quoted in the text. Our sister agency used those words in its *Christiana* opinion when it rejected the objecting shareholders' contention that mere market prices should be ignored and that an inquiry should be made into the intrinsic investment value of the security there involved, the common stock of E. I. Du Pont De Nemours & Company. The SEC noted that such explorations are inherently speculative. It added that this did not mean that they were always out of bounds. In the SEC's words:

> At times the law undertakes explorations almost as speculative as those on which the objectors ask us to embark. Thus in the law of tort judges and juries place price tags on pain and suffering - and indeed on human life itself. And to come closer to home, in reorganizations under the Bankruptcy and Public Utility Holding Company Acts we and the courts try to estimate the probable future earnings of business enterprises and the multiples at which it is appropriate to capitalize those earnings. Those inquiries are undertaken because justice requires that the effort be made.
>
> That differentiates those situations from this one. Here justice requires no ventures into the unknown and unknowable. An investment company, whose assets consist entirely or almost entirely of securities the prices of which are determined in active and continuous markets, can normally be presumed to be worth its net asset value." 45 S.E.C. at 667-68. Quoted with approval in 432 U.S. at 51.

That is our situation here. We design hypothetical capital structures when our consumer-protection mission requires us to do so. Here, however, that mission is not implicated. So we need not convert ourselves into a Supreme Court of Oil Pipeline High Finance. Nor are we under any compulsion to speculate about what oil company balance sheets would look like in a different world of our own devising.

332 Of course, there is a lot of guesswork in regulation and elsewhere in the law. So the effort could be made. However, we see little point to this kind of guesswork in the context of our ratemaking for oil pipelines.

333 Questions have been raised as to whether comparable earnings analysis tells us much about what investors are likely to do. Those questions need not be faced here.

334 Hence they will normally take great pains to see to it that capacity is ample and service adequate.

335 That means, of course, that the risks are borne by the parents' stockholders. However, this truism does not supply us with much analytical help. Shareholders are *always* at risk for a company's borrowing. That is called "financial risk." It is at the heart of the difference between a stock issued by a highly leveraged company that has borrowed heavily and the stock of a conservatively financed issuer.

Investors are compensated for that risk by a higher rate of return on their equity. They do *not* increase the amount of their equity in the company by assuming a high degree of financial risk.

336 They are not dedicated to pipelining. They are dedicated to oil. Nor do they have any franchises to protect.

337 Under existing law oil companies are free to invest in many things. And every reader of the financial pages knows that they avail themselves of that freedom. They do not confine themselves to oil or even to energy.

338 It is well known that some of the oil company non-oil investments referred to in the preceding footnote have not been shatteringly successful. This shows that, like other investors, oil companies are fallible. It also shows something else. It shows that by and large oil company managers are interested in high risk-high *potential* reward situations. Thus, for example, the Charter Company bought the Philadelphia Evening Bulletin. That turned out unhappily. The Bulletin is no more. We think it safe to assume that Charter had high hopes for that paper when it invested millions in it. But it must also have been obvious to Charter's managers that an afternoon metropolitan newspaper that was losing money heavily was a high-risk proposition and that there was no assurance that the property could be turned around. Nevertheless, Charter chose to gamble on the newspaper. It did not invest in electric power, retail gas, or telephones. Indeed, we know of no instances in which oil companies have chosen such low-risk outlets for their excess capital. On the contrary, their diversification efforts have generally involved the assumption of substantial risks. There is a moral in that for us.

339 That assumption raises a question. Why have the complaining shippers refrained from investing in these attractive and according to them relatively riskless propositions? Kerr-McGee clearly has the resources. It budgets about $600 million a year for capital expenditures. But it finds North Sea oil development a more attractive outlet for those funds than pipelines in the Mid-Continent region. *See Wall Street Journal*, August 28, 1982, p. 28, col. 3.

340 That sentence should not be misconstrued. It is *not* a finding "that oil pipelines are relatively risk-free." Rather, it is a policy judgment that whether they are or are not is far from central to our inquiry. What we find, in essence, is that risk analysis does not advance this inquiry.

The risk issue has been hotly and extensively debated in this record and elsewhere. Though we find that debate of little consequence for present purposes, we think that we should say something about it. The industry's critics maintain that the risks of oil pipelining are about on a par with that of natural gas pipelining. Both industries push hydrocarbons through pipe. The oil pipeline industry answers by pointing to the insulation from competition that the Natural Gas Act gives the gas lines. That is not much of an answer. For one thing, it exaggerates the pervasiveness of the shelter that the Gas Act gives. That statute does not create monopolistic fortresses. *See, e.g., Ozark Gas Transmission System*, 16 FERC ¶ 61,099 (1981), *rehearing denied*, 17 FERC ¶ 61,024. In fact, most major metropolitan areas are served by two or more gas pipelines. Second, the massive capital investment needed to bring an important pipeline into being is a formidable barrier to entry. So existing oil pipelines enjoy what can be viewed as the functional economic equivalent of a legal barrier to entry. The industry also makes much of the fact that the long-term contracts common in natural gas transmission are absent there. That in our view is somewhat more important than the absence of a certification requirement. We recognize that there is little likelihood that the shipper-owners will desert their own lines for those of others—contracts or no contracts. This is said to have happened on occasion. But it is hard to believe that it happens often.

Of course, the independent oil pipelines have no captive customers. Moreover, their most important customers are free to leave them and to build lines of their own. Those customers are also in a position to lower transportation costs by exchanging oil among themselves. Hence it seems to us that considered as a class, the independently owned pipelines confront risks appreciably greater than those faced by the gas lines.

Thus far we see no significant difference between the shipper-owned oil lines and the gas lines. That does not mean that there is no such difference. There is. It stems from two factors. The first is that many oil pipelines face vigorous competition from water carriers. Natural gas pipelines are immune from that. The second distinction between the two industries is that the oil lines are far more heterogeneous than the gas lines. Viewed as a whole, the oil pipeline industry seems prosperous and flourishing. Parenthetically, we note that the Association of Oil Pipelines does not claim that its membership is on the brink of destitution. Instead, it tells us that the industry has done quite nicely over the years. But instances of particular pipelines that have done poorly and that have had to be rescued by their parents are far more numerous here than they are in gas. *See* S. M. Livingston, *Oil Pipelines: Industry Structure* in E. J. Mitchell, ed., *Oil Pipelines and Public Policy* 328-35 (1979).

On balance, it seems to us that:

(1) Most oil pipelines are probably at least somewhat riskier than most natural gas pipelines.

(2) That risk difference cannot be quantified.

(3) Even if we were able to quantify it, so that we could announce with some confidence that oil pipelines are on average 10% riskier than gas pipelines, that number would be of little aid in dealing with concrete cases involving particular pipelines.

341 Georges Clemenceau is said to deserve the credit for that aphorism.

342 Moreover, we have no disinterested expert testimony about the culture of oil pipelining before us. Hence we are constrained to rely on the impressions we have formed and on the testimony of pipeline executives and investment bankers. That testimony we sprinkle liberally with salt to allow for those witnesses' patent self-interest. However, we do not discount it in toto. Dogmatic skepticism can be as mistaken and as misleading as naive credulity.

343 *Realized* rates of return are much easier to measure than *expected* rates of return. But the two

should not be confused with each other. One who contemplates an equity investment can never be sure about the return he will actually realize. But he knows the return he expects.

[344] Thus, for example, civil servants seldom think like businessmen. That is one of the great problems of economic regulation. It is mitigated in the utility field by the fact that there the industrial culture is itself quasi-bureaucratic and somewhat akin to that of a civil service.

[345] A sitting Supreme Court Justice has expressed the view that "a utility is far closer to a state-controlled enterprise than is an ordinary corporation." Justice Rehnquist dissenting in *Central Hudson Gas & Electric Corp. v. Public Service Commission of New York*, 447 U.S. 557, 587 (1980). No one would label oil companies "state-controlled enterprises."

[346] Parisi, *Inside Exxon; Managing an $85 Billion-a-Year Empire, New York Times*, August 3, 1980, § 6 (Magazine), 18 at 36.

[347] Everyone agrees about that. The parties differ only about the *extent* of the need. Even if the Age of Oil has passed its peak and even if hindsight should show that the petroleum industry is now mature or declining *(see, e.g.*, Martin, *Twilight Nears for the Age of Oil, New York Times*, August 29, 1982, § 3 Business, p. 1), new fields will be discovered, new refineries will be built, and old pipelines will wear out. Hence new pipeline plants will be required.

[348] Consider, for example, the case of the Mobil Pipeline Company. At the end of 1980, its valuation was about $370 million, according to the traditional ICC formula. But its depreciated net investment was only $82 million. The ICC considered a return of 10% on valuation proper. This meant that Mobil could earn $37 million a year without exceeding the bounds of propriety. Computed on original cost, however, that is a return of 45%. Texaco-Cities Service Pipeline Company illustrates the point even more strikingly. The Commission's valuation of its properties is approximately nine times their depreciated original cost. Texaco-Cities Service's valuation was $64.2 million at the end of 1980, as against depreciated net investment of $7.3 million. Arapahoe Pipeline Company is also worth a look. Its net investment rate base is only $579,000. Its valuation is slightly over $8.8 million.

[349] Some brand this concern spurious. They say that oil companies build pipelines to move their own oil and to facilitate their own integrated operations. They add that historically revenue from outsiders has not been material to the investment decision. This is one of the central themes of a 1978 University of Oklahoma doctoral dissertation. J. K. Piercey, *The Pipeline Segment of the Domestic Petroleum Industry: Structure and Conduct*. Dr. Piercey quotes a 1958 Twentieth Century Fund study, which suggested that "a line is usually built not as a means of earning money directly but as a unit in integrated petroleum structures." S. N. Whitney, *Antitrust Policies* 123 (1958). This view suggests that there is much to be said for limiting oil pipeline owners' revenues to something just a bit above the constitutional minimum. That would be a boon for the shippers. And it wouldn't really hurt the owners because their lines are not built for the purpose of producing revenue. We think that approach unwise.

Our two threshhold thoughts with respect to it have already been developed at length earlier in the Opinion. The first is that the idea is hard to square with the legislative history, murky though that history may be. What we have to bear in mind on that is that Congress never attempted to regulate the Standard Oil Company's entire integrated business. That which it subjected to regulation was a small segment of that business, the pipeline segment. Hence it seems to us that we are for the most part compelled to look at the pipelines as though they stood alone, that our freedom to regulate on the basis of speculations about their owners' non-pipeline motivations is extremely limited (if indeed, we have any such freedom at all), and that this is so even if those speculations are well-founded. Second, the governing statute is along the lines here suggested. For us to break dramatically with the established regulatory tradition and to embark on a radically new course of action on the basis of the aforementioned speculations without any semblance of a mandate from Congress for such a course would, we think, be unseemly, improper and very probably damaging to the public interest we are chartered to protect.

Moreover, the notions that we here reject oversimplify some complex realities. True, most of the oil that moves over most the lines still belongs to their owners. But it does not follow that non-owner patronage is inconsequential. On the contrary, it is more significant than it used to be. Compare the discussion of the contemporary "scramble for traffic" in WOLBERT II at 62-81 with the discussion of earlier times in WOLBERT I at 43-52, which concludes that "During the early formulative period of petroleum industry development, the tremendous competitive differential in the transportation phase enabled the large companies possessing extensive pipeline systems to locate their refineries near tidewater or large marketing areas, while the smaller outfits were forced to construct their plants near the producing fields." Hence inferences drawn from the industrial environment of 1906, 1936, 1946, or even 1956 are no guide to public policy in the oil pipeline environment of 1982. Today prospective non-owner patronage and the revenue such patronage can be expected to produce is a significant factor in many pipeline investment decisions.

Finally, the "regulate these things as though they were electric utilities or telephone companies, keep a watchful eye on every dime of 'excess revenue' and have no fear of the consequences - nothing bad is going to happen" approach ignores the independent pipelines. We can conceive of no hypothesis on which *their* incentives to invest could be deemed unimpaired and unaffected by tight regulation.

[350] *See Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942) ("The Constitution does not bind ratemaking bodies to the service of any single formula or combination of formulas."); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 601 (1944) ("The fixing of prices, like other applications of the police power, may reduce the value of the property which is being regulated. But the fact that the value is reduced does not mean that the regulation is invalid."); *Nebbia v. New York*, 291 U.S. 502, 522-539 (1934); *Battaglia v. General Motors Corporation*, 169 F.2d 254 (2d Cir. 1948); *Ohio Utilities Company*

v. Public Utilities Commission of Ohio, 58 Ohio St. 2d 153, 389 N. E. 2d 483, 488 (1979).

351 The Commission must, of course, comply with the law. And the courts have the last word on what the law is. But the problems with which the Commission deals are not primarily legal. As Justice Frankfurter said a few months after he had left his public utilities classroom at Harvard for a place on the Supreme Court Bench: "The determination of utility rates-what may fairly be exacted from the public and what is adequate to enlist enterprise-does not present questions of an essentially legal nature in the sense that legal education and lawyers' learning afford peculiar competence for their adjustment. These are matters for the application of whatever knowledge economics and finance may bring to the practicalities of business enterprise. The only relevant function of law in dealing with this intersection of government and enterprise is to secure observance of those procedural safeguards in the exercise of legislative powers which are the historic foundations of due process." *Driscoll v. Edison Light & Power Co.,* 307 U.S. 104, 122 (1939) (concurring opinion).

352 Frankfurter, J., dissenting in *West Virginia State Board of Education v. Barnette,* 319 U.S. 624, 646 at 670 (1943).

353 We do not say that this was the sole factor in their calculations. Other motivations were also present. These may have been of greater weight than the regulatory considerations. *See* n.348, *supra.* Nevertheless, we think it clear that the regulatory methodology was a substantial factor in many oil pipeline investment decisions. That is obviously true of the investment decisions made by the independent pipeliners, such as Williams.

354 *Daniel* 6:12.

355 *See, e.g., Report of the Antitrust Subcommittee of the House Committee on the Judiciary on the Consent Decree Program of the Department of Justice,* 86th Cong., lst Sess. 301 (1959). *See also* E. V. Rostow, *A National Policy for the Oil Industry 58, et seq.* (1948).

356 That their astute legal advisers were that sanguine is even more doubtful.

357 The industry's adversaries poke much good-humored fun at its claims of reliance. They make some excellent debating points. Thus they argue that:

(1) Though the rate base methodology was outlined in a general way in *Ajax Pipe Line Corporation,* 50 I.C.C. Val. Rep. 1 (1950), that explanation was so vague and so unilluminating that it explained nothing. Save for the ICC's own valuation staff (a staff that came to this agency on October 1, 1977), no one really knew anything about the valuaton formula until the ICC's Division 2 issued its opinion in the instant case. 351 ICC. 102, 109-116 (1975), *aff'd. by the full Commission,* 355 I.C.C. 479 (1976). And the explanations in those opinions left much to be desired. The full oil pipeline rate base story was not told until 1977, when Mr. Jessee Oak, a valuation engineer who had been on the ICC's staff for a long time and who was later in our employ, testified in detail about the workings of the methodology. Accordingly, the formula reproduced in n. 295, *supra,* has come to be known as "the Oak formula." Our staff, the Department of Justice, and the shipper-complainants ask how the industry could possible have relied on a formula that was unknown to it?

(2) Though the industry claims to have relied on the ICC's rate of return standards, the record shows that there was no consensus in the trade about what those standards were. Different witnesses had different impressions. The whole subject to rate of return was shrouded in a dense fog.

Were this a debating society, we should have to say that the critics win hands down. But this is not a college debate. It is a quasi-judicial proceeding about real things in the real world. In that context the critics' critique of the industry's reliance claims becomes underwhelming and unshattering. True, the industry did not know the *precise* formula. But it obviously had a quite sophisticated understanding of the valuation process. The data that the valuation staff used and uses came and still comes from the industry itself. The industry also knows what the final valuations are. Moreover, oil pipeline companies have mathematically literate people in their employ. Finally, the industry had worked very closely with the ICC in the development of the early valuations. JOHNSON at 240-1, 391-5. Indeed, oil company personnel worked on valuations at the ICC's offices. JOHNSON at 450. Those who look askance at this industry's history and at the ICC's indulgent style of regulation are well aware of the intimacy of this industry-government liaison. Yet they turn a blind eye to it in order to ridicule the industry's claims of reliance on the traditional oil pipeline rate base methodology. We are not free to do that. A physician who prescribes a drug about which he knows a good deal in general but who does not know that drug's precise chemistry is neither proceeding ignorantly nor guilty of malpractice. That is our situation here. We find that the industry knew a great deal about the valuation methodology. Its claim of reliance on that knowledge is accordingly well-founded.

When it comes to rate of return, the reliance issue is much muddier and much more complicated. There it is impossible to tell exactly what the industry thought it was relying on. But the industry's real or feigned confusion about the ICC's rate of return standards does not detract in any way from its claim that it relied on the Oak formula. Whatever the permissible rate of return was, the industry knew that it would be allowed on the rate base later described by Mr. Oak.

358 ASSOCIATION BRIEF at 40-41.

359 A newcomer to the business that was not an oil company would find those risks especially formidable. It would have no captive traffic of its own. Hence it would have to look to the major oil companies for business. They might prove unaccommodating. Some think that history shows that they have been exactly that. So it is unlikely that the promoters would be deluged with prospective investors. We note in this regard that:

(1) Practically every important pipeline system was originally built by a major oil company or by a group of such companies.

(2) Williams is not the only "independent" to have come into the trade by purchasing an existing pipeline system from its oil company owners. Others have also done that.

360 We do not say that it is omnipresent.

[361] Whether the two kinds of competition are of sufficient vigor to obviate the need for regulation or to warrant a drastic overhaul of the statutory scheme is a question for Congress to answer. We make no recommendation with respect to it. Our concern here and now is with the statute as it is, not with an as yet unwritten statute that might perhaps be an improvement. And under the statute as it is, we have both the power and the duty to look at the competitive factors that differentiate oil pipelining from electric power and from natural gas transmission.

[362] *See* Navarro, Peterson, and Stauffer, *A Critical Comparison of Utility-Type Ratemaking Methodologies in Oil Pipeline Regulation*, 12 Bell Journal of Economics 392 (1981).

[363] In the case of large shippers, the construction of "private lines" immune from regulatory controls may also be a viable option. See the discussion of the so-called "Uncle Sam" doctrine in n.90, *supra*.

[364] *See Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 590 (1942); *Galveston Electric Co. v. Galveston*, 258 U.S. 388, 395 (1922); *Nader* v. *Federal Communications Commission*, 520 F.2d 182, 202 (D.C. Cir. 1975).

[365] Inflation-sensitive rate bases do not eliminate this phenomenon. But they do much to mitigate it. That is so because the gap between the depreciated cost of *reproducing* a pipeline built in 1939 and the depreciated cost of *reproducing* another pipeline built in 1979 is much narrower than the gap between those lines' depreciated *original* costs.

[366] The considerations to which the industry points are often neutralized or outweighed by other factors. The most important of those factors is that new lines tend to be of wider diameter than the older ones. That makes for enormous economies of scale.

As Wolbert says: "There is no dispute that pipelines have substantial economies of scale. The basic reason is that as pipeline diameters are increased, pipe costs . . . increase somewhat less than proportionately, construction costs increase linearly, but capacity increases exponentially ... The construction cost proposition has been expressed as follows: one 36-inch line is equal in capacity to seventeen 12-inch lines, but its construction cost is less than 3-1/2 times that of one 12-inch line. The operating comparison is illustrated by the fact that the per barrel cost of operating a 36-inch line is about 1/3 the cost of operating a 12-inch line. The basic reasons are that certain capital costs such as surveying, right of way, damages and communications do not vary with line diameter. The big ticket item is the cost of steel which will decrease per unit of carrying capacity as the size increases. The second most important item is the friction factor which is influenced principally by the inner surface area of the pipe. Because the volume increases more than does the surface area, it follows that in the larger pipe, a smaller proportion of the oil touches pipe surface area. Less friction per barrel is created and hence the energy required for pushing the fluid will increase at a rate significantly less than the increase in throughput. In addition to reducing operating costs, this factor also affects capital expenditure because for a given throughput, the optimal sized line will require the least horsepower capital investment. *The combined effect of all these component factors is that the cost of transporting a barrel of oil generally decreases about 1/3 each time the design pipeline throughput is doubled.*" WOLBERT II, at 98-100. (Emphasis added; footnotes omitted.)

[367] *See* n. 13, *supra*.

[368] A basic analysis that was sound and perceptive in 1982 may not look quite so astute in 1987 or in 1992.

[369] We refer, of course, to shippers who are not owners. The new line's owners will almost always find it in their interest to prefer their own high-priced line to somebody else's low-priced line.

[370] Also pertinent is the fact that for most of its history the interstate natural gas transmission industry has operated in a sellers' market. It has traditionally been able to sell all the gas it was able to acquire from producers. Accordingly, competition in natural gas transmission has in the main been a rivalry for limited gas supplies rather than a rivalry for customers. Customers have normally been abundant and eager to commit themselves to long-term contracts. That is changing now. And it may change even more in the future. Hence innovative regulatory responses to changes in the economics of gas transmission may be in order. We note the point. But we do not pursue it. That would take us much too far afield. Nor would that digression serve any useful purpose.

[371] It will do this only if inflation is actually in progress. However, inflation has been in progress since 1940. And lasting and total victories in the fight against inflation do not appear imminent. Should inflation be conquered at last, it might be well for our successors to take a fresh look at the oil pipeline rate base question. But fresh looks will then have to be taken at many things, some of them of greater social significance than oil pipeline rate bases.

[372] *See* n. 357, *supra*.

[373] When this case was in the Court of Appeals on appeal from the ICC's decision to adhere to its classical oil pipeline rate methodology, our predecessors asked that tribunal for a remand so that they could "begin their regulatory duties in this area with a clean slate." The court granted that request because its members thought "it . . . logical both to avail ourselves of some additional expertise before we plunge into this new and difficult area, and to allow the relevant administrative agency to attempt for itself to build a viable modern precedent for use in future cases that not only reaches the right result, but does so by way of ratemaking criteria free of the problems that appear to exist in the ICC's approach." FARMERS at 421.

But we cannot escape history. Whatever this Commission's briefs may have said back in 1977 and 1978 and however jaundiced the court's view of the ICC's methodology, the fact is that that methodology has been in place for a long time and that drastic conceptual changes would be disruptive. And as has already been noted, such changes would frustrate entrepreneurial expectations that we deem rational, legitimate, and worthy of respect. Perhaps even more important is the total absence of any evidence to support a finding that the incremental benefits of the exercise would be worth its costs.

374 What is said in the text seems to call for a gloss. As we have said many times, the real equity investors here are oil companies and profit-maximizing conglomerates. They are not consumers. They do not buy food. They do not buy clothing. They do not buy shelter. Nor do they have any need for medical care. So why look to the consumer price index? The answer to that seems simple to us. The companies are conduits. The funds they invest in pipelines are their shareholders' funds. Those shareholders are people. Even when legal title is in an institutional investor, the equitable interest is normally held by flesh and blood people. Those people eat, wear clothes, live in houses, and go to doctors. And theirs is the purchasing power that regulators should try to protect.

375 We explain what we mean by the term "entrepreneurially adequate" at pp. 340-43, *infra*.

376 Transitional rate bases would have to be constructed for each of the many common carrier oil pipelines. That would be a formidable, a difficult, and a costly endeavor. The task could be by-passed by using the most recent valuation (or in the alternative the cost of reproduction new less depreciation element of that valuation) as the transitional rate base. But then how much substantive change would there really be for existing pipelines? We conclude that the change would be far more costly than it is worth.

377 Excluding the Trans Alaska System the aggregate estimated depreciated cost of reproducing the nation's oil pipeline plant was approximately $10.3 billion at the end of 1979. Aggregate valuations were approximately $9.169 billion. The magnitude of that difference is far from awesome.

378 Rights of way, on the other hand, are valued at original cost less depreciation. The industry maintains quite properly that those rights should be valued in the same way that other depreciable property is valued.

379 However, that is so only in the *reproduction* cost calculations. When *original* cost is calculated, account is taken of actual interest expenses incurred during construction.

380 Moreover, no return at all is given for equity funds advanced during construction.

381 When it comes to the value of land, however, we have some doubts about the strength of the industry's claim of gross inequity. True, a rule that arbitrarily values land at half its cost sounds like something devised by the Mad Hatter. But that rule is flexible. The carriers are free to submit appraisals of their lands. And when those appraisals are found persuasive, the land goes into the rate base at present appraised value.

382 ASSOCIATION BRIEF at 66.

383 Some of them were made for the railroads. Their relevance to pipelines may be dubious.

384 So far as we can tell, no one now alive has ever seen them.

385 Our predecessors held rulemaking an inappropriate means for coping with the questions that the *FARMERS* court remanded us in this case. But they also thought that rulemaking might have an important role in this field after adjudications in the instant case and in the *Trans Alaska* proceeding had resolved the basic conceptual issues. *See* the last paragraph of the discussion in *Association of Oil Pipelines*, 10 FERC ¶ 61,023 at p. 61,037.

386 However, we shall make two changes. The first relates to the rate base treatment of property that the carriers use but do not own. Such property is leased from others. The carrier's rental payments to its lessor are, of course, part of the cost of service. However, the ICC also included such "used but not owned" property in the rate base. This gave the carriers a return on investments that they never made. That is egregious double counting. The ICC offered no defense for this strange practice other than "that is the way it has always been." *Williams Brothers Pipe Line Company*, 355 ICC 479, 486 (1976). Nor can this Commission conceive of any reason for this anomaly other than tradition. Now we are not insensitive to tradition's claims. Our decision this day shows that. However, intelligent conservatism is not to be confused with a neurotic affection for ancient evils, based solely on their antiquity. In our view, the ICC's treatment of "property used but not owned" was grossly irrational. Accordingly, we shall eliminate all such property from the rate base. Moreover, we shall apply the new rule retrospectively. Neither equity, nor good conscience, nor the Constitution, nor anything else of our acquaintance requires that a return be given on an investment that was never made.

The second rate base point on which we diverge from the ICC relates to its treatment of working capital. The ICC used a rule of thumb formula that was derived from the balance sheet, that was somewhat complicated, that had been developed long ago, that appears dubious, and that seems at first blush to cry out for re-examination. Accordingly, our predecessors viewed working capital as a subject of moment. *See* the order entered in this docket on February 23, 1979, 6 FERC ¶ 61,187 at pages 61,364 - 61,365. Initially, we were of the same view. On reflection, however, we conclude that this is one of those areas in which pragmatic administrators can learn more from the arithmetical facts than from dialectical reasoning. The fact is that working capital does not bulk large in oil pipeline rate bases. Thus, for example, at the end of 1979 the entire industry's aggregate rate base (exclusive of TAPS) was $9.169 billion. Working capital accounted for only $67 million of that. So a mere three-quarters of one percent of the industry's rate base came from the working capital allowance. Moreover, much of that $67 million consisted of allowances for materials and supplies. Those are based on accounting records and are seldom, if ever, controversial. The controversies relate to cash working capital, *i.e.*, to how much cash does a particular pipeline need to have on hand in order to do business? In this industry the answer to that question seems to be not much. So cash working capital needs are minimal.

In these circumstances we find it best to:

(1) Attach a weak rebuttable presumption of correctness to the ICC's traditional working capital formula, however questionable that formula may be.

(2) Hence the formula will control only if no litigant chooses to question it.

(3) However, shippers, carriers and other parties in interest (*see* p. 205, *supra*) who choose to question

> the traditional working capital formula are free to delve into this subject and to demonstrate what the particular carrier's actual cash working capital needs are.

This is a tentative, short run, *ad hoc* solution. Should the whole rate base question be given a searching look at some future time, working capital will, of course, be on the agenda. It is also possible that experience may lead us to our successors to restudy the oil pipeline cash working capital problem as a discrete matter, divorced from larger and more troublesome rate base points.

A final word on cash working capital: we note that the complaining shippers maintain that Williams' method of doing business is such that it needs no cash working capital at all. They are entitled to every fair opportunity to show that this is actually so. We assume, of course, that Williams will disagree. And it should, of course, be given ample opportunity to rebut the shippers' claims and to present its own position with regard to its working capital needs.

[387] The ICC had begun to do so. *See* n.245, *supra*. This shows that our predecessor agency did not consider its oil pipeline rate base methodology sacrosanct or immutable. We know of no reason why this Commission should take a more reverential view.

[388] For a discussion of the relative youth of the nation's oil pipeline plant as compared to its natural gas plant *see* J. A. Hansen, *Competitive Aspects of the United States Pipeline Industry: Implications for Regulatory Analysis* 157 (Yale University Ph.D. dissertation 1980). Dr. Hansen was formerly an economist on this Commission's staff. Like Dr. Hansen, we exclude the Trans Alaska system. Were that enormous facility thrown into the pot, the text statement would be even truer than it is.

[389] However, the industry is quite heterogeneous. So there are many pipeline companies that derive substantial rate base benefits from the condition percent approach.

[390] This material is not in the record. But it is public. It comes from the reports that the carriers file with us and from the valuations that we publish.

[391] 100%—47% = 53%.

[392] 100%—42% = 58%.

[393] At least for the short run.

[394] As noted earlier, the carriers obviously see long-run benefits for themselves from the perpetuation of the condition percent methodology.

[395] The territory is new and wholly unexplored. Hence we are unable to offer any road maps.

[396] *See* n. 324, *supra*.

[397] As noted earlier, depreciated original cost was only $101.1 million.

[398] That rent control may well be a poor idea has no bearing on the point. Whether rent control is good or bad is for the legislators to determine. Once the legislature has opted for rent control, it is not for the administrators to substitute their ideas about sound housing policy for those of their legislative masters.

[399] Williams places great stress on the fact that it owned the system for three years before it raised its rates. In our view, that does not invalidate the text statement.

[400] The assurance that it sought and obtained related solely to accounting. It had nothing to do with rates. *FARMERS* at 420.

[401] Shippers' initial post-hearing brief at 103 (emphasis added).

There are exceptions to this rule. The ratepayers concede that. But those exceptions involve situations in which the transfer of ownership promotes efficiency. In such a case the excess over original cost can be viewed as capital dedicated to the public interest. *See* 1 Priest, *Principles of Public Utility Regulation* 189 (1969). This is obviously not such a case. And Williams' able counsel wisely refrained from suggesting that it is.

[402] *See* p. 98, *supra*.

[403] *Uniform System of Accounts for Pipeline Companies*, 337 I.C.C. 518, 522 (1970), quoted with approval in *Williams Brothers Pipeline Company*, 355 I.C.C. 479, 488 (1976).

[404] *Uniform System of Accounts for Pipeline Companies*, 337 ICC 518, 523 (1970), quoted but disregarded in the opinion of the ICC's Division 2 in the instant case (351 ICC 102, 107 [1975]) and totally ignored in the later Opinion of the full Commission.

[405] *FARMERS* at 420-21 (footnotes omitted).

[406] Cautious purchasers will probably seek declaratory orders before proceeding.

[407] *Reduced Pipe Line Rates and Gathering Charges I*, 243 ICC 115, 142-143 (1940); *Minnelusa Oil Corp. v. Continental Pipe Line Co.*, 258 ICC 41, 53-57 (1944); *Reduced Pipe Line Rates and Gathering Charges II*, 272 ICC 375, 384 (1948).

[408] *Petroleum Rail Shippers' Ass'n. v. Alton & Southern R. R.*, 243 ICC 589, 663 (1941) (involving the very system now before us in the instant case). See also the *Minnelusa* case cited in the preceding footnote.

[409] *See* Note, *Legal and Practical Aspects of Petroleum Rates and Terminal Tankage*, 102 U. of Pa. Law Rev. 894, 910-11 (1954).

Writing as long ago as 1954, the author of the Pennsylvania note to which we have just referred found the crude-refined distinction dubious. He went further. He suggested that it was the crude lines that were riskier. Noting that there had been an explosive growth in products pipeline mileage between 1940 and 1952, the author said (at page 911 of 102 U. of Pa. L. Rev.):

> It can be inferred from these figures that the higher return allowed to products lines is no longer justified by their relative newness and the unpredictability of their success ... In fact, it would seem that the prospects of a products line, since it usually begins at or near a refinery, are less uncertain than those of a crude line, which becomes useless when the field it serves is depleted.

[410] A hostile critic characterized the proceedings as "cabalistic." E. V. Rostow, *A National Policy for the Oil Industry*, 59 (1948).

[411] When the Court of Appeals dealt with the instant case, it censured the ICC's failure to pay "even . . . exiguous attention to . . . the actual cost of equity capital to Williams." *FARMERS* at 418, last sentence of the court's n.27.

[412] The industry says that these were mere "guidelines." But the ICC never used that term. Moreover, both the words used and the results decreed in its oil pipeline rate opinions show that it viewed its 8% and 10% holdings as conclusive tests, not as invitations to protracted dialogues about upward adjustments. Thus, for example, in the very first opinion in which it seriously addressed oil pipeline rates the ICC began its rate of return discussion with these words: "If an annual return of 8% be taken as fair—and to us it seems ample . . . " *Reduced Pipe Line Rates and Gathering Charges I*, 243 I.C.C. 115, 142 (1940). Getting down to particulars, the Commission held on the following page of 243 I.C.C. that "On the present record no finding could be made that the rates of the 14 respondents which earned less than 8 percent upon value are unjust and unreasonable because excessive. As to the remaining 21 respondents, *the earnings of each must be found to be materially in excess of a fair return, and the general level of their rates found to be unjust and unreasonable*." (Emphasis added.) The ICC's later oil pipeline rate of return opinions were of like tenor. It clearly did that in this case. *TAPS* was something of a deviation. But that deviation was very slight. *See* n.414, *infra*.

[413] True, the ICC had no oil pipeline rate cases between 1948 and the mid-1970's, when it had to deal with the instant case and with *TAPS*. But when the later cases came along, the Commission treated its 1940's rate of return precedents as holy writ.

[414] In its last oil pipeline decision, *Trans Alaska Pipeline System*, 355 ICC 80 (1977), *affirmed sub nom. Mobil Alaska Pipeline Co. v. United States*, 557 F.2d 775 (5th Cir. 1977), *reprinted in its entirety as an appendix thereto* (557 F.2d at 784-801), and again *affirmed sub nom. Trans Alaska Pipeline Rate Cases*, 436 U.S. 631 (1978), the ICC allowed an interim 10% return on the Alaskan crude oil line. However, the Commission stated that this was not "intended to be a general standard." The result turned on the magnitude of the Alaskan project and on its special risks. Noting "that the 8% on valuation standard arose in the early 1940's, when capital costs were substantially lower than they are today," the ICC commented that this standard "could continue to provide a substantial return on original investment of established carriers, whose valuations have risen well above their actual investment because of inflation." But the ICC went on to add, "In the case of the TAPS carriers . . . their property was contructed so recently that valuation is little higher than actual cost, and an 8% return becomes quite deficient." 355 ICC at 85, *reprinted in* 557 F.2d at 791.

[415] *See Williams Brothers Pipe Line Company*, 351 ICC 102, 105-106 (1975), for the Opinion of the Commission's Division 2 and *Williams Brothers Pipe Line Company*, 355 ICC 479, 486-88 (1976), for the full Commission's Opinion.

Neither the Division nor the full Commission was unanimous. Commissioner Corber dissented from the Division's Opinion. 355 ICC at 1[illegible]-33. And Commissioner (later Chairman) O'Neal dissented from the full Commission Opinion. 355 ICC at 496-503. The future Chairman O'Neal took a skeptical view of the validity of the ICC's 1940's precedents. He also questioned the scrupulousness of the tests and analyses employed "even . . . then." *Id.* at 498.

[416] As we said at the outset of this discussion, the whole thing is odd. One very striking oddity is the idea that there is something inherently just and axiomatically reasonable about nominal rates of return that appear to have been plucked out of the air in the first place and that are then applied mechanistically and religiously decade after decade. That flies in the face of every regulatory principle known to us. It was most emphatically not part of the classical fair value system. In the famous fair value case of *Bluefield Water Works & Improvement Company v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 692-93 (1923), a unanimous Supreme Court said: "What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled . . . to earn a return . . . generally being made *at the same time* . . . on investments in other business undertakings which are attended by corresponding risks and uncertainties . . . *A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally*." (Emphasis added.) The ICC's fetishistic oil pipeline rate of return numerology violated these elementary precepts, which are as sound and as authoritative today as they were when the High Court articulated them in 1923. Note should also be made of a lesser oddity. That one is case-specific. Though Williams is predominantly a carrier of refined products, it also carries some crude. Accordingly, it would seem that the bifurcated 8% for crude, 10% for refined test would have called for a quantitative analysis of Williams' business and for the derivation of an overall rate of return somewhat below the 10% to which a pure products pipeline is deemed entitled. The ICC gave no attention to this point.

[417] Even the ICC had grave doubts. True, it adhered to its traditional tests in the instant case. But it proposed to reexamine them in a rulemaking context. *See Williams Brothers Pipe Line Company*, 351 ICC 102, 105-106 (1975); *Williams Brothers Pipe Line Company*, 355 ICC 479, 487 (1976).

[418] *FARMERS* at 416.

The court applied that label to the ICC's rate base methodology as well. We take a different view. We think the rate base methodology still serviceable. Our reasons for so holding have already been stated at length. But we agree with the court that the traditional oil pipeline rate of return methodology is indefensible, that it must be scrapped in toto, and that something quite different from the moss-covered 8% and 10% numerology is essential.

[419] *Id.* at 419-20.

[420] We have already observed that serious questions were raised about that a generation ago. *See* n.409, *supra*.

[421] The quotation is from footnote 31 to *FARMERS* at 420.

[422] The quotation is from the last paragraph of the *FARMERS* footnote cited in the preceding note.

[423] *See* p. 89, *supra*.

[424] *See* Black, *Oil Pipeline Divorcement*, 25 Corn. L. Q. 585 (1940). *See also* WOLBERT I at 142-60; WOLBERT II at 237-41, 314-25; JOHNSON at 286-304.

[425] The industry claimed that 2.5 billion real, old-fashioned pre-World War II dollars were at stake. JOHNSON at 291.

[426] Among the defendants were the Great Lakes Pipe Line Company, Williams' predecessor in interest, and Great Lake's eight shipper-owners. *United States v. Great Lakes Pipe Line Co.*, Civil Action No. 182 (U.S.D.C. D.C.) (filed September 30, 1940).

[427] The role of defense considerations and of high officials in the Executive Branch is discussed in JOHNSON at 298-304. Professor Johnson makes some interesting observations. One of them reads: "If Arnold had a lever in the size of the potential liabilities under the Elkins Act, the industry had a countervailing force in the deepening defense emergency. No responsible administration would deliberately create chaos in the face of an all-out war threat, and the industry knew it. In essence, this became the trump card in the game the negotiators were playing." A few lines later he says: "One cannot but feel from a review of the record that, at least from mid-summer 1941, officials in the higher levels of the Executive Branch were seeking ways to hasten a conclusion of the proceedings against the oil industry." *Id.* at 303.

[428] That was done in *United States v. Atlantic Refining Company*, Civil Action No. 14060 (U.S.D.C. D.C.). All of the major oil companies of that day and all of their pipeline affiliates were defendants in that action.

[429] Excess earnings must be segregated and are in effect frozen. They can be used for additions and betterments. But additions and betterments that are so financed cannot be included on the valuation on which the 7% is based. Thus there is no incentive to use excess earnings, if any, for expansion. The only way in which a shipper-owner can get its hands on the excess earnings is to sell its interest in the lines. The consent decree expressly permits recapture in this situation. That may have had some bearing on the motives of the eight oil companies that sold the Great Lakes Pipe Line Company to Williams back in 1966.

[430] Nothing in the Valuation Act requires *annual* valuations. These were never made for the railroads. Nor did the Interstate Commerce Commission ever make them for pipelines before the consent decree. In fact, it made no pipeline valuations of any kind until 1934. The pressure for annual pipeline valuations came entirely from the industry. It is hard to imagine who else would have wanted them. After the consent decree, the carriers were so eager for annual Interstate Commerce Commission valuations that they wanted to pay for them themselves. JOHNSON at 393.

[431] *See* WOLBERT I at 153-55.

[432] *Report of the Antitrust Subcommittee of the House Committee on the Judiciary on the Consent Decree Program of the Department of Justice*, 86th Cong., lst Sess. 301 (1959).

[433] The difficulties and the confusions created when the valuations were out of date are described in JOHNSON 335-36 and in WOLBERT I at 153-55.

[434] Copies of those reports go to those authorities.

[435] That view does not rest on our decision to adhere to the valuation rate base for regulatory purposes. When a rate case arises, an ad hoc valuation of the particular carrier involved can be made for purposes of that litgation. Accordingly we agree with the House Committee of 1959 (n.432, *supra*) that "Annual valuations . . . are not needed to discharge regulatory responsibilities." (At 331).

[436] Even after the consent decree made borrowing attractive, some shipper-owners continued to maintain a negative attitude toward debt. JOHNSON at 338-39.

[437] Had they done so, obvious questions would have been raised under the consent decree. The Justice Department would undoubtedly have maintained that the "interest" payments to the shipper-owners were really "dividends" in violation of the decree. Troublesome tax questions might also have been presented under the so-called "thin capitalization" doctrine. *See* B. Wolfman, *Federal Income Taxation of Business Enterprise* 117-23 (1982); Plumb, *The Federal Income Tax Significance of Corporate Debt: A Critical Analysis and a Proposal*, 26 Tax L. Rev. 369 (1971).

[438] *All-debt* financing is used on occasion. Mobil funded its interest in the Trans Alaska Pipeline System that way.

[439] The industry maintains that since the loan to the pipeline is guaranteed by its parent, that loan is really a loan to the parent. So it is just as though the parent went out and borrowed the money to make an equity investment in the pipeline. Ergo, the pipelines' debt capital is really equity capital and entitled to an equity rate of return. We have already noted our disagreement with that view. *See* pp. 236-37, *supra*. For the reasons there stated, we are unable to accept this approach for regulatory purposes.

[440] That assumption is correct only when the pipeline is new. Even then book value will differ *slightly* from valuation. That is so because of the 6% going value allowance in the valuation formula and because of the somewhat idiosyncratic way in which that formula compensates the carriers for the time value of the funds tied up during the construction process.

[441] It may well be that returns of that magnitude are seldom actually realized. But regulators are in the ceiling business. Their task is to *limit* what regulated entities can earn. However "light-handed" and however permissive the regulatory scheme may be, those who administer it are not free to wink at ceilings that are stratospheric and limits that are gargantuan. The courts would not permit that. Nor do such methods comport with our conception of our duties.

[442] This may not have been wholly spontaneous. The initiative appears to have come from the Congress. It may have stemmed from a House investigation of antitrust decree practice. That

inquiry made in 1957 bore down heavily on the pipeline decree. The majority of the Committee expressed the view that the Justice Department had permitted the companies to outsmart it back in 1941, that the Department later compounded the error by assenting to a strained reading of the decree that stripped it of any semblance of meaning and that the Elkins and Hepburn Acts had been eviscerated so far as the pipelines were concerned. *See* JOHNSON at 440-456; PIERCEY at 42-45.

[443] The Supreme Court explained the effect of this in a footnote reading: "Assuming a carrier has an I.C.C. 'valuation' of $10,000,000, $2,000,000 of which represents stock investments of $1,000,000 by each of two shipper oil companies, and $8,000,000 of which represents debt because of money borrowed by the carrier from others, on the appellee-companies' interpretation of the decree, each of the two shipper-owners would be entitled to 'dividends' of one-half ($1,000,000/ $2,000,000) of 7% of $10,000,000 or $350,000. On the Government's new interpretation instead, each shipper-owner's 'share' would be one-tenth ($1,000,000/ $10,000,000) of 7% of $10,000,000 or $70,000, this being 7% of each one's actual investment of $1,000,000 in the company." *United States v. Atlantic Refining Company*, 360 U.S. 19, 22 n.2 (1959).

[444] *Id.* at 23. (Footnote omitted.)

The last paragraph of the Opinion pointed out that the Government might seek to modify the decree, "which continues the jurisdiction of the District Court." No such effort was ever made. Instead, as has already been noted, the Government is now urging that the decree be vacated in toto.

[445] The industry likes this idea today. But that was not always its position. *See* the following footnote.

[446] The industry itself was of that view in 1941 during the negotiations that led to the decree. *See* JOHNSON at 291-300. Not until the consent decree turned out to be so favorable to it, did the industry adopt its present position.

[447] *Trans Alaska Pipeline System*, 355 ICC 80 (1977), *affirmed and reprinted as an appendix to Mobil Alaska Pipeline Company v. United States* 557 F.2d 775, 784-801 (5th Cir. 1977), and again *affirmed sub nom. Trans Alaska Pipeline Rate Cases*, 436 U.S. 631 (1978). The ICC bluntly said, "We do not accept the 1941 consent decree as a standard of reasonableness under the Interstate Commerce Act." *Reprinted in* 557 F.2d at 786.

[448] As our predecessor agency said (355 I.C.C. at 84-5, *reprinted in* 557 F.2d at 790-91):

> [T]he consent decree standard has never been employed in a Commission proceeding as the test of reasonableness of rates. Its sole legal status is as a limit on the amount of dividends that pipelines may pay to shipper-owners without risking prosecution under the Elkins Act for illegal rebates. Moreover, as a standard of reasonableness, it has nothing to recommend it from a conceptual standpoint. Although valuation is a measure of the entire investment, the consent decree standard allowed a return on valuation to be used entirely to compensate one segment of the capital invested. Such a standard can have no relationship, except by coincidence, to the carriers' true capital costs.

[449] It was obvious that the carriers would play a vital role in the war effort and that the nation was in desperate need of their aid. See *Reduced Pipe Line Rates and Gathering Charges II*, 272 ICC 375, 377-78 (1948). *See also* JOHNSON at 307-32. So the industry's bargaining position was strong. *See* n.427, *supra*.

[450] Anyhow, those questions were not our questions. The adjective "rebative" is not an antonym to the phrase "just and reasonable."

451 It is hard to imagine anybody in the real world making so strange a financing decision. Were the amounts involved substantial, a business decision of that character would almost certainly provoke derivative actions by angry shareholders and their hungry lawyers.

452 That makes the comment of the Mobil Pipeline Company's president (quoted in WOLBERT II at 328) that "A 7 percent return on valuation is not a red-hot business deal" hard to take seriously. This is so special, so peculiar, and so generous a 7% that the industry has lived happily with it for the past 41 years. Comments about its *apparent* niggardliness do more to obfuscate than to illuminate.[453] It is, of course, quite true that the guarantees involve risks for which appropriate compensation is due. But nothing in the consent decree relates that compensation (which the decree permits to be huge in many situations) to the quantum of risk assumed. *See* WOLBERT II, at 319-20. We note in this regard that Dr. Wolbert's view of the consent decree in his first book was much less favorable. Writing in 1952, he branded it a pernicious absurdity. Summarizing his conclusions about the consent decree at that time, he said: "The consent decree was found to be riddled with ambiguities, 'a potential lawsuit in every word' *and apparently not to have contributed materially toward rate reduction.* For these reasons it was felt that the decree should be abolished, and that Federal regulatory authority over interstate pipe lines should be confined to the Interstate Commerce Commission." WOLBERT I at 163. (Emphasis added.) On this point we find WOLBERT I far more persuasive than WOLBERT II.

454 However, we obviously disagree with the Division's blanket condemnation of the valuation rate base.

455 These views are expressed in the "MOTION OF THE UNITED STATES TO VACATE THE FINAL JUDGMENT AND FOR OTHER RELIEF" filed on November 16, 1981, in *United States v. Atlantic Refining Company*, Civil Action No. 14060 (D.D.C.). They have a long history. The Antitrust Division lost faith in the consent decree at an early date. Indeed, it may never had any faith in the arrangement. Wartime pressures and decisions made by those in higher authority in response to those pressures led the Division to assent to what it regarded as a ludicrously cheap sweetheart settlement that settled nothing. Thus, for example, one journalistic commentator of that day wrote of the disposition of the "Elkins Act suit against the pipe lines with a consent decree so weak that two attorneys who worked on the case for the government refused to sign it, and one of them resigned in disgust." The quotation, which is from a piece by Mr. I. F. Stone entitled *A People's War-Or Monopoly's* that appeared in The Nation in 1942, can be found in R. Engler, ed., *America's Energy* 192 (1980). *See also* JOHNSON at 299: "Within the Justice Department . . . opposition to signing the decree in its existing form did not subside on the staff level." At 303-304 JOHNSON says: "[R]eading between the lines, it seems likely that the speed with which the whole affair was brought to a close reflected pressure from the top level of the Roosevelt administration. The abruptness with which Arnold agreed to accept the draft . . . over the opposition of his staff, plus the unwillingness of his negotiating staff to sign the decree, lend credence to this interpretation."

As long ago as 1944 Francis Biddle, then the Attorney General, expressed skepticism about what, if anything, the decree had actually accomplished. 90 Cong. Rec. 3202 (March 28, 1944). After the Supreme Court rejected the government's ingenious attempt to reinterpret creatively the decree's language in the light of hindsight *(see* pp. 316-17, *supra)* the Antitrust Division came to regard the decree as useless. That conclusion as to its utter futility was reached a long time ago. *See* PIERCEY at 45.

456 The decree requires annual reports to the Division by each of the defendants.

457 We do not intend to intervene unless harm is alleged. When such an allegation is made, however, our rules of decision must be based on standards less capricious than the consent decree's 7% limitation.

458 Of course 7% is less than 8%. And it is much less than 10%. However the consent decree's 7% is so very special a 7% and so prone to manipulation by those purportedly restrained by that limit as to render elementary school arithmetic a deceptive guide to economic reality.

459 *See* pp. 336-38, *infra*.

460 *See* JOHNSON at 472-75.

461 By either the Interstate Commerce Commission or this Commission.

462 The instant case and the *TAPS* proceeding appear to have killed that idea. Ergo the industry's current interest in deregulation.

463 That is contrary to basic regulatory principles. *See* p. 272, *supra*. But the consent decree sanctions it. *See* ¶ III (d) of the decree and the discussion thereof in WOLBERT I at 156-59.

464 Many carriers intervened in this case. All of them are ably represented. And many of them made exhaustive presentations. Neither the evidentiary presentations nor the arguments based on them are perfectly homogeneous. There is no all-embracing "industry view." However, these intra-industry differences relate in the main to nuance and emphasis. Hence we think it unnecessary to detail each and every fine point made by the various participants. When we speak of the "industry's position," we refer to the broad consensus within its ranks. Our study of the record and of the briefs leads us to believe that the positions espoused by the Association of Oil Pipelines reflect the essential views of practically all of its members.

465 The industry placed much stress on this point in the abortive rulemaking proceedings in which rate of return was a central issue. *See Association of Oil Pipelines*, 10 FERC ¶ 61,023 (1980). *See also* n.247, *supra*. In these proceedings the point is made with more art and with a greater measure of subtlety. Nevertheless, it is still here.

[466] They have within the past year yielded as much as 15%.

[467] ASSOCIATION BRIEF at 120.

[468] *Id.* at 123.

[469] We are merely summarizing the general idea. Different companies favor different numbers. But those differences are not material. Of course, all of the presentations were heavily influenced by money market conditions when the record was made and the briefs written. Hence our sketch of the industry's position reflects a certain amount of updating by us. But we have made every effort to be faithful to the essentials of the arguments made.

[470] The industry, of course, asks for a liberalized valuation formula that would widen the gap between valuation and original cost. *See* pp. 281-83, *supra*.

[471] We gather that most pipeline owners believe that their properties are in the "high-risk" class.

[472] There is an air of unreality about all this. It is a little hard to believe that the industry is really serious. Does it actually think that the courts would sanction anything as openhanded as that? We note in this connection that:

(A) The industry lived happily with the ICC's 8% and 10% tests for many years.

(B) It continued to do so long after inflation had become virulent.

(C) Indeed, it objected strenuously to the ICC's 1976 decision to broaden the scope of its valuation rulemaking inquiry to include a re-examination of rates of return.

(D) By 1976, inflation was an old, a well-known, and a very serious phenomenon.

(E) Neither the industry's arguments about its competitiveness nor its post-1950 earnings record suggests that returns of this magnitude are likely to be realized in an appreciable number of cases.

(F) Loose and permissive though the consent decree is, it would certainly inhibit practically everybody affected by it from sending that kind of money upstream to an oil company parent.

This is what we had in mind when we commented earlier on the industry's "the best defense is a good offense" strategy. *See* n.118, *supra*.

[473] No other industry whose rates are regulated at the Federal level makes any such claim.

[474] *Cf. FARMERS* at 419-20.

[475] We are not unmindful of the 10% standard later applied to refined products lines. That however is irrelevant here. Even the industry concedes that the differential is now outmoded and unjustified.

[476] *See* n.410, *supra*.

[477] *Reduced Pipe Line Rates and Gathering Charges I*, 243 ICC 115, 142 (1940).

[478] The Court of Appeals also took that view. It pointed out that though the ICC of 1948 adhered to the 8% on valuation rule laid down by the Commission of 1940, an essential prop of the earlier decision was absent from the later one. In the *FARMERS* court's words (at 415, second paragraph of n.13):

[B]y 1948, the ICC was no longer willing to accept the "general assertion that rates for pipeline service should make allowance for the need of [higher] earnings in view of the material hazards of the business" ... Nonetheless, having made this observation, the ICC continued to utilize the 8% rate of return maximum that it developed at a time when it did accept the industry's "higher risks" assertion. (Citations omitted.)

[479] It must be remembered that when the Interstate Commerce Commission of 1940 dealt with these matters, it found rates of return that it considered outlandishly high. *Reduced Pipe Line Rates and Gathering Charges I*, 243 ICC 115, 130-44 (1940). The general tenor of that Opinion suggests that far from being intended as permanent, the 8% standard was viewed by the ICC of that day as a mere first step (a giant step in view of the state of affairs at that time) to oil pipeline rate reform. See Cook, *Temporary National Economic Commission Monograph No. 39, Control of the Petroleum Industry by Major Oil Companies* 19 (1941); Note, *Public Control of Petroleum Pipe Lines*, 51 Yale L.J. 1336 (1942).

Though the industry's critics later denounced the 8% on valuation rule as farcical and openhandedly generous and though they have done so with great heat in these proceedings and in others before this Commission, that was not quite their view in 1940. They thought that a step forward (which they hoped would be the first of a series of such steps) was being taken. Thus, for example, a journalist as far to the left and as critical of the oil industry as Mr. I. F. Stone wrote in 1941 that "the liberals on the I.C.C. have finally prevailed upon their colleagues to exercise, for the first time, the power given them by Congress thirty-seven years ago to regulate pipe lines. An order has been issued reducing crude-oil pipe line rates to an eight percent return (they have been averaging 25 percent ...) No doubt the companies will use this as an additional argument for softening up the consent decree they are now negotiating behind the scenes with Thurman Arnold. Thus the I.C.C., like Providence, moves in mysterious ways. The joke is that very few independents will get to the pipe lines anyway. So long as we permit integrated companies to control the value of oil from the well to the service station pump, a reduction in the rates they charge themselves for the use of their own pipe lines merely forces them to put less in one pocket and more in the other." Stone, *Pipe Lines and Profits* (1941), reprinted in R. Engler, ed., *America's Energy* 187-89 (1980).

[480] The last two sentences of footnote 8 to *FARMERS* (at 413) read: "The important point ... is that in passing the Valuation Act, Congress explicity refused to endorse any ratemaking theory ... Consequently, to the extent that the ICC finds a mandate for 'fair value' ratemaking in the Valuation Act, we disagree." See also the court's discussion of and serious concern about "double counting" at 418-21 of *FARMERS*.

[481] *See* pp. 223, 327-28, *supra*.

[482] There is, of course, a question as to whether this kind of purchasing power parity in fixed-income securities is or is not a good idea. We put that

question to one side because what we are really dealing with here is the fair rate of return on the *equities* of regulated industries.

[483] Much political and financial history revolves around this conflict.

[484] The industry's rejoinder is that pipeline assets are not bonds. We agree. They are much riskier. We also agree that the investor must be compensated for that. But this compensation must be related to the *quantum* of additional risk. And it cannot be given twice.

[485] The hypothetical case is, of course, fantastic. This industry bargains very hard with investment bankers and with prospective lenders.

[486] The only possible defense would be the so-called "business judgment" rule. And the borrower would have to be in really terrible shape, it would have to be on its economic deathbed, for that to wash.

[487] That is what would be said for public consumption. Privately, management would in all probability laugh at the demand for a cost of living allowance double the actual rise in the cost of living as a humorous bargaining ploy that the union's negotiating committee concocted in a really lighthearted moment at a bar and one that the negotiators would be happy to trade off for an additional paid holiday. And that is pretty much our reaction to some of the industry's more extreme rate of return arguments.

[488] Both the flaws and their fatality were obvious to the *FARMERS* court. They are also obvious to us. After the Court of Appeals remanded the case to this Commission, the industry offered torrents of expert testimony in support of its position that it is entitled to full compensation for inflation in the rate base and to a second dose of compensation for inflation in the rate of return. That evidence has not impressed us.

[489] *See* p. 101, *supra*.

[490] *But see* pp. 351-57, *infra*.

[491] Some regulatory purists would add a caveat to that. They would insist that this is so only when the financing is prudent. In their view, the full quantum of interest called for by contracts and by trust indentures cannot be given when the financing has been reckless or imprudent. We agree. But the point is of no practical importance in this context. Unlike the railroads or the utilities, the oil industry has never been "banker-controlled." If by chance either a suspiciously open-handed sweetheart deal with an investment banking syndicate or some patently inebriated financing decision should turn up in a particular oil pipeline rate case, the matter can be dealt with on an ad hoc basis.

[492] The burden of showing that this is so is, of course, on the rate applicant.

[493] The burden of quantifying this premium will also be on the rate applicant.

[494] This is an industry in which lenders are prone to insist on promises from third persons to answer for the borrower's debts. Were those third persons surety companies or credit indemnity insurance companies, it would be obvious that the premiums paid them are part of the cost of borrowing. Lenders who exact such guarantees seldom pay for them out of their own pockets. They normally insist that the borrower pay the premium. From the borrower's perspective that premium is clearly part of his cost of capital. It is an element of the total price that he absolutely has to pay for access to other people's money. And that is true even when in *form* it is the *lender* who pays the premium. In that situation the premium is initially part of the lender's cost of capital. But since borrowers are normally more necessitous than lenders and since borrowers whose creditors insist on fortifying themselves with supplemental undertakings from people other than the borrower himself must be deemed willing to pay an interest rate that covers the cost of those undertakings, it is fairly obvious that the cost of credit insurance is practically always borne by the borrower. Where the borrower is an entrepreneur, that cost is a direct and an inescapable cost of doing business. Over the long run the borrower-entrepreneur must pass that cost on to his customers in the same way that he has to pass on the cost of fire insurance or liability insurance.

[495] *See* pp. 239-42, *supra*.

[496] It is easier, and we think better, to work with the facts as they are than with theories about what the facts ought to be, might be, or could be if things were different.

[497] *See* pp. 312-17, *supra*.

[498] A legal system that deems itself capable of putting price tags on arms, legs, pain, suffering, and life itself should be able to rise to this occasion.

[499] *See* p. 338, *supra*.

[500] *See* pp. 251-57, *supra*.

[501] That is our difficulty with the industry's position. Its ultra-elastic rate of return yardstick is unrelated to anything else known to us.

[502] Oil pipelining is part of the oil industry. So it makes sense to look at the larger whole of which the pipelines are merely a small part.

[503] In looking at returns on oil investments generally, pipeline revenues must be excluded. Otherwise, one is in effect assuming the answer to the very question he is seeking to investigate. To put it another way, you are comparing oil pipelines to themselves.

[504] Items (v) and (vi) may be important for the independent pipeliners, such as Williams.

[505] Everybody who uses the lines is in the oil business. Hence it is hard to see how shippers can have a legitimate complaint on the ground that profits throughout the oil industry are obscene. They themselves are sharing in those allegedly excessive profits. So what claim do they have to a free or even a cheap ride on the pipelines from their big brothers who own those facilities?

Such a claim arises only when *pipeline* profits are altogether out of line with *oil* profits. That was the case in 1906. And that was the evil that the statute sought to remedy. But the ICC failed to act. So the disparity between pipeline profits and oil profits continued. Through the 8%-10% standard and the consent decree, the ICC and the Department of Justice sought to eliminate or lessen that disparity. Some say that the disparity no longer exists. If they are right, there may no longer be any need for the statute. But having been directed by the Congress to administer this putatively obsolete statute, we are not at liberty to proceed on that assumption. Instead, we are constrained to assume that there is at least a potential disparity between pipeline investments and returns on other kinds of oil investments. Moreover, we are obligated to assume further that this potential disparity is at least something of a social evil. Hence it has to be checked. We think the methodology fashioned this day an appropriate check.

[506] These require no citation. Of course, the "contributory negligence" and the "voluntary assumption of risk" of which we speak here are very cool, calm, and very rational. That doesn't matter. What does matter is that the risks for which compensation is sought were and are self-created. Tort lawyers and tort scholars may think those doctrines outmoded. And they have been much diluted. We make no claims to special expertise in tort lore. But it is our understanding that even in the most liberal and the most permissive of jurisdictions one who knowingly creates a danger to which he then falls victim cannot look to others for compensation in tort. We regard this as a sound regulatory precept. Indeed, we can conceive of no alternative to it. It lies at the heart of the prudence principle so frequently invoked by regulators and by those who litigate before them.

[507] Section 165(d) of the Internal Revenue Code provides in pertinent part that "Loses from wagering transactions shall be allowed to the extent of the gains from such transactions." *See also* 26 C.F.R. § 1.165-10 (1982) and *McClanahan v. United States*, 272 F.2d 663, 664 (5th Cir. 1959), *cert. denied*, 368 U.S. 913 (1961).

[508] It is not just that the rates themselves will be high. The following factors are also important. Indeed, they may well be much more important:

(A) Those high equity rates of return will be given on a fair value rate base; and

(B) They will be given to an industry most of whose capital is debt capital.

See pp. 351-57, *infra.*

[509] *See* the preceding footnote.

[510] But those sectors must be sectors in which the pipelines' parents would be likely to invest. Hence returns on investment in such personal service enterprises as advertising agencies, brokerage, and law firms are out of bounds.

[511] By "relevant period" we mean the time period that was looked to in order to derive the appropriate nominal rate of return.

[512] Additions and retirements may make for nice questions of computation. But even nicer questions of that sort have been found manageable. We see no reason why that should not be so here.

[513] The *FARMERS* court expressed serious concern about the fairness of the cost of reproduction concept. Distinguishing "reproduction cost" from "replacement cost," it said: "[T]he valuation formula is weighted rather heavily toward inflation. That is to say, since reproduction new reflects the higher prices characteristic of modern materials, without also reflecting the efficiencies of modern technology—as would replacement cost—it overemphasizes inflation's effect on the hypothetical cost of reconstructing the plant." *FARMERS* at 419, n.29.

That point is valid and important. Indeed, there are contexts in which it is crucial. But this is not one of them. The methodology that we this day adopt obviates any cause for excessive concern over the dichotomy between reproduction cost and replacement cost. Suppose that reference to reproduction cost rather than replacement cost does lead to an overly generous allowance for inflation in the rate base. What of it? The rate of return on equity is reduced by the precise amount of the overstatement.

[514] *See* n.511, *supra.*

[515] *See* pp. 348-49, *supra.*

[516] Indeed, when management fails to borrow enough to give the ratepayers what the regulators regard as a square deal, a hypothetical capital structure that does that is substituted for the actual one. *See, e.g., Communications Satellite Corporation v. Federal Communications Commission*, 611 F.2d 883, 902-908 (D.C. Cir. 1977). *See also Kentucky West Virginia Company*, 1 FERC ¶ 61,111 (1977), *rehearing denied*, 2 FERC ¶ 61,020 (1978), *affirmed sub nom. Public Service Commission of Kentucky v. Federal Energy Regulatory Commission*, 610 F.2d 439 (6th Cir. 1979).

[517] *See* pp. 251-57, *supra.*

[518] Potential competition may well be of greater moment than actual competition. *See* pp. 186-96, *supra.*

[519] *See* pp. 102-103, *supra.* Were that standard to be applied here, we would trend only the equity portion of the rate base for inflation.

[520] *See* n.217, *supra.*

[521] However, we are using a valuation system, not an original cost system. So the standards of propriety traditionally associated with original cost are not necessarily controlling. That is so because the two systems differ radically from each other in the way in which they allocate revenues over time. *See* pp. 269-80, *supra.*

[522] They are also influenced by the thinness of the equity cushions. That thinness spawns financial risks. Our methodology compensates the equity investor for those risks by giving him the full benefit of the leverage effect.

[523] Our doubts about the validity of a narrowly arithmetical view of the regulatory task in this field have already been voiced. *See* pp. 250-54, *supra.*

[524] One who looks at the numbers that way will also give some weight to the front-end load and income-bunching factors discussed at pp. 268-78, *supra.*

[525] These classes often have many members.

[526] The quotation is from page 8 of the Division's memorandum of April 3, 1978, in *Valuation of Common Carrier Pipelines*, Docket No. RM78-2 (previously known at the Interstate Commerce as *Ex Parte 308*). Note that the Division does not take an extreme point to point position. It does not urge the Commission to see to it that the rate from A to B is perfectly aligned with the rate from D to E. Rather, it speaks of comparing one "pipeline" with another when both are under common ownership and of "wholly separate" pipeline assets.

[527] ASSOCIATION BRIEF at 124.

On this issue, however, the industry is not really that far apart from the Antitrust Division. The industry concedes that there is a place for "segmented regulation" in unique, new, and geographically separate systems such as TAPS. *Id.* at 123.

[528] *Houston Lighting & Power Company v. United States*, 606 F.2d 1131, 1148 (D.C. Cir. 1979), *cert. denied*, 444 U.S. 1073 (1980), *affirming Incentive Rate on Coal-Cordero, Wyoming to Southern Lake, Texas*, 358 ICC 537 (1977).

[529] Those factors engender most of the rate disparities. *Cf.* J. A. Hansen, *Competitive Aspects of the United States Petroleum Industry: Implications for Regulatory Analysis* 129 (Yale University Ph.D. dissertation, 1980): "[T]he results of the rate analysis tend to confirm the expected incentive for pipelines to use high rates in non-competitive markets to subsidize competitive initiatives in markets with a greater number of firms."

[530] We note in this regard that no one contends that the Trans Alaska Pipeline System's owners should be permitted to "average" their Alaskan earnings with those derived from pipeline operations in the Continental United States.

[531] At first blush, this special rule about shipper-owners who treat themselves too well seems irrelevant to cases, like this one, involving pipeliners that move little or no oil of their own. But oil pipelining is a complicated business. We have said that before. And we now have to say it again. In the instant case the complaining shippers allege that Williams, which happens to be in the fertilizer business, has moved its own fertilizer over its own pipelines at unreasonably low rates. This is said to have been detrimental to unaffiliated oil shippers. Should the shippers support these claims by an adequate prima-facie showing, questions that demand the most painstaking examination will be presented.

[532] That happened here. See the last sentence of the *FARMERS* court's footnote 4 at 411.

[533] *Cf.* Note, *The Mutual Fund and Its Management Company: An Analysis of Business Incest*, 71 Yale L.J. 137 (1961).

[534] ASSOCIATION BRIEF at 140.

[535] The reference is to 18 C.F.R. §§352-1(13) and 1(14) (1982). The first of these sections requires that "The records and supporting data of all transactions with affiliated companies shall be maintained in a separate file .... The file shall be maintained so as to enable the carrier to furnish accurate information with supporting documentation about particular transactions within 15 days of the request."

That same section also imposes the following additional requirements:

(i) Each bill rendered by an affiliated company shall state specifically the basis used for determining charges, unless the file contains other information to support the specific basis of the charges; and

(ii) The carrier shall record, as the cost of assets or services received from the affiliated supplier, the invoice price (plus any incidental costs related to those transactions) in those cases where the invoice price can be determined from a prevailing price list of the affiliated supplier available to the general public in the normal course of business. If no such price list exists, the charges shall be recorded at the lower of their cost to the originating affiliated supplier (less all applicable valuation reserves in case of asset sales) or their estimated fair market value determined on the basis of a representative study of similar competitive and arm's-length or bargained transactions.

The second of the two sections does not deal specifically with payments to affiliates. It relates to *all* transactions. It reads: "*All* [emphasis added] charges to the accounts ... shall be just, reasonable and not exceed amounts necessary to the honest and efficient operations and management of carrier business. Payments shall not exceed the fair market value of goods and services acquired in an arm's-length transaction."

[536] ASSOCIATION BRIEF at 140.

[537] *See, e.g., Shlensky v. South Parkway Building Corporation*, 19 Ill. 2d 268, 166 N.E. 2d 793 (1960), holding that in transactions between corporations under common control "the defendant directors had the burden ... to establish the fairness and reasonableness of the various transactions, and that the corporation was paid full consideration and suffered no detriment, nor was deprived of any proper benefits." 166 N.E. 2d at 805. Also noteworthy in this connection is *Ripley v. International Railways of Central America* and *United Fruit Company*, 8 N.Y. 2d 430, 209 N.Y.S. 2d 289, 171 N.E. 2d 443 (1960). Like most of the corporation cases in point, *Ripley* was a shareholder's derivative action. But the business context that gave rise to that case had much in common with the one here involved. *Ripley* involved the relationship between the United Fruit Company and its transportation affiliate, International Railways of Central America. The plaintiffs were minority stockholders in the railroad. They claimed that United Fruit had used its power over the railroad to secure unfairly low freight rates for its bananas. In sustaining that claim and in affirming a most substantial judgment in favor of the victimized subsidiary, the intermediate appellate court said: "*[C]ontracts fixing shipping rates become suspect and must be carefully scrutinized since they obviously were dictated by the controlling corporation.* Where a divided loyalty exists, as it clearly did here, it becomes incumbent on the controlling corporation to justify the fairness of any transactions which are questioned ... While there was an attempt to give a verisimilitude of complete independence and separation between the companies, the realities presented a case of complete domination. That stubborn fact cannot be dissipated by ingenious but unconvincing, arguments." 8 App. Div. 2d 310, 188 N.Y.S. 2d 62, 72 (lst Dept. 1959). (Emphasis added.) Those words seem in point here. *See also Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590 (1921).

[538] This is no novelty. As long ago as 1922, in the heyday of fair value, a Supreme Court that was never accused of insensitivity to the just claims of regulatees, held unanimously that parent-subsidiary transactions "require close scrutiny ... to prevent imposition upon the community." *City of Houston v.*

Southwestern Bell Telephone Company, 259 U.S. 318, 323 (1922).

539 *See* n.535, *supra*.

540 Shippers do not litigate for the fun of it. So they will seldom find it worth their while to raise issues about expenditures that have no real impact on the rate.

541 This very case shows that. As the *FARMERS* court observed, "petitioners argue that payments by Williams to two affiliated companies for terminal leases and administrative services were unreasonably excessive, allegedly suggesting intracorporate extravagance that should not be charged to ratepayers." *FARMERS* at 411, last sentence of the court's footnote 4.

542 See the quotation from the Uniform System of Accounts in n.535, *supra*.

543 Such explorations can get out of hand. That is true of all inquiries. But experienced hearing officers know how to see to it that investigations do not encroach on eternity. In areas such as this, we rely heavily on the acumen of our administrative law judges.

544 Internal Revenue Code § § 1501-1504.

545 As the Court of Appeals for the Second Circuit said when it spoke through Judge Learned Hand in *Helvering v. Gregory*, 69 F.2d 809, 810 (2nd Cir. 1934): "Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." Also in point are Judge Hand's subsequent observations when he dissented in *Commissioner v. Newman*, 159 F.2d 848 (2d Cir. 1947), *cert. denied*, 331 U.S. 859 (1947): "[T]here is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant." 159 F.2d at 850-51.

546 Oil pipeline companies are not "utilities." For purposes of resolving this issue, however, they can properly be viewed as though they were "utilities." With respect to this question, we see no valid distinction between "utilities" and other types of businesses whose prices are regulated.

547 At this point a footnote cited *Florida Gas Transmission Company*, 47 FPC 341, 363 (1972).

548 *Columbia Gulf Transmission Company*, 20 FERC ¶ 61,036 (1982).

549 That need stems from *City of Charlottesville, Virginia v. Federal Energy Regulatory Commission*, 661 F.2d 945 (D.C. Cir. 1981).

550 Oil pipeline regulation is something of an exception to that. But that is so only with respect to the rate base.

551 That difference stems from the then novel depreciation provisions of the Internal Revenue Code of 1954. In this area that enactment made a sharp break from its predecessor, the Internal Revenue Code of 1939.

552 *See* Sections 167 and 168 of the Internal Revenue Code and the regulations thereunder.

Congress opted for this course because it thought that "The faster tax write-off would increase available working capital and materially aid growing businesses in the financing of their expansion. For all segments of the American economy, liberalized depreciation policies should assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of living." H.R. Rep. No. 1337, 83d Cong., 2d Sess. 24 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 26 (1954).

553 Like every generalization, this one has its exceptions. But those exceptions are rare.

554 After a certain cross-over point is reached, however, the situation reverses itself. Tax depreciation having been exhausted for the most part becomes very low. Regulatory cost-of-service depreciation, on the other hand, remains constant. So the latter exceeds the former by a wide margin.

555 Based on the 46% rate at which corporate income is normally taxed.

556 *See* n.552, *supra*.

557 ASSOCIATION BRIEF at 128-129.

Some may find an inconsistency between this position and the industry's even more vehement contention that an original cost rate base would be unworkable here because under it earlier generations of ratepayers would be forced to subsidize *future* ones.

558 *FARMERS* at 411, n.5. (Emphasis added.)

559 *See* our Order No. 144, *Tax Normalization for Certain Items Reflecting Timing Differences in the Recognition of Expenses or Revenues for Ratemaking and Income Tax Purposes, FERC Statutes and Regulations* ¶ 30,254 (issued May 6, 1981): "[T]ax normalization matches tax benefits with cost responsibility. The Commission finds that this matching concept leads to fair and equitable results both to the regulated entities and their customers. Equity is also achieved over time by the use of tax normalization." (At 31,525-31,526.) *See also* our Order No. 144-A, Order Denying Rehearing, Lifting *Stay and Clarifying Order, FERC Statutes and Regulations* ¶ 30,340 (issued February 22, 1982).

560 *See Buckeye Pipe Line Company*, 13 FERC ¶ 61,267 (1980).

561 *See* pp. 264-77, *supra*.

562 At the purely legal level the oil pipeline case differs sharply from the utility case. Save for historical exceptions of the so-called "grandfather" type, Sections 167 and 168 of the Internal Revenue Code preclude utilities that do *not* normalize from availing themselves of accelerated depreciation. That prohibition does not apply to oil pipelines. What this means is that:

(1) Congress *mandated* normalization for utilities; but

(2) It did no such thing for oil pipelines.

563 Perhaps not in Japan, West Germany, or Switzerland where people are said to be thriftier than they are here. But we are not talking about those countries. We are speaking of the United States, which has a population whose propensity to consume appears very high.

[564] *See Accounting Principles Board Opinion No. 11*, which adopted normalization for 1968 and subsequent years.

[565] An elaborate statistical demonstration of this phenomenon appears in *Effective Corporate Tax Rates in 1980*, A Special Supplement prepared by the Editors of Tax Notes, Arlington, Virginia (1982).

[566] Since economic reality keeps them from getting more now, their choice is obvious.

[567] *San Antonio, Texas v. United States*, 631 F.2d 831, 847 (D.C. Cir. 1980) (Emphasis added).

[568] Note should be made of a special point peculiar to the instant case. For tax purposes, Williams calculates, and is entitled to calculate, its depreciation deductions on the basis of the price that it paid for its properties when it acquired them back in 1966. However, we have this day held that 1966 price irrelevant and out of bounds for regulatory purposes. Hence the depreciation component of Williams' regulatory cost of service will be substantially less than the depreciation deductions quite properly claimed on its Federal income tax returns. To whom do the tax benefits stemming from this aspect of the matter belong? Do they go to the shareholders of Williams' parent? Or do they go to the ratepayers?

The key thing here is that the shippers will *not* be paying the depreciation expense that spawns *this* tax benefit. Hence it follows that:

(A) This benefit belongs to the investors. They, and they alone, are paying the additional depreciation expense that spawns the tax benefit.

(B) Accordingly, deductions from the rate base to reflect this benefit would give the ratepayers an inequitable windfall.

[569] That legislative decision led us to suggest earlier that the carriers should go to Congress if they wish to obtain that same favorable result in the accelerated depreciation area where Congress has not spoken. *See* p. 382, *supra*.

[570] 78 Stat. 35.

[571] *See* the definition of "public utility property" in Sections 46(c)(3)(B) and 46(f)(5).

[572] Congress repealed the credit in 1969. In 1971, it reinstituted the credit, readopted the restrictions of Section 203(e)(2), and enacted Section 46(f).

[573] There is also a third way. But it is irrelevant here.

[574] When Congress enacted Section 46(f), it stated:

Although the technical term "cost of service" includes the cost of common stock investment (that is, the cost of capital rate assigned to such investment times the amount of such investment), the rule of the first option—permitting a rate base reduction if it is ratably restored—overrides the flat rule prohibiting any reduction of cost of service. S. Rep. No. 437, 92d Cong., lst Sess. 39, n.4 (1971).

This indicates to us that the term "cost of service" of Section 203(e) included the return allowance and that hence rate base reduction was prohibited. It took a special declaration to override that. One commentator agrees:

> Any "other method" of reducing cost of service would seem to comprehend reductions in return allowance or in rate base. Meilman, *Public Utilities, Tax Accounting for Depreciation and Investment Credits* (1979) at 13 n.68. *See also* footnote 16 to the opinion of the Supreme Court of California in *Southern California Gas Co. v. Public Utilities Commission*, 153 California Reporter 10, 591 P. 2d 34, 43 (1979).

[575] *Cf. North Central Airlines, Inc. v. Civil Aeronautics Board*, 363 F.2d 983 (D.C. Cir. 1966), and *States Steamship Company v. United States*, 428 F.2d 832 (Ct. Clms. 1970). Both cases held that the investment tax credit could not be used to reduce subsidies. We see no distinction between subsidies and rates.

[576] Hindsight convinces us that it was wise for the judge to begin that way. His questions were carefully worded and precise. They facilitated and expedited an inquiry that could have bogged down interminably.

[577] Designated question G in the judge's document.

[578] This was the judge's question H.

[579] *See* pp. 199-206, *supra*.

[580] *See FARMERS* at 422.

[581] The judge will, of course, pass on the preference, prejudice, and discrimination issues. Those issues involve the Explorer Pipeline Company as well as Williams. *See FARMERS* at 423-24. Explorer has moved for the dismissal of the proceedings as to it. We refer that motion to the judge.

Appendix

What was the Nation's 1981 Oil Bill?-A Conservative Estimate

To calculate the amount spent by ultimate consumers of petroleum products, the first step was to determine demand. The source for the figures in Column I was the March 1982 *Survey of Current Business*, S-31. This shows United States domestic demand in millions of barrels for the various categories of petroleum products in 1981. The source for the average price of each of the products in Column II was the *Monthly Energy Review*, May 1982, Part 9.* To arrive at the amounts expended, the following adjustments were made:

(a) Gasoline-The average price of a gallon of gasoline (which includes all types of gasoline) has a substantial tax component. To eliminate that, 10 cents a gallon was charged for the tax. Thus the amount expended was calculated by multiplying the 2.415 billion barrels x 42 (gallons per barrel) x 125.3 cents a gallon.

(b) Distillate fuel oil includes both diesel oil and home heating oil. The average of the two prices was used multiplied by the number of gallons.

(c) Residual fuel oil - price per barrel x number of barrels.

(d) Aviation fuel - number of barrels x 42 x price per gallon.

(e) Liquefied gases-the average of the wholesale prices of butane and propane was used. The amount spent by consumers at retail substantially exceeded the amount in the table.

(f) Asphalt-the number of barrels was converted to short tons by dividing by 5.5. This figure, 22.7 million tons was multiplied by $135 a ton, the 1980 price per ton.

(g) Kerosene-the 1980 price per gallon was used times the volume x 42.

(h) Lubricants-no breakdown was available of products so no value was assigned.

The total is thus a conservative amount.

Amount Expended for Petroleum Products by United States Consumers in 1981

Category	I *Volume*[1] *(Millions Barrels)*	II *Price*[2] *(Cents per gallon)*	III *Amount* *(Billions of $)*
a. Gasoline	2,415.0	135.3[3]	127.1[3]
b. Distillate Fuel Oil	1,032.0	113.3[4]	49.1
c. Residual Fuel Oil	752.5	$32.50 a barrel	24.5
d. Aviation Fuel	368.6	131.5	20.4
e. Liquefied Gases	542.2	53.8[5]	12.3
f. Asphalt	124.8	$135.0 per sh. ton[6]	3.1
g. Kerosene	46.2	90.1[7]	1.7
h. Lubricants	56.0	—[8]	—[8]
	5,337.3		$238.2

[1] Source: *Survey of Current Business,* March 1982, p. S-31.
[2] Prices excluding taxes at retail unless otherwise noted. Source: *Monthly Energy Review,* May 1982, Part 9.
[3] Price includes taxes. In calculating amount 10 cents a gallon was eliminated for taxes.
[4] Average of diesel and home heating oil.
[5] Average of butane and propane at wholesale.
[6] 5.5 barrels = a short ton. 1980 average price used.
[7] 1980 average price.
[8] No products identified so no prices could be established.

— Appendix Footnotes —

* With respect to asphalt and kerosene prices, supplemental information was obtained from the Energy Information Administration of the Department of Energy.

— COMMISSIONER SHELDON'S STATEMENT —

Sheldon, Commissioner, *concurring:*

I concur in the result and wish to add a few words of my own. I do so for several reasons.

One is that I am the only member of the present Commission who has been here since October 1, 1977, the day on which this agency was created and also the day on which it inherited both the Interstate Commerce Commission's general oil pipeline rate jurisdiction and the instant case. So I have been involved with this area for a much longer time than have any of my present colleagues. That seniority has not given me greater expertise than they. I make no claim to that.

What I can say, and should say, at this time is that every person who has served on this Commission since it began five years ago has spent much time and energy on the questions dealt with in this Opinion. Our decision has been long delayed. Many factors contributed to that [1], but bureaucratic sloth was not one of them.

A second reason for this individual statement relates to an important point made at considerable length in the Commission's Opinion. That is the oil pipeline rate problem is essentially legislative and cannot be resolved by this or any other administrative agency. I agree.[2]

But I go further. In my view, the Interstate Commerce Act's oil pipeline rate provisions are totally anachronistic. The oil industry that evoked them has practically nothing in common with the oil industry of today. In 1906 the United States was by far the most important oil producing country. The price of the commodity was made here.

It was widely believed that the strength of the large producers' grip on oil and on its price stemmed in large measure from their mastery of the pipelines and that they used their pipeline-buttressed monopoly power to exploit the independent producer.[3] The majority says that. It quotes at length from Ida Tarbell. Its opinion is also liberally sprinkled with statistical materials of later vintage and greater contemporary relevance.

My colleagues are bashful about drawing the conclusions to which their historical investigations point. Those conclusions, which seem obvious to me, are that:

(1) Ida Tarbell's world is not our world.

(2) John D. Rockefeller, Sr., has been dead for a long time, and his world isn't our world either.

(3) The contemporary policy case for continued oil pipeline rate regulation is uneasy and unpersuasive. This is and has for a long time been regulation for regulation's sake. It makes no visible contribution to the well-being of the American people.

(4) Save for oil transit, the Government is no longer interfering in petroleum economics. This last vestige should be deregulated. The task of assuring freedom of access to the lines should be turned over to the Department of Justice and to the courts.

Turning to what has actually been held this day, I have serious reservations about the administrative practicality of the rate of return formula. That formula's key concepts (an imputed suretyship premium and a so-called "real entrepreneurial rate of return on common equity") are novel and unprecedented. They are easy to state. But they will be hard to apply.[4] These new ideas may well turn out to be fruitful sources of:

(1) unproductive and socially undesirable litigation; and

(2) handsome annuities for legal practitioners.[5]

Yet, as stated at the outset of this Opinion, I concur in the results reached by the majority Opinion. I will briefly set forth my reasons.

The majority continues to approve the previously adopted valuation rate base. I concur. A different manner of stating what has been set forth in the majority Opinion is that under the 1906 Act, this Commission is in the business of regulating an industry for the benefit of industry. I agree that the ultimate consumer of the product transported by the regulated industries will not feel the impact of our regulation, whatever methodology we approve. Therefore, the historical adoption of valuation rate base treatment leads me to conclude that a present change of course in treatment would cause economic disarray in an industry which appears to be serving its purpose quite well.

Having arrived at valuation rate base treatment for this industry, the majority Opinion proceeds to allow the investors the benefit of the inflation associated with that methodology. I concur. I am aware of only two ways in which an investor could be allowed the benefits of such treatment within the methodology adopted. One would be through depreciation and a consequent recoupment of inflation's value through the "cost-of-service" component of the rates. The majority's "condition percent" depreciation method does not do this. I have no quarrel with this result. The only other vehicle for the investor to obtain the benefits of inflation is through return. I concur with the result of this portion of the majority's Opinion.

Whatever return number is ultimately arrived at in Phase II of this case, the majority Opinion would apply that number to the entire valuation rate base. In this result, I concur. It makes logical sense. If the industry is to be allowed a valuation rate base, and if the return dollars allowed (as opposed to earned) are to be alike or akin in their magnitude to those earned by the regulated industry's brethren for whose benefit the regulation is applied, then the return allowed should be applied to the entire valuation adjusted rate base.

In this respect, there should be no double counting. The majority Opinion proposes to prohibit double counting by backing out from a benchmark return number an inflation component. I concur in this result as well.

As indicated previously, however, I must express concern with two matters which may very well affect the ultimate result reached in Phase II of this case. One involves our final generosity in the return number allowed. The second involves the administrative implementation of our methodology.

As stated earlier, this industry appears ripe for deregulation. I am drawn to this conclusion by virtue of indications in the record that competitive forces are at play among the members of the industry we regulate, as well as sources of competition outside that industry. Therefore, it makes logical sense to set an *allowed* return at a level high enough to be consistent with a desire to promote competition at lower levels. However, the allowed return should not be so high as to enable members of the industry, who are less subject to competition, to charge unreasonable rates. I am concerned that the application of the return methodology described in the majority Opinion might arrive at such a result. We shall see.

Accordingly, in Phase II of this case, I implore the administrative law judge to scrutinize carefully the evidence offered in response to the return methodology stated today so that our final decision on that number will be consistent with the "just and reasonable" standard applicable to this industry under this statute.

In this connection, while I do not disagree *per se* with the majority's utilization of an "insurance premium" as a component of the return, I am concerned that if that component is to become a part of the final return number, that it is indeed factually based. Further, with respect to the "benchmark" used as a starting point for the rate of return computation, I believe that point of departure realistically should reflect contemporary returns earned by industry. My concurrence in the result reached should not be taken as an intent on my part to allow frivolous presentations of evidence to be welded into unreasonably high numbers.

Moreover, I am even more concerned about the administrative implications of the majority Opinion today. I believe that a generic return number could be developed from the evidence offered in Phase II of this case, which could then be applied to the industry as a whole. I have often stated publicly my view that this agency would needlessly congest its already crowded dockets by permitting a multiplicity of proceedings covering each individual pipeline's rates to be permitted under the 1906 statute. I feel that the majority Opinion could foster such a result. Since, however, that is not yet a result reached by the present majority Opinion, I can nevertheless concur in the result reached today. By this concurring Opinion, I further request of the administrative law judge that the record made in Phase II be of sufficient breadth that a generic return decision could be reached ultimately by this Commission.

This case is old. The litigants have a right to a decision while they are still alive. So the Commission cannot continue to search forever for the perfect oil pipeline rate of return methodology.

There probably is no such thing. Moreover, a prompt decision in this case is imperative. And skeptical though I am about the workability of the prevailing Opinion's rate of return ideas, I confess that after a good deal of thinking about the subject, I have nothing compellingly better to offer. Accordingly, I concur in the result for this case and for this day only.

— Footnotes —

[1] They have been enumerated in *Trans Alaska Pipeline System,* 20 FERC ¶ 61,044 (1982). So I need not restate them.

[2] That the appellate courts are also in inadequate and an inappropriate forum for basic policy questions of this character is equally plain.

[3] Whatever view one takes of today's oil industry, who claims that this is still a realistic portrayal of the essentials of petroleum economics?

[4] I do not envy the administrative law judge who will have to figure out what those heretofore unheard of notions really mean, as applied to the facts of this case.

[5] Expert witnesses should also do well.

— COMMISSIONER HUGHES' STATEMENT —

HUGHES, Commissioner, *dissenting in part and concurring in part:*

Introduction

The Commission's statement today culminates four years of introspection on the reasons and methods for regulating oil pipelines by this agency. The product is an apologia for the ICC's lethargy in this field which I cannot accept and which does not appear to satisfy the Court's decision which remanded this matter to us. *Farmers Union Central Exchange v. FERC,* 584 F.2d 408 (D.C. Cir. 1978), *cert. denied* 439 U.S. 995 (1978), hereinafter *"Farmers Union."*

While I am concurring in some aspects of this decision, there are portions from a myriad number of pages out of the total number that I do not address in this Opinion, but with which I would take issue, both as to tone and content. While the majority "treatise" [1] on oil pipelines is erudite, clever and ingenious, there is much irrelevancy, undue length (aside from the 391 pages, there are footnotes which outdistance the body of the text on numerous pages) and some sophistry that, for my literary and legal tastes, could have been omitted.

Procedural Considerations

The FERC's procedural path to today's decision, although well intentioned in the beginning, has proven to be unduly long and tortuous. Apparent short-cuts became detours and deadends. Clearings became thickets, and firm ground turned soft.

It was laudible of our predecessors to try to shoulder the burden that had befallen the Court in *Farmers Union* by asking for a remand of the matter. At this date, however, it is safe to say that had they not done so, our entry into oil pipeline rate-making would have been guided by a more definitive judicial statement on the issues involved.

Unfortunately, following the remand, the Commission retrieved the instant proceeding from the hands of an ALJ, denying itself the value of an initial decision. This would have given us a summation of the record and an analytical springboard. The "lead case" designation made this a more difficult decision by forcing consideration of a number of questions not present with respect to the Williams pipeline, but important to the industry as a whole. Williams is indeed an atypical oil pipeline because of its origin, in its lack of oil company affiliation, its capital structure and its markets. It is truly an unrepresentative lead case, which promises to be the lodestar for results that will be inequitable either to Williams or to the other more typical members of the industry.

Nevertheless, the remand of this proceeding to this agency was to avail the Court of our expertise and to allow us to build a "viable modern precedent" for future cases. But, taken in its totality, the Commission's Opinion has managed to decide fewer of the issues presented than the ICC did in its 1976 decision, *Petroleum Products, Williams Brothers Pipeline Company,* 355 ICC 479. Thus, we have retreated further from the Court's goal of achieving a contemporary rate standard than when a predecessor Commission voluntarily requested (unwisely, it now seems) an opportunity to consider this case anew. I would have thought that this case, being the first oil pipeline case in 30 years for the ICC and the first for FERC, would reach more conclusions on basic methodology rather than stolidly adhering to a status quo which was thoroughly discredited over four years ago by the Court.

Much of the majority Opinion is "smoke screen" for the failure to adequately review and find a workable solution to an admittedly complex problem, but one made worse by only cursory acknowledgment of the underlying issues and tacitly ignored thereafter by the majority.

This is precisely why I am proposing another method which meets their tests for a "dream" rate base. The benefit would be simplicity and ease of administration since it would only mean transforming the existing base to a fixed annual sum which would need no subsequent re-evaluation. Simple adjustments could be made thereafter that everyone will understand and recognize.

Valuation Rate Base

The history of ICC valuation methodology is a litany of repudiation. In a telling dissent by Commissioner O'Neal to the ICC's last oil pipeline decision in *Petroleum Products, Williams Brothers Pipe Line Co.,* 355 ICC 479 (1976), many of the infirmities of valuation were catalogued. That view, in many respects, was echoed in the decision by the D.C. Circuit Court of Appeals in *Farmers Union.*

Rooted in obscurity, the valuation procedures or "Oak Formula" has no logical basis shown of record nor does the majority Opinion herein make any rational explanation of it in their mystifying attempt to perpetuate a decaying form of arcane, regulatory lore.

The Court expressly sent the case back to the Commission with instructions to build a "modern, viable precedent for use in future cases that not only reaches the right result, but does so by way of ratemaking criteria free of the problems that appear to exist in the ICC's approach." *Farmers Union* at 421.

Instead, the Commission, suffering from amnesia, responds at page 279 [2]:

> Were we writing on an absolutely clean slate, were we beginning afresh in a brave new world, were pipelines a novelty that had just made their appearance, we would fashion an inflation sensitive, anti-bunching rate base policy simpler and more logical than the ICC's.[373]

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[373] But we cannot escape history. Whatever this Commission's briefs may have said back in 1977 and 1978 and however jaundiced the court's view of the ICC's methodology, the fact is that that methodology has been in place for a long time and that drastic conceptual changes would be disruptive. And as has already been noted, such changes would frustrate entrepreneurial expectations that we deem rational, legitimate, and worthy of respect. Perhaps even more important is the total absence of any evidence to support a finding that the incremental benefits of the exercise would be worth its costs.

If this is not the time and place to do it, then where and when? What was our mandate: to weigh the cost or to accomplish the task? Is "preservation" the Commission's best answer to a "viable, modern precedent"? I had thought the burden of proof for retention was on valuation's proponents, not its detractors.

Let us now analyze and review the majority decision to determine the validity of maintaining the valuation system already condemned by the D.C. Circuit Court of Appeals and other evidence of record in this proceeding.

The central element in the ICC valuation is the weighting of reproduction cost and original cost according to the ratio of each to the sum of the two. This weighting principle leads to a result somewhere between original and reproduction cost, but nearer the latter in inflationary times. This is the very point that seems to have been condemned by the D.C. Circuit in *Farmers Union, supra* at 418: "Both the oil pipeline precedents and the history of valuation computations under the Valuation Act are in large measure products of a bygone era of ratemaking . . ." The Court further noted that the ICC had seen fit to abandon its "so-called tradition of valuation computation and ratemaking" in the railroad area, also subject to the Valuation Act.

Even if one were to dismiss this inflationary debility out of hand with a "so what" as does the Commission Opinion, there is another reason why it is fatally defective, which is not discussed or addressed by the majority. The element of the Oak formula dealing with cost of reproduction new is designed to estimate what it would cost to duplicate the pipeline in all of its aspects at current prices. The fallacy inherent in this premise is that the current technology, materials and labor of contemporary pipelines is not exactly equal to pipelines of yesteryear. There is record evidence reflecting much criticism of this method which is echoed by Professor Bonbright in his *Principles of Public Utility Rates* (1961), p. 227:

> The resulting valuation of the property (reproduction cost new) is therefore an economically meaningless application of up-to-date prices to out-of-date properties.

Due to current economies of scale (see the majority's n. 366, pp. 273-274), the record herein reflects that the Williams Pipeline would never reproduce its present system with small diameter lines, yet the ICC formula nonetheless embodies such fallacious assumption.

The kernel of every argument against the use of the discredited valuation methodology is its complexity and unreliable nature. This is best illustrated by a description of its calculation. The reproduction cost of a pipeline is calculated by trending the original cost of the various components backward or forward to 1947 from the year in which the cost was incurred through the use of ICC indices for various categories of construction materials.

Those 1947 prices are then trended forward to the present by use of ICC "period indices." These, in turn, are derived by averaging prices for three prior years, one future year (estimated on the first five months), and the current year. The majority admit that reproduction cost is thus systematically understated since the current costs are not contemporary, but are derived from a trailing five-year period index. (p. 283). The only other base period ever established prior to the 1947 period was 1934. While recognizing the difficulty posed by changes in technology since 1947, no one, including the originators of the formula, did or has explained for the record why the indices have not been updated since 1947.

Additional serious flaws have been pointed out in other elements of the Formula of which a partial catalog will suffice.

Valuation of land is the first element in the Oak formula. Land is deemed worth only half of what it cost, with no adjustments having been made since 1953. But, the majority says (P. 282), that the sums involved are relatively insubstantial. No matter that it might be unfair to other systems, or that it might involve substantial sums connected when used with a new pipeline.

The 6 percent "going value or concern allowance" is admitted by the majority and the carriers to be "pure water" but defended as compensating for other errors, such as the understatement of inflation, the trailing indexing period, and items relating to land. The 6 percent formula is more unexplained largess from the outdated nature of ICC's valuation, but the majority Opinion makes no calculations to state the amount of under-valuation or to disclose how the 6 percent correlates with the undervalued land figure. Neither the ICC nor this Commission has ever explained specifically why *6* percent was chosen.[3] No one seriously supported it in the record, but the majority embraces it without any explanation other than that it allegedly makes up for other erroneous understatements.

As to depreciation, the Opinion deplores as "disquieting" the mismatch between straight line methodology for cost of service and condition percent for rate base purposes. Sample this interesting description from P. 285 of the Opinion:

> The assumptions about useful lives and about the rates at which things wear out are based on ancient studies made decades ago. The studies themselves disappeared[383] many years ago.[384] Hence our valuation staff works solely with the conclusions drawn by the deceased authors of those missing ancient books. We suspect that something must have changed in the intervening decades. So we are inclined to take a fresh look.

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[383] Some of them were made for the railroads. Their relevance to pipelines may be dubious.

[384] So far as we can tell, no one now alive has ever seen them.

Following this condemnation of depreciation methodology, and awaiting the inclination toward this refreshing new look, we are then told that a reformation of such a moribund method is better done through notice and comment rulemaking, notwithstanding that this case has passed through that stage earlier. The Opinion then says in order to be fruitful, that the rulemaking "should be preceded by *intensive staff studies,"* (P. 286). [Emphasis added]

However, the "suggestion-rejection" syndrome is not over. The "intensive staff studies" process is then repudiated for being too "costly and time consuming" and thus questionable as to the value received from such cost. With circular spin, the majority Opinion then makes this startling conclusion:

> This question calls for further reflection. This is neither the time or place for that. We can ponder the point on another day. (P. 286).

I thought this was the time and the day. The matter is apparently consigned to an uncertain oblivion by asserting in the decision that it will be best to stick to the rate base status quo until getting a clear direction from Congress through statutory change. There is another "however," however. The contingency for legislative inaction is covered by a conditional possibility, grounded on a tenuous qualification; should the resources be available "without detriment to *other programs* of *greater import,* we or our *successors* may revisit the scene." (PP. 288-289) [Emphasis added].

This is great comfort to the remanding Court who, some four years ago, indicated this agency could receive back the proceeding to do that which we are avoiding doing today. It is even more reassuring to the litigants who have been denigrated to second class recognition in the Commission's new case classification: "Programs of lesser import."

Cash working capital is given the same summary treatment in the valuation methodology, but with a shift in the burden of proof to the shippers or carriers to show it improper. Otherwise, it is to be treated exactly as it was by the ICC.

In what could be classified as minor tinkering, the majority exclude the value of leased property from the rate base. The ICC had included the asset's value in the valuation formula and also allowed recovery of a carrier's rental payments to its lessor as an annual expense. While this is branded a small item, there are no numbers to suggest the magnitude of such payments.

With respect to the exclusion of other irrational items from the valuation process, the majority did not heed its own warning that "intelligent conservation is not to be confused with a neurotic affection for ancient evils, based solely on their antiquity." (P. 286, n. 386).

The majority admits that it would have been better to have used another rate base methodology. There are several items they would place in a "dream rate base":

(A) Link the valuation to consumer price index or gross national product deflator.

(B) Give an inflation-free rate or return on the equity portion of inflation sensitive rate base. PP. 279-280.

A "straw man" is then constructed indicating an imagined problem entailing "social costs" with a transition rate base, however desirable, but then removing the societal barrier by concluding it could be bypassed by using the most recent valuation. (P. 281, text and n. 376). Somehow, this confusing and twisted logic is to suffice for the conclusion that no change will be made.

Rate of Return

We now turn to the area where the majority attempts to remedy one of the problem areas of the ICC methodolgy condemned by the Court: rate of return.

One of the contentious issues raised with respect to the ICC methodology and which is incorporated by the Commission's Opinion into the FERC method is the application of the valuation procedure to the debt portion of the rate base. The Commission's Opinion defends and explains the matter on two grounds. (PP. 346-357). First, an example is given of a business transaction in an unregulated setting (the purchase of a house), with the premise that any increase in the value of assets should inure to the benefit solely of the equity investors. Second, since the method allows only a "real entrepreneurial" rate of return on equity, the increase in the rate base, and hence also return that results from trending the debt portion, is merely the means to compensate equity holders for inflation. (PP. 346-351; 356-357).

I reject the first explanation by example as unnecessary and inappropriate. The oil pipeline industry *is* regulated and a model that ignores this central fact is patently flawed and inconsistent with the majority's Opinion. (P. 280). This is inapposite since we are dealing with rewards to investors in the form of current income, not asset appreciation and sale in a competitive but unrelated industry. (PP. 351-355). This construction is unnecessary, subject to a crucial restriction explained hereinafter, because the second rationale by the majority is acceptable.

The contention that trending the debt portion of the rate base compensates equity holders for the effects of inflation has merit. My acceptance is, however, premised unequivocally on equity holders receiving only a *real* rate of return. The Opinion introduces a financial concept which may be known to others but is new to me: a "real entrepreneurial" rate of return. To the extent that the new concept is at variance with the usual sense of a "real" rate of return, I would be forced to reject the prospective trending of debt. To determine whether this unorthodox term has a rational basis, it is essential to examine the proffered meaning of a "real entrepreneurial" rate of return. (PP. 340-342). The Opinion describes this concept by mechanical process: first, a determination is made of the nominal rate of return on equity for an appropriately chosen class of stockholders in oil and other American industries as well as a host of various common stock portfolios for differing periods of time. This nominal rate of return is then reduced by the annual percentage increase from a beginning valuation rate base formula to the most recent valuation. I find this process flawed in two ways.

First, the example in the Opinion calculates the annual average percentage increase by dividing the total change in valuation by the number of years of trending. This ignores the compounding effect by using an inappropriate arithmetic average which tends to overstate the level of trending and consequently understate the "real entrepreneurial" return.

A much more serious defect, and I believe, an uncorrectable one, is the unstated assumption that the trending of the rate base in the valuation formula approximates or should approximate the course of inflation. A preliminary review of inflation figures for the period 1970-1981 and of the change in valuation for Williams Company indicates on both a year-by-year and on a total cumulative period significant differences. The table below shows clearly the unpredictable differences between the rate of inflation, measured by either the Consumer Price Index (CPI) or the Gross National Product Deflator (GNP deflator), and the change in valuation of Williams Company by the ICC methodology. In only one year was inflation (measured by either the CPI or the GNP deflator) within 20% of the change in valuation. The degree of capriciousness in the relationship is also highlighted by the change in the sign of the percentage differences which discloses whether the valuation kept pace with either measure of inflation.

For example, in 1976, the two index numbers showed 5.2% (GNP) and 5.8% (CPI) increases in inflation, while Williams' valuation increased by 11.3%, more than twice as much. The differences reflect the measure of how much the "real entrepreneurial" rate of return over- or under-compensates equity investors in Williams.

Comparison of Percentage Changes from Previous Year of the Gross National Product Deflator, Consumer Price Index and Valuation of Williams Company

1971—1981

Year	*GNP Deflator*	*CPI*	*Williams Valuation*	*Valuation compared to GNP***	*Valuation compared to CPI***
1971	5.0	4.3	6.1	21.8	41.6
1972	4.2	3.3	1.2	−71.9	−64.2
1973	5.7	6.2	3.9	−31.2	−37.1
1974	8.7	11.0	10.2	16.7	−7.5
1975	9.3	9.1	12.4	33.1	35.5
1976	5.2	5.8	11.3	117.3	95.8
1977	5.8	6.5	3.6	−38.6	−44.8
1978	7.3	7.7	10.9	49.2	42.2
1979	8.5	11.3	6.8	−19.7	−39.3
1980	9.0	13.5	7.0	−22.1	−48.2
1981	9.1	10.4	2.3.*	−74.3	−77.4

* Tentative

** A negative sign indicates the valuation change was less than inflation; a positive sign indicates the valuation change was more than inflation.

The majority Opinion correctly discredits the fair value rationale for the valuation methodology. (P. 214). The only two possible remaining justifications stated for the continuation of ICC valuation are: (1) it is highly disruptive to change methodologies; (2) it is an appropriate means to adjust for inflation. The majority has recognized that the first justification can be by-passed by accepting valuation as the beginning rate base, as previously discussed. As to the remaining point, if insulating equity holders from inflation is the objective, the above table shows the inadequacy of the valuation procedure. The gross disparities demonstrate that the majority's approach would lead to arbitrary and capricious adjustments that would have little relation to actual inflation.

Just as the foregoing discussion reflects the arbitrary and capricious nature, as well as the illogic, of the majority Opinion's rate base methodology, so it is with the rate of return process. The Opinion recognizes the need to adjust the return on equity to eliminate any "double counting" (P. 336) associated with adjusting the rate base to reflect inflation by applying a rate of return that also accounts for inflation. But there is apparently a basic misunderstanding of the manner in which nominal rates of return account for inflation.

Nominal returns on equity indicate the market return required by investors for investments of a given level of risk. This return has both a real and an inflation component. However, the inflation factor required by investors is for prospective or *future* inflation which the investors expect will occur. To adjust the required rate of return correctly, it is this perception of *future* inflation that must be accounted for. What does the majority propose? Their adjustment would remove *past* increases in valuation. What is the connection between past increases in valuation and investor perception of future inflation? The above table shows that valuation does not even track historic inflation. What possible logic could explain the required correlation when none can exist? No answer is provided in the majority Opinion.

The large variances between the Williams Pipeline's valuations and inflation highlights one of the most worrisome aspects of the majority's rate of return method. It invites an enormous amount of gamesmanship. Eight rate of return options are suggested, some with multiple choices of time periods. The inflation/valuation variance gives exciting new twists to a pipeline's choice among the candidates. Thus a firm might choose to base its return one year on stock market performance after a bull market, and in its next filing switch to a high oil company comparison which might be offset by a small increase in its own valuation.[4]

The majority excuses its generosity by citing the pipelines' threat that they can go out of business if we don't give them a more handsome rate of return than that received by gas pipelines (which, as public utilities, can't go out of business without first receiving abandonment authority from the Commission).

This Commission should resent being held hostage to such a threat. I also think the threat is hollow. Integrated oil companies need their oil pipelines to move their crude to their refiners and to move their product from the refineries to their market. Moreover, the assumption is wrong. As with other business enterprises, all oil pipelines try to maximize profit. Shareholders demand it. We think it would be difficult for a company's management to justify divestiture of oil pipeline investments if they are earning an after tax return equal to what gas pipelines are now earning, even recognizing the recent increases in the market risks they face. By rough calculation, gas pipelines' earnings usually exceed 20% and may sometimes exceed 30%. Alternative industrial reinvestment opportunities average 12 percent (as the financial press indicates may be a general industrial average). There has been no rush to abandon gas pipeline properties, and there is no reason to think that equivalent returns would not support continued operation of oil pipelines.

We neither can nor should guarantee natural gas companies freedom from the risks of competition. Competitive fuels have always been a source of competition for gas pipelines. Today, they are a powerfully real source of competition: many industrial customers of interstate pipelines with dual fuel capability switch from gas to oil on the basis of cost. With the recent fall in oil prices and the constantly increasing gas prices, many industrial gas sales have been threatened and some have been lost.

We are also unable to provide guarantees against competition by other gas pipelines. We have no authority or control over the entry of intrastate pipelines into a state-wide marketing area of an interstate pipeline. Nor are we barred from providing competition between interstate pipelines:

> Nothing in this section shall be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already being served by another natural gas company. Natural Gas Act, Section 7.

Just recently, this Commission has allowed for the entry of a new pipeline into a production area even though it provided competition to the only existing pipeline for gas supplies from that area. See, *Ozark Gas Transmission System,* Opinion No. 125 (issued July 28, 1981 [16 FERC ¶ 61,099]). As a final point, it is important to remember that gas and electric rates provide an opportunity to earn a rate of return established by the Commission. See *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia,* 262 U.S. 679, 692 (1923). They do not guarantee that the utility will earn the approved rate of return.

A Modern Approach

The majority's circular sophistry and counterpoint does not move us to a contemporary resolution of the issues. Departing from the tradition of analysis by negative appraisal inherent in the dissenting opinion process, a positive alternative is presented. It is made not for the purpose of proving it is the only solution, but only to show that there are workable alternatives which could be employed by a responsible agency to construct and administer a contemporary rate methodology.

An appropriate methodology to meet contemporary conditions of a particular industry must flow from a rational basis, drawing on economic, financial and regulatory precepts, and that basis must be fully explained. Further, we need an approach which addresses several technical problems that have been identified in the course of these proceedings. One is the front-end loading quandary, for which the majority admits the valuation formula is not the ideal solution (P. 279). Also, there are the issues of intergenerational equities and elasticity of demand effects. Finally, we desire an approach which will not be unfair as to either existing shippers or equity holders.

We have basically three options in the record to choose from: the ICC methodology (or a modification), original cost rate base ratemaking or variations of trended original cost.

For the reasons previously stated, I reject the valuation methodology, not only because the Court of Appeals has already deemed it unacceptable, but principally because it lacks any sound basis in economics or finance, as attested to by numerous experts of record in this case.

The second option, original cost, is the standard approach this Commission uses in its electric and gas ratemaking. However, in the very different setting of the oil pipeline industry, several aspects of this method have much more serious adverse impacts. Specifically, the phenomenon of front-end load on revenue requirements for competitive pipelines has potentially damaging implications, to include reduced throughput levels caused by elasticity of demand impacts.

A variant of the third option, however, seems to meet all our objectives. I believe the Commission would have been well advised to adopt the following approach: [5]

This method begins by recognizing that most oil pipeline facilities are added in large lumps. Each of these (including additions or improvements) would be treated as a separate project for the purpose of calculating its capital cost. Even minor plant items, such as pumps and sections of pipe can be dealt with the same way, or in groups of additions made in the same year, because the process is very mechanical once it is in place. The total capital costs to be recovered are computed asset by asset on an entry-in-service basis with appropriate indexing to compensate for inflation.

For each project, an accounting life is determined. Periodically, the Commission would determine an industry-wide real cost of equity capital. Using the actual investment, which is adjusted for multi-year projects to year-in-service dollars, along with the generically determined real cost of equity capital for each project, a level amortization payment (in year-in-service dollars) is to be computed at the time the investment enters service. This computation yields equal annual or monthly payments which will, over the life of the project, repay the present value of the equity investment and a fair return on it (in constant dollars).

The total revenues to investors in any year would be the sum of the levelized payments for all projects still within their accounting lives, adjusted to reflect the appropriate degree of historic inflation or deflation. To that must be added the annual operating and maintenance and tax expense and the costs of servicing the outstanding debt, to obtain an annual revenue requirement. From that sum, rates can be determined. This method could be applied to a total company or to its constituent systems, as the majority envisions, (P. 358).

For plant additions that are beyond their accounting lives, revenues representing return on investment could be allowed to be recovered upon a showing that such plant additions operate in a competitive market. Other treatments are possible and could be pursued within the administrative process.

For transition purposes, the existing ICC valuation, less outstanding debt, *i.e.,* the original equity, the trended equity and trended debt,[6] could be taken as the present equity investment for each company or system. Current debt outstanding would be transferred at its actual cost. Thus, return *of* and *on* all existing equity investment can be reduced to a single amount for the first year and indexed thereafter without further calculation of ICC valuations. What we would be doing, in the final analysis, is using the trended valuation rate base for existing projects only to achieve an orderly transition between ratemaking methodologies.

Choosing as the transition rate base the last ICC valuation less outstanding debt would certainly transfer some outmoded or erroneous values. I recognize the argument for over-compensation on cost of capital under ICC valuation. I am mindful, however, of the Court's statement in *Farmers Union,* 584 F.2d at 421-422, that a pipeline's reliance on existing methods might be justified, and that, to that extent: "[T]he solution is not to perpetuate that reliance but to end it prospectively, without allowing reparations based on its occurrence in the past. [Footnote omitted]"

Likewise, I am persuaded that it would be inequitable and unfair to impose a radically different rate level and resulting revenues on investors who made decisions based on the longstanding regulatory regime imposed by the ICC over a period of some 40 years. It would be a financial and administrative debacle for this agency to attempt to reconstruct an original cost rate base. Higher rates of return could be imposed initially, adding to the front-end load factor. It might also constitute unlawful retroactive ratemaking if it tampered with earnings made under past lawfully established rates.[7]

I also find merit in the arguments that (even if by accident of timing) the rate of return allowed by the ICC is now equivalent to a real, *i.e.*, non-inflated, rate of return on equity. Thus, the increase to date in total rate base value under the valuation method represents the original equity investment and the reinvestment of the inflation component of the return on equity that was never paid out to equity holders in dividends.

This variant of the trended original cost method, espoused by Dr. Meyers, would tend to provide for a level revenue stream or levelized rates which are constant in real dollars. It thus responds to the arguments made against front-end load problems which are severe with original cost and somewhat less with other trended original cost methods. I believe the level return on equity approach comes closest to the viable, modern precedent we are seeking.

The proposed method would not impose additional administrative burdens on the Commission staff, in stark contrast with the majority Opinion, which would greatly increase its workload. For each significant addition to pipeline plant, the staff will need to calculate the levelized revenue increment. However, this is done *only once*. The Commission will also have to determine on a periodic, generic basis a real rate of return on pipeline equity. With the majority approach, all of the effort necessary to review and potentially litigate valuation results would be required *every year* which has the latent ability to bog down the Commission in a morass of case-by-case adjudications. This is compounded by another aspect of the majority's effort to "fix" the rate of return by engrafting an insurance premium for risk which the Opinion says "will have to unfold itself through case-by-case adjudication." (P. 339)

Industry-Wide Returns

One of the few admirable features of the ICC's oil pipeline regulatory system was that it spawned so few adjudicated rate cases. This is a virtue I would hope to retain, regardless whether my proposal or the majority's is adopted. We could do so by setting rate of return on an industry-wide basis. That is, we would undertake the analysis described, beginning on page 340 of the decision in a separate rulemaking docket. Therein, we would prescribe a rate of return to be used by any oil pipeline in developing its rate filings, just as the 8 percent and 10 percent levels prescribed by the ICC were used.[8]

That rate of return will be subject to review, by us, whenever changing economic circumstances make it appropriate.[9] The majority has not dealt squarely with the volume of case-by-case litigation its decision invites. With the new approach, if there is a shipper protest, our staff will be obliged to look into a pipeline's capital structure, its debt guarantees based on credible testimony from designated experts, (P. 340)[10] its application of rate of return, and the correctness of its inflation adjustment.[11] Our experience in the other industries we regulate is that where we allow parties to litigate these issues, they will. The expense involved will be considerable and could have an impact on the due process rights of the litigants.

For an industry already familiar with an industry-wide rate of return, it is astounding that the majority would abandon the efficiency of that system and willingly enter the probable morass of case-specific adjudications. (pp. 205-206)

The only limitation on the size of this morass is the restriction against staff initiation of, or participation in, oil pipeline cases. This restriction raises its own question of fairness and efficiency. The majority answers the fairness question by saying that a pipeline's rates are of no concern if there are no unaffiliated shippers. The efficiency of staff participation in terms of completeness of records, is nowhere addressed.

Conclusion

The majority has not succeeded in breathing logic into the ICC valuation method. Its rate of return creation is seriously flawed. Yet it thinks there is no other solution possible. I have suggested one, however, and there may be others. The suggested method meets all the criteria set out by the majority, it eliminates the need to calculate valuations *ad infinitum* into the future, and it will minimize the burden of case adjudication. I sincerely hope that we do not have reason to regret that we missed the opportunity to adopt this method.

— Footnotes —

[1] I acknowledge my admiration to Bernard Wexler, Director, Office of Opinions and Review, whose thankless and lonely burden it has been to assist in drafting the Commission's Opinion over these long months. His legal scholarship and his knowledge of the oil pipeline industry have been invaluable.

[2] Page references to the majority Opinion will be given as P.—hereinafter.

[3] Perhaps it was chosen in the same manner as the well known "7 percent solution" by the same ICC and rejected by the Court in *San Antonio v. U.S.*, 631 F.2d 831 (D.C.Cir. 1981).

[4] Note that the "pipeline's option" method extends to the choice between normalization and flow-through depreciation accounting methods. It seems we have created the regulatory equivalent of "Dialing for Dollars" rather than "The Price Is Right."

[5] This is a variant of the trended original cost method advocated by Dr. Stewart C. Meyers. (Tr. 3587) See also Thomas R. Stauffer and Peter Navarro, "A Critical Comparison of Utility-type Rate-making Methodologies in Oil Pipeline Regulation," Harvard University, Energy and Environmental Policy Center discussion paper, January 1981.

[6] This is the same equity base used by the majority, but the method can be used with any other choice of equity base.

[7] *City of Piqua v. FERC*, 610 F.2d 950, 954 (D.C. Cir. 1979); *Atlantic Seaboard and Virginia Gas Transmission Corp.*, 11 FPC 45, 48 (1952).

[8] In that rulemaking, we could consider also whether different return rates should be set for product and crude pipelines.

[9] See *F.P.C. v. Hope Natural Gas*, 320 US 591, 615 (1944). But, since we would be setting an inflation-free, *real*, rate of return, it should be relatively insensitive to rapid obsolescence. *Cf. Generic Determination of Rate of Return on Common Equity for Electric Utilities, FERC Statutes and Regulations* ¶ 32,242 (August 26, 1982), in which we proposed quarterly indexation, and full review biennially, of nominal rates of return.

[10] The class of experts is so tightly defined that our staff witnesses may not qualify.

[11] See the foregoing discussion headed "Rate of Return."

— COMMISSIONER RICHARD'S STATEMENT —

RICHARD, Commissioner, *concurring:*

"Why with time do I not glance aside to new-found methods . . ." *Shakespeare, Sonnet 76.*

The case before us today is one of the most time consuming and problematical ever faced by this Commission, deciding, as it does, the regulatory methodology which is to be applied to the entire oil pipeline industry. The history of oil pipeline regulation has been detailed at length in the decision. (Indeed, the length of the decision is one of my quarrels with.it.) The years of litigation and months of debate invested in this case have not told us as much as that history. When the oil pipelines were made subject to the Interstate Commerce Commission, it is unclear what kind of regulatory restraint Congress envisioned that agency should impose. To the extent we are aware of Congressional intent and to the extent we can identify the class which the 1906 Act sought to protect, it tells us very little. Regulatory agencies were a new phenomenon then. We simply cannot pretend that Congress made any enlightened choice between what has come to be considered classic public utility methodology and some less intrusive mechanism.

I think that we can agree that we are confronted by a statute, unexamined for 76 years, mandating regulation. We can probably agree further that the statute was imposed out of concern for monopoly power. We can even agree perhaps that in some times and at some places oil pipelines may possess at least the potential for monopoly power. The Anti-Trust Division of the Department of Justice should be our watchdog.

I do not feel driven to drastically change the way pipelines have been regulated without a strong showing that they have earned outrageous profits compared to similar industries. To the cry from some that oil pipelines should be regulated as we do interstate gas pipelines, I must reply that a very different jurisdictional authority makes that an impossible task.

Unlike our authority over other regulated entities here at the Commission, we do not have the power to correct a miscalculation of what we *thought* was fair if we seriously underestimate our ratemaking methodology's ability to allow an adequate return for oil pipelines.

We can not guarantee an oil pipeline's market from competition either intermodal or intramodal because we cannot certificate the facility and close the system as in gas pipelines. In short, we cannot keep the ships off the seas, trains off the tracks, barges off the rivers, and trucks off the roads. That is a real world factor that must be considered. We can assure that our natural gas pipelines are protected from competition at least enough for them to closely cover their costs, investments and a reasonable return. We can close an area from additional gas pipeline competition to maintain the original pipeline's financial integrity through this non-rate factor.

For the short time that I have served on the Commission I have sought for a compromise which would reconcile these points of view. In the end, that has proved impossible and I am faced with a choice between a methodology with surface logic which can seriously disrupt a vital industry and a mechanism which approximates the results of ICC regulation. No alternative methodology with any semblance of logic achieved the latter result.

The Commission has received no Congressional mandate to launch a new era of stringent oil pipeline control. The administrative costs alone of such an undertaking are staggering. I have seen no documented estimates of such regulation, but if they approach the expense of regulating natural gas pipelines, I believe that a public which currently bears the *de minimis* cost of oil transportation would be poorly served by the additional cost of regulation. Therefore, today I concur with the majority, but I also express my view that the time is ripe for Congress to give us a clear direction in this field.