

INTERVIEW III

DATE: July 26, 1988

INTERVIEWEE: JOSEPH SWIDLER

INTERVIEWER: Michael L. Gillette

PLACE: Chairman Swidler's office, Washington, D.C.

Tape 1 of 2, Side 1

G: Let me ask you to begin today, Chairman Swidler, by talking about the role of the commission in achieving electric rate reductions and postponements of increases.

S: In approving or appealing, did you say?

G: In securing.

S: Securing. Well, that was a period when there weren't many applications for rate increases. It was a period of considerable prosperity for the electric utility industry. They were reaping the benefits of improved technology, taking advantage of the economies of scale and, for the most part, retaining the benefits.

The problem was to put into effect rate reductions at wholesale and to do it in a way which would insure that the benefits would be passed along to the consumer. We had an even more highly organized way of doing that in the gas cases where there were a lot of rates that were, in effect, subject to refund, very substantial refunds, and we had ways of conditioning the refunds to be sure that consumers got the benefit. What we did first is have our people review the data. All the companies were required to file comprehensive reports with us, and we reviewed the data to see whether their rates were

Swidler -- III -- 2

out of line in relationship to their costs. We brought in a considerable number. We didn't necessarily try every case because frequently you could negotiate a reduction. But we did try a good many. If we had wanted to, we couldn't try every case. There just aren't that many hearing examiners. That was a situation where the companies were not in pain, where they knew they were at least comfortably well off, and where they fought only middling hard to avoid sharing the benefits. But without going after them, they just wouldn't have done it. I don't remember the aggregate of the refunds, or the rate reductions, rather, that we ordered--not so much refunds. Refunds you order when people apply for increases, and you allow the increase subject to refund but that wasn't true on the power side, so it was a matter of ordering reductions.

Now, one of the benefits of rate reductions in the power area under those circumstances, which are not the same as the present ones, was that it created an incentive to economy. As long as they were making more than a fair return, there was no incentive to save a lot of money, because from the viewpoint of some of them, at least, they just would have had to give the money away. So we ordered these very substantial reductions. As I recall, there wasn't an awful lot of litigation on the fairness question; there was serious litigation about jurisdiction, but I don't recall many appeals on whether we had cut to the bone or we had cut too little.

G: To what extent was this a departure for the commission to move into this area?

S: Well, the commission had never done it before.

G: What was the rationale?

S: There wasn't any rationale; they just never got around to it. Of course, there was also the jurisdictional problem. Until they could work out a theory of jurisdiction that was a

Swidler -- III -- 3

workable one, if they had hauled the companies in, the companies would have claimed that they were not selling power in interstate commerce, and if you had to go to the old tracing technique, it might be hard to prove otherwise. And even after you proved it, it might not be true in the next case where you had a little different movement of the electricity.

Once you had the jurisdictional question out of the way and you had tested it under various operating circumstances, then you get down to the question of the fairness of their earnings. In a period of declining costs, you don't get the same public clamor for rate reductions that you do when there are rate increases. Because if the electricity prices remain stable, and there is some general inflation, in real terms there is a price reduction every year.

The big question that we discussed on a good many occasions was how often to check up on it. There was one group within the commission that said, "You ought to check on them often, at least every six months." There was another group that said that that was counterproductive, that if they [the power companies] didn't feel that they could get any benefit from greater efficiencies, they wouldn't be tempted to go after them. And that you ought to give them long enough after each reduction to have them go out and try to cut costs some more, and then cut again for the future. But if you did it every six months, they wouldn't have anything to cut. I was in the school of thought that there ought to be encouragement for them to improve their efficiencies, that in the long run, the level of costs would determine rates. We kind of compromised on it I think, maybe it was a year or a year and a half, something like that, between rate cuts.

Swidler -- III -- 4

There are some people who focus on rates irrespective of costs. They say that the company is making too much money. Well, that may be a part of the picture, but the real object of regulation is not to prevent the industry from making money, but to bring rates down. Sometimes preventing them from making money is counterproductive because they have no incentive then to cut their costs. In the long run it's the low-cost producer who will provide the lowest rates. We had a many differences on that score. It's one that was a key policy difference, and it continues to this day. There are just an awful lot of people who have a much closer eye on what the utility is making than on keeping the level of rates down in the long run.

G: How was it resolved at the time?

S: As I say, I think we kind of compromised. I don't remember what interval I thought was appropriate. I favored going back to them periodically but I wanted a long enough period between reductions so that they could say, "Well, if we could make more money this year by tightening up on our costs" and that they could keep [so much?]," then you would go back and do the same thing a year or two later. But if they thought that they couldn't keep any of it, they just wouldn't try to keep costs down.

G: Was there dissent within the commission for entering this whole area of rate reductions?

S: No, I think the commission was unified on this.

G: Was there one particular case that was significant in terms of deciding the commission's jurisdiction in this matter?

S: There are a number of important jurisdictional cases. I think I mentioned that one of them was under litigation when I came to the commission. We took it over and appealed it on our theory of the case and won it. That was the key victory. It's the *Colton*

Swidler -- III -- 5

case--C-O-L-T-O-N--California case. It was ultimately not decided by the Supreme Court until 1964, but in the meantime, we had acted on the assumption [that the commissions had jurisdiction] and a lot of the companies had given up on it, so we were exercising jurisdiction long before that. That was--that's 376 *U.S.* 205.

G: The other companies that I have involved were Southern Nevada Power Company--anything on the rate reduction or postponement there that you recall as being significant?

S: No.

G: Southern California Edison?

S: That's this one; that's Colton.

G: Wisconsin-Michigan Power Company?

S: I guess that was a jurisdictional case.

G: Potomac-Edison Company; Cincinnati Gas and Electric, and Narragansett Electric?

S: Well, *Narragansett* was an old case, as I recall, where the Supreme Court held that interstate rates was an area reserved to the FPC [Federal Power Commission]. It identified a gap in the law. Let's see--it led to the 1935 amendments to the Federal Power Act. [Inaudible] That's my recollection of the importance of *Narragansett*. The other cases may have their own special interests, but I don't recall it now. But we called in an awful lot of companies and tried a good many of the cases.

G: We've discussed the Northeast power failure, the blackout and your role in that previously, but there were a number of other interruptions, power failures of a much smaller dimension that the commission became involved with. Is there anything significant in going into these other areas?

Swidler -- III -- 6

S: Well, that outage happened while I was down there.

G: Yes, making your report?

S: Making my report. I came down there with Stu [F. Stewart] Brown, our chief engineer, to make our report on the Northeast blackout. Communications were interrupted at the Ranch, and the President said, "What's going on here?" He wanted us to find out. So Stu peeled off--he never did get to talk with the President--and he was on the phone the whole time trying to find out what had happened. It was the same story as the one in New York except on a smaller scale and without the same serious consequences. But it was quite a coincidence that it happened when I [was] presenting the Northeast blackout report.

G: You had one four days later, Gulf States Utilities.

S: It was the Gulf States Utilities one, not the El Paso one. I think that was the one that affected the White House. What date?

G: December 6, [1965], and El Paso was December 2.

S: December 5? It was the sixth.

G: Okay.

S: So, whatever happened on the sixth was what I'm talking about. That's the day of the report. I trust you have a copy down there.

G: Yes.

S: Then you have a power system disturbance on the Western Interconnection, April 1966; Anchorage power failure, May 1966. Well, I was gone by then. I think that, as a result primarily of [the] New York power failure and the report that we wrote on it and presented to the President that got wide publicity, the power companies put into effect more stringent regulations on the loading of power lines and on their maintenance so that

Swidler -- III -- 7

outages of that sort became less frequent. They still occur, but I don't think we are apt to have one like the Northeast blackout which resulted not primarily from mechanical reasons but because the Consolidated Edison operator wouldn't trim load, wouldn't dump load in order to avoid overloading his system. But I think all of the companies now understand and the control room people now understand that this has got to be done.

G: Okay, let's move on to the natural gas area. I want to start with the topic of pipeline safety because the commission did become involved in this issue after, I guess, the Natchitoches, Louisiana, accident.

S: Natchitoches.

G: Is that it? Okay, in 1965.

S: Was it in 1965 or earlier?

G: Yes, I have March 1965.

S: That could be. That was a bad one. The pipe broke and it was like a blowtorch, a huge blowtorch for I don't remember how many minutes before the gas could be turned off. A good many people were killed, and a lot of property was damaged.

G: Did you go down to the site?

S: No. There is a problem of erosion or corrosion of steel pipe that occurs from magnetic factors when the pipe is in the ground. Now, this can be corrected with the right equipment, but a lot of the pipelines at that time did not have that equipment. They had no electromagnetic protection or inadequate protection. And I guess a lot of lines were operating whose pipe--where the walls had become very thin on account of erosion. I believe now that there is equipment to detect these weak spots and the companies do a much better maintenance job. But the gas pressures are very great. You're talking about

Swidler -- III -- 8

pressures of a thousand pounds to the square inch, something like that, enormous pressures. And the thickness of the pipe is not all that great. I think there will always be a danger of a pipeline rupture somewhere.

Gas is just flammable; that's what creates its usefulness and at the same time its hazard. But now I think most of the accidents are not pipeline accidents. They are either accidents at the producing end when you get an explosion at the well, such as happened only last week in the North Sea on this Occidental Petroleum Company station, or it happens on the distribution systems where all kinds of pipe are laid under all kinds of conditions. It may happen because of a break within a house that is out of the range of any company's care. So you are dealing with a dangerous substance for which not everybody is prepared to cope.

G: Before this Louisiana accident, had you been sensitive to this whole area of pipeline safety? I realize that there had been earlier explosions, tragedies.

S: Yes, I think we were, and I was familiar with the phenomenon of erosion through these electrical forces in the earth. I don't remember what we did about it. We had no explicit jurisdiction over pipeline safety, as I recall. When the Congress did set up a pipeline safety institution [or] agency, the jurisdiction was given to another agency rather than the Federal Power Commission although I think we were much better equipped to handle it than the other. I think for the reason that by that time the FPC had acquired a reputation for strictness and the pipelines preferred to have it in hands that they thought would be more understanding.

G: What year was this? Do you recall?

S: It was after I left, 1966 or 1967.

Swidler -- III -- 9

G: Did it go to Transportation?

S: I think that's right. Which knew nothing about pipelines.

G: The commission did take some steps as a result of the Louisiana accident. Do you want to talk about those?

S: I don't remember what they were.

G: One was a questionnaire to pipeline companies that got some indication of the number of failures that had taken place since--I think the date was 1950--in the last fifteen years. Did you worry that there were all of these pipelines that were twenty years old in the ground?

S: Indeed I did.

G: What could the commission do here?

S: Oh dear, I wish my memory covered it better. I know we did a lot of jawboning. When our people identified a company that had a poor record or otherwise knew of some danger, why, we encouraged them to apply for building new lines, and a lot of that was done. I don't recall whether we actually imposed any requirements or not.

G: There were some limits placed on the maximum pressure allowed.

S: Yes, we could do that. We put some limits on pressure. We required periodic reporting. I think we did an awful lot by way of surveillance to make these fellows very safety conscious.

G: There was a distinction between pipelines that were already in the ground and permits being sought to lay new.

S: Yes, we would not permit new pipelines to be laid except with all the safety precautions. Now, one of the safety things that we did--a particular source of danger was when the

Swidler -- III -- 10

pipeline was out of the ground crossing a bridge or something like that and also where you were going through built-up areas. I remember one case in particular on Long Island where the line was proposed to run underneath a schoolyard. It was the practice of the industry to encase the pipeline in cement at places where trouble was apt to erupt. We extended our rules quite a bit so that we made the decisions, as to concrete encasements and as to routing, in order to minimize the danger of a break. So far--knock on wood--I don't think there has been a break of a high pressure pipeline in a densely populated area, but it requires an awful lot of money and an awful lot of care in designing the line so that it will be safe.

G: Did the pipeline companies oppose the commission's work in this area?

S: Well, they were looking at the investment dollars a little more strictly than we were. Yes, they would say it isn't worthwhile to change the routing and make it longer in order to avoid this hamlet, or this isn't the proper case to require us to put the pipeline in cement, and that sort of thing. There were differences in detail, but I think the industry knew that it had a safety responsibility, and in the end, unless they did a good job, it would reflect on them.

G: Do you feel that it was industry lobbying that led the monitoring to take place in the Transportation Department rather than the FPC later on?

S: Well, you can't be sure. It may have been that [the] Transportation Department made a strong bid for it but I do think it was the industry lobbying.

G: I wanted to talk about natural gas rates and the whole question of the area rate formula that the commission devised. Why don't you just begin at the beginning and describe this formula?

Swidler -- III -- 11

S: Well, we used the formula that by that time was pretty widely accepted, the prudent investment formula, that the industry was entitled to a fair return on the capital prudently invested in the artifacts of the industry, which included not only the dollars in plant, but also the working capital that they needed, of course, and their office buildings and whatnot. Using that rule, you had two decisions to make: one was what is the proper base on which to calculate a return on the investment, and the other one, what is the appropriate rate of return?

There also came to be, during my tenure, increasing emphasis on a third factor which is the rate structure. After you had agreed what the rate base was, multiplied it by the percentage of rate of return so that you knew how much money they were entitled to, then we also went into the question: who do you get it from, what classes of customers; how do you adjust for various conditions of service, that sort of thing. Now, on the pipeline side, the allocation problem was not all that serious, as I recall, especially in the early days, because all of their gas property was under the jurisdiction of the commission. Whereas on the power side, there was a lot of property devoted to retail service. You had to make a lot of allocations; that was sometimes the essence of the rate case.

I guess maybe at that time some of the companies still felt that they were entitled to more than a return on their investment. In an earlier era, the standard was different. It was a fair return on the fair value, not the prudent investment, but the fair value of the property employed in the business. Now, fair value took a lot of things into consideration: not only the investment that was made, but also what had happened to the market since the investment was made; what it was worth today, reproduction cost, that is, and various intangibles. That made rate-making a kind of guessing game in which you

Swidler -- III -- 12

had experts on each side trying to guess what property built in 1930, on a technology that was no longer used, was worth in 1960.

The depreciation standard was also different in the earlier period. That too was a guesstimate. It's called observed depreciation, so if you looked at a pipeline and you kicked it and it sounded all right, you said, "There is no depreciation here." In my day we used straight-line depreciation so that you really could determine both the investment and the depreciation from the books. Of course, by that time we had got control of their books, and they were reliable. We're talking natural gas pipeline now.

There is a special feature to gas pipeline rates which doesn't apply to power companies and is related to the major differences as to type of organization, whether you are organized vertically or horizontally. Vertically, as in the power case, where the same company owns the generating plant, the transmission lines and the distribution system, or horizontally, where there are three kinds of companies which feed into each other: the producers, the pipelines and the distribution systems. Since you're organized horizontally and cover a great area, take care of only the pipeline function, that means that you may be serving customers over a distance of a thousand miles from that same pipeline. The question is, do you charge the same price fifty miles from the producing fields as you do a thousand miles away?

Most pipelines had, and have, zone rates where they're a little like the zone rates on parcel post. Within a certain number of miles you charge one rate and for a further distance of miles another rate, a bit higher, and so on to the end of the line. Naturally, there is always a lot of contention among the distributors as to how to fix the zone rates.

Swidler -- III -- 13

The people who were far away from the production areas had a different concept of how the zones should be set than the folks that were right close.

There is another facet of the problem of pipeline rate-making and that is, how much of the cost of the gas and of the transportation should be charged in the demand charge and how much in the commodity charge? In other words, if you're undertaking to serve the needs of a community then you have a considerable investment there, even though the community doesn't take a single mcf [thousand cubic feet] of gas. So you have to charge something for the capacity that you make available, the investment that you've got, and sometimes even the commitment to buy gas so that you'll have it if the community wants it. Then, of course, you charge separately, depending on how much gas they take. That means that although the pipeline buys on a pure mcf basis without capacity charge, it translates its costs into demand and energy. Now, it's traditional in rate-making that a part of the capacity costs are included in the commodity charge. There was a lot of discussion, some movement, some changes on the formula to be used, a lot of what you might call "sashaying around," if you understand Texan, on that question, which I don't think is settled finally to this day.

Tape 2 of 2, Side 1

S: When I came to the commission, the great problem holding up the decision in the pipeline rate cases--there was a great backlog, a backlog which my predecessor said would take up the time of the commission until the year 2025 or something like that even if no new cases were filed--

G: Eighty years was the projection, I believe.

Swidler -- III -- 14

S: --was the fact that the rate had to include the cost of the commodity. Those commodity rates were dependent upon the costs at the well, and the commission was up in the air about how to pin those down. You couldn't really dispose of any of these cases until you knew what prices to allow to the producer. Now, what we did was to work simultaneously on a long-range answer to the commodity rates--and here I may be going beyond what you want me to talk about because I'm getting into producer rates now, but they're tied together. We worked on the long-range method of determining rates in the field, or rates to be paid to producers, and since that was going to take quite a while to work itself out, it became necessary to develop short-term formulas that would provide some basis on which the rate cases could be disposed of--talking about the pipeline rate cases.

At that time, the pipelines had such a tremendous amount of their earnings tied up in cases subject to refund that they didn't know whether they were solvent or insolvent, literally; if they had been required to refund all the money that was being held subject to refund, they were broke; if finally you set rates that gave them a chance to pay the producers and still have something left for themselves, then they were in pretty good shape. Well, we developed a system of interim rates which the court, recognizing the necessities of the situation, approved. There was some thumbsucking involved, I'll have to admit; there wasn't any real science in setting those interim rates, but we tried to be fair. They were pretty close to reality and to the final rates that we did set when we had a record. We entered into the settlements with the producers and with the pipelines on a finality basis so that the rates were no longer subject to refunds beyond those involved in the settlements. Some refunds were required, in fact, very large refunds, because we had

Swidler -- III -- 15

started out with the rates that were requested by the companies. I guess we ordered something like a billion dollars or maybe more in rate refunds. See, now this is different from ordering reductions for the future, money that the consumer had never paid. When it came to refunds it was getting money back that he had already paid.

It was during my tenure--I think it was 1962 or 1963--that this country, I think, had the first year in which there was no increase in the cost of living, the price index remained stable or went down slightly, as a result of these refunds. Of course, if the cost of living had been going up rapidly it wouldn't have made all that difference but since the rate of inflation was very low, it made the difference.

G: This must have had enormous public appeal.

S: Yes. It got an awful lot of publicity.

G: How many individual refunds were there, do you have any [idea]?

S: Every pipeline had to make substantial refunds, every pipeline, because their asking amounts were always well above what we finally arrived at. Now, there was a lot of opposition within the staff to the refund program because they were based on settlements. We had people within the staff who said, "You should never settle. Try the case and when you have all the facts, issue an order, on the record." Well, that was a program that would have ended up with an order eighty years later while other cases piled up behind it. So we came awful close, as I say, to what the final result was when we finally decided the area rate cases, but we settled them, and the oil companies also knew what their revenues were. It wasn't quite as important for them because they had a lot of oil revenues too, so they could take some uncertainty at the margin of their revenues. But for the pipelines, it was a matter of life and death. They couldn't raise any money with the

Swidler -- III -- 16

uncertainty as to whether they were solvent or not. And we finally led them out of economic captivity into solvency.

G: Did it also provide a price stabilization that was lacking before?

S: Yes. We had commitments as to when they would be able to file again. It was an overall settlement that protected consumers for several years in the future. Well, those were, in a way, golden years, because we really were able to eliminate this situation in which nobody knew whether he was making money or not. We got all these cases off our docket, and we could look to developing policies and procedures for the future.

Now the first area rate case wasn't decided until, I think, 1965; the *Permian* case. And it wasn't decided by the Supreme Court until 1968. But in the meantime, we had the blessing of the Court to go ahead, and we did.

Do you want to ask a question now?

G: The refunds were of such a tremendous scale that I have to ask, was there a political advantage that accrued from this for the party in power?

S: I'm sure that there was. A lot of this happened under Kennedy. You have to say for Kennedy that he was not anxious to have his name mentioned in connection with every refund. We didn't have to announce that, "the President authorizes me to say that," and so forth. I think probably it was a background factor in his popularity, one of many. I think it probably helped Johnson, too.

G: Did the industry by contrast attempt to take credit for it, in terms of mailing out the checks or was there any--

S: Well, no, that brings me back to the question of being sure that the refunds were made to the customers. You see, the customers of the pipelines were not individual domestic or

Swidler -- III -- 17

commercial industrial customers. They were the distributors: Consolidated Edison and Brooklyn Union, Southern California Edison--which is a combination company with both gas and electric, or is it? No, it's Pacific Gas and Electric which is the combination company. These were some of the customers. Now, there was nothing that we could do to force them to pay over that money to the consumers. We had no jurisdiction over the distributors. All we could do is announce who was getting how much, to send letters to the state utility commissions reporting who was getting how much, and to talk a lot to the newspapers about the fact that it was up to the local utilities and the state commissions to see that the money that was paid to the distributor went back to the consumer from whom the distributor had received the money. I think almost all of it was distributed. There was enough of the light of day. It was a big enough thing so that the newspapers all focused on it. It was the story of the day in every town where refunds were made. You couldn't hide that money anymore.

G: Did it also raise the visibility of the commission?

S: I think it did, sure. Although we were one step removed. When the order came to pay over that money from the distributor to the consumers, it was the order of the state commission, not ours.

G: I see. But all of the announcements and--

S: Well, the initial announcements, they didn't always go back to the places--if you read the *New York Times* or the *Washington Post*, you would know, but you wouldn't always know if you were living in Wappinger Falls, Minnesota [New York].

G: Now, the whole area rate formula was a novel formula for regulation. Is that not true?

Swidler -- III -- 18

S: Yes, that was true. And my predecessor had started an area rate case and then dropped it because they didn't know how to move it. Truth to tell, neither did I. It was *terra incognita*. Nobody had ever done it before. I did know that there were Supreme Court decisions which could be construed as permitting a kind of area rate-making. The one I recall in particular was the *Nebbia* case in New York where in fixing prices for milk in a milk shed, the Court had said something that could be construed as sort of area rate-making. That's N-E-B-B-I-A. I thought we were on sound legal grounds, and I knew that the Court itself was on the spot. When I say the Court, I mean the Supreme Court because they had said, in the *Phillips* case, that the FPC had jurisdiction and had the responsibility to exercise it. And here we were doing our damndest to carry out the responsibility that the Supreme Court had placed on our shoulders. So I thought that we were entitled to assume a sensible appraisal of what we were doing, and not a technical one. We referred it to an administrative law judge, or hearing examiner as it was called in that day, on the assumption that he would live with that one case, if necessary for two or three years, [and] then come up with something; in hearing the case he would get many suggestions, many proposals, many ideas from the parties and from expert witnesses, and that he would make a contribution. On the other hand, we would be making a mistake if we tried to set down the rules before we knew what the facts were. That's the way it worked. We had a great hearing examiner. I guess he was assigned--we couldn't pick the hearing examiners for particular cases. They were insulated from our influence--

G: Really?

S: Yes.

G: Who picked them?

Swidler -- III -- 19

S: --to a degree. I hired them, but the assignments were made by the chief hearing examiner. Did I hire them? There was a special federal office that had to approve them. I don't recall the details. I think I was able to hire them, but they had to pass tests and whatnot. They were a good group, and I think I have told you that our commission had more big cases than any other agency in Washington. So we needed very able people. These were cases involving hundreds of millions of dollars, each one. I wish I could think of his name. I had lunch with him only a month or two ago. Sy Wenner, W-E-N-N-E-R. Sy, I think, stands for Seymour. Seymour Wenner, who later was borrowed by the AEC [Atomic Energy Commission] and the NRC [Nuclear Regulatory Commission] to straighten out their ALJ's [administrative law judges]--get their quasi-judicial machinery going--and is one of the most knowledgeable on administrative procedures of all the people here in Washington. But in *Permian*, he came up--in the first place, we had to go out and get some facts. So we got the investment of the industry in every well that they had drilled, and the production revenues, the dry holes and the whole thing. It was a terrific amount of data for which our computers of those days were barely able to cope. The questionnaire got a little publicity on one of the television news programs. It was called "the four-foot questionnaire" or something like that, which was a tricky way of putting it. One of the publicists for the producers managed to interest one of the national news outfits in showing a picture of this guy with a stack of questionnaires four feet high. The trick to it was that that included information on every field in the country. Only an outfit as big as Exxon or Texaco would have to fill all that in. If you only operated one field, there was a very thin questionnaire. So a lot of this was just a different report for

Swidler -- III -- 20

different fields, but it got a lot of publicity anyway. I asked for equal time, but they denied me the opportunity to respond. (Laughter)

It got an awful lot of publicity, but they wouldn't let me explain it.

What he [Wenner] finally came up with was two rates, one for flowing gas and another for so-called new gas. That is the root of all the multiplicity of gas rates that later came about. The idea being that the flowing gas, you already had your money sunk, and it was sunk at levels that were reflected in the books, but for the future, you would need more money than that; you'd need an incentive to drill some more. So there was another cent or so per thousand cubic feet added for new gas.

G: This assumed that the older wells had cost less to drill, is that right?

S: Well, it assumed that the older wells cost less than the new ones which had to go deeper, but I think it also reflected the fact that maybe you ought to allow a little more profit in order to hold out an incentive for more drilling. At any rate, there were many, many individual questions that we had to examine. We held two days of oral argument after the recommended decision was reported by Wenner to the commission. Then the parties had a chance to come in and in effect, to appeal to the commission. And the commission held two days of hearings in connection with which the Governor of Texas at that time was one of the people who argued. What was his name again? He's still there. He just went through bankruptcy.

G: John Connally.

S: Yes. John Connally. He made an excellent lawyer-like argument.

G: Was it the hearing examiner's own idea to make this distinction between the flowing gas and--?

Swidler -- III -- 21

G: I don't know whether it was his own idea or one of the witnesses proposed it. These were proceedings with many, many parties; many, many experts and the wisdom of the industry was drawn into it, and that was the right way to lay a foundation to decide it. And there was some data. Now, the interesting thing looking backward--I think the price that we arrived at was something like 16½ cents. We went a little higher than Wenner recommended. Connally was arguing for the enormous price of 20½ cents, which looks like chicken feed today.

Now, I might say that I was not easy in my mind about that decision, and I wrote it. I don't mean that I wrote every word of it, but I signed it, and I wrote a good bit of it. The whole question was whether it provided incentive enough. After the war came the period of the great expansion of transmission lines as natural gas was made available outside the area of production and throughout the whole country. Lines sprouted everywhere. Until then, gas had come up as a byproduct of producing oil. A good deal of it was flared in--

G: Something to be flared off [inaudible].

S: They didn't know what to do with it. A lot of it was sold for a cent or two. Some of the old contracts that we dealt with were two or three cents, still. Among other things, what we did was relieve producers of those old contracts. We brought that price up. Now, when nobody much was using the gas, when you had only local use for the gas, the relationship between reserves which had been discovered and annual use was--the ratio was very high. You had twenty-five, maybe fifty, originally, to one-fifty of reserves in relationship to annual use. That number kept going down. Now, there was uncertainty as to the reason. It would be uneconomic under any circumstances. The whole fifty years of

Swidler -- III -- 22

supplies on the shelves; that's a lot of money invested in gas for which you won't be compensated for a long, long time. So you could explain it by saying, well, there is no reason for them to drill for gas. On the other hand, you could also say that we're using up the surplus awful fast. I think when I came to the commission it was something like twenty to one and something like fifteen to one when I left and it was beginning to get just a little bit scary.

So in *Permian*, if you read the commission's opinion, you will see that I urged that that be reviewed periodically to be sure that enough incentive remained for drilling. Unfortunately, that wasn't done. When the next area rate case was decided, it did not take a fresh look at that question, it followed *Permian* almost, almost. . . . I think that the commission was slow to raise prices to afford incentive. In fixing the price in *Permian*, that itself was a compromise. Two of the members of the commission wanted it a little higher; two wanted it a little lower, and I didn't want a divided vote. I finally managed to find a number we could all agree on. I think 16½ cents or something like that.

G: Was it then unanimous?

S: It was unanimous. Yes.

G: There was a long span between the time the case was concluded, September 1963, and the FPC opinion, almost two years later, August 1965. Now, you've explained that after the hearing examiner had ruled, you allowed the parties to argue before the commission and--

S: There wasn't two years between the examiner's opinion and the commission's decision.

G: Is that right?

S: Is that what you're saying?

G: Yes, that's what my records show.

Swidler -- III -- 23

S: That the examiner's . . . ?

G: Or between the conclusion of the case

S: Well, the conclusion was also after allowing them to file for rehearing. There was a rehearing phase in there too. As I may have explained to you, I arranged with President Johnson to stay on the commission until [the] rehearing phase was completed. We wrote two long opinions in that case.

G: It was unusual, I gather, for the commission to actually formally write an opinion in a case like this.

S: Oh, no, no.

G: It was not?

S: No, no. We wrote a formal opinion in every case, unless there was a settlement.

G: As opposed to simply adopting one that [inaudible]?

S: We almost never simply adopted the examiner's recommendation.

G: Really?

S: Let me come back and explain that. First, I want to talk about the problem of regulation, when only a part of the country is covered. The Natural Gas Act exempted intrastate transactions, and it helped to define what an intrastate transaction was for purposes of the act. Within that definition, there were a lot of intrastate pipelines in the producing states, Texas in particular, Louisiana, Arkansas--where else? California--but principally Louisiana and Texas, I think, were the big ones. I think you'd have to say that regulation in the long run was really doomed by that exception, because it meant that no matter what price you fixed on the interstate rates, it was a regulated price. An interstate pipeline can go up a quarter of a cent and buy it all. Sometimes I had the feeling I was just working to

Swidler -- III -- 24

make Oliver--what the heck's his last name; you've got an entrepreneur that's still there, first name Oliver, in the gas business--I was just working to make him a billionaire. I think I finally succeeded because as I say, he would buy it all up until the interstate market was starved.

G: Oscar Wyatt?

S: Did I say Oliver? I take it all back. That's right.

I think without that exception, regulation would have been workable, without that exception and with a more sensitive feeling for what it took to encourage people to drill. I might say one of the other concepts that was introduced in the Wenner opinion was the conclusion that the producing industry was now able to invest its money directionally, either in an oil-prone or gas-prone field. They could drill either for oil or gas. Gas didn't have to be a byproduct of oil. If the price was good enough, people would drill for the gas. If it wasn't, they wouldn't drill for gas. And that was the basis, the factual basis for the differential. If there had been no directionality, there wouldn't have been any point to providing an incentive.

G: How did the Texas Railroad Commission affect this intrastate question of gas in Texas?

S: I think by the time I got into it, they didn't have too much of an influence. Earlier, through their control over what they called allowables, they could control the amount of production in Texas, keep supplies low, prices high, or if the prices were favorable, to raise the allowables. But it permitted a lot of juggling, and they really kind of, in those days, were almost like OPEC [Organization of Petroleum Exporting Countries].

G: Did it affect the interstate market significantly, as well as the intrastate?

Swidler -- III -- 25

- S: Yes, I guess it did, sure. You had to pay whatever. . . . I think they had an allowables--then the other state was Oklahoma where they had a lot of intrastate pipelines. The three important ones were Oklahoma, Louisiana, and Texas, and I think they followed the allowables system also. Texas was really onto something. But I don't think they had much of a role after we determined the prices and took over.
- G: Would it be fair to say that the *Permian* decision reduced their impact?
- S: It reduced their impact on prices. They still had all the authority they had had before, but they weren't able to use it as they had in the past as a cover for price-fixing.
- G: Was there a way without legislation for the FPC to regulate intrastate?
- S: No, Congress had made it so very clear, that our jurisdiction did not extend to these intrastate markets. Texas also got a special deal on power system regulation. They now have the benefits of regulation without the obligations under a special Texas deal. They had very powerful representation. The Texas delegation was very influential.
- G: And normally sided with the producing interests in the state. Were there other significant cases at this time that followed this Permian Basin precedent?
- S: Well, there was also a Supreme Court decision in the Southern Louisiana case, but I don't think that that covered new ground. I think that was pretty much a rehash of what went before. Then the FPC extended the area rate to national rates, which is where we are today. Instead of having separate rates for the various areas, there is a rate for the whole country. But now there is such a mishmash of regulated and exempt rates and whatnot, it's become very complicated.
- G: How essential was this area rate approach for the practical matter of implementation and getting compliance in effect?

Swidler -- III -- 26

S: I don't know of any other way it could have been done. I don't know anyone who has suggested a third way. Originally, as you know, the commission got started on individual rate cases. They never finished one. I think I may have mentioned how I came to the conclusion that we just had to use the area rate concept because otherwise it would have been so ridiculous that it would have dropped of its own weight. You would have had a different rate not only for each company, but inasmuch as many, if not most wells have many owners, if you had done it on a company-by-company basis, then the flow of gas out of a single well would have had many prices, one price for each owner. You couldn't live with a system like that. How could you determine the prices on a field-by-field basis? And when you had determined them, how could you translate them into rates? It would mean that the rates in one part of the country, not necessarily any further from the fields than in another part, would be very different depending on whose pipeline got to a certain area first. It would have been just a jungle. I just decided it would be wasting our time going that way. I tried to really look at the possibilities of going that route, and I just couldn't see it. It didn't take me very long to conclude if we were to get regulation it had to be on the area basis.

G: Was there a precedent for the area approach that suggested itself?

S: Well, I told you about the *Nebbia* case, which was a milk producers case.

G: Any other [precedent]?

S: I don't recall any other; there may have been general language in the cases about--

G: Was there anyone else involved in the adoption of this approach, aside from the other commissioners? Anyone else who explored the, let's say, developments?

Swidler -- III -- 27

S: We had people on the staff who did some briefs on it to convince themselves and to convince the commissioners that we had a chance of winning in the Supreme Court. They brought together these precedents, but in--

Tape 2 of 2, Side 2

G: You were following these constitutional [inaudible].

S: Yes, and I guess I was relying primarily on *Nebbia*. But there were more cases that the staff discovered that gave us a little encouragement. But it was an innovation; there's just no question about it.

End of Tape 2 of 2 and Interview III

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