United States Senate

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BUSINESS and FINANCE

By DONALD I. ROGERS
Business and Financial Editor

Breaking Bureaucratic Shackles

IT IS strange, some times, how strictly political issues in Washington embody overtones which can affect whole segments of American business. Such is the case with the Fulbright Bill, scheduled by Senate Majority Leader Lyndon B. Johnson, D., Tex., for early consideration. It's a measure which would relieve the nation's natural-gas producers from the price-fixing controls imposed by the Federal government after a Supreme Court decision in the Phillips Petroleum case in June, 1954.

Donald I. Rogers

At the same time, the bill would permit interstate pipe-line companies to pass along to their customers only such increases in gas prices as the Federal Power Commission determined to be a reasonable market price. The House in July passed the Harris Bill, almost identical to the Fulbright Bill.

Current interest in the producer-regulation issue is largely political and centered almost wholly in Washington. Yet there are implications that go beyond politics or even beyond the natural-gas industry and have become of concern to business men and the general public. These aspects are brought out in a recent report to the general membership of the Natural Gas and Oil Resources Committee by its Executive Committee. This is not an impartial group, by any means, and the committee, in its own words, is "made up of individuals and companies concerned with natural gas and the broader basic issues of a free economy."

But here's what the committee says: "After eighteen months of the Federal government's efforts to regulate natural gas production, most of the predictable consequences are now evident. A reluctant, understaffed Federal Power Commission has failed to find a means of applying a realistic and equitable formula to the competitive production of natural gas. The Commission's bewilderment and indecision are reflected throughout the industry. The incentive to explore and develop has been largely removed."

Looking beyond the immediate, the report continues: "But what is far more important than the predictable, material consequences of regulation—important as they are—is the broad and general danger implicit in the new concept of Federal controls which has developed since the Phillips decision. For these attempted controls are depriving a whole industry of the right to compete. And in doing so they pose a threat to a freedom which is vital to the American economy."

Granted that these spokesmen have an ax to grind, and recognizing the fact that one control on one industry does not necessarily pose a threat to all industries, I feel these men may be justified in sounding the alarm.

The Phillips case involved only one producing company,

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Rogers

(Continued from page six)

yet the Supreme Court's 5-to3 decision has been broadened to include 8,000 producers. There was no war or other national emergency to spur a quick and sweeping application. There was no evidence of monopoly or of price fixing. There was, in fact, abundant evidence to the contrary.

Yet bureaucracy was imposed on one of the larger, least centralized, most vigorously competitive industries in America in which 743 producers supply only 80 per cent of the gas, according to the Bureau of Mines.

So a precedent for denial of the right to compete has been established. What started as a decision about prices has been interpreted as something to require controls clear back to the wellhead so that now the F. P. C. even controls the production and pricing of distillates of gas.

If the precedent is accepted, per se, it may embody some elements of contagion, and this could concern all business.

Competition is not just a vital, a necessary element in the Republic's economy; it is the keystone of our success. We should guard it as zealously as we police its violators.

AMENDMENTS

Douglas

UTILITY REGULATION OF LARGER PRODUCERS ONLY

(Douglas Amendment)

The assertion that regulation on a size basis would be administratively feasible fails to consider the structure of the industry. The administrative load would not be lighter than that placed on the Commission by the Fulbright Bill. On the contrary, the consequence would be tremendously heavier and a compounding of the existing confusion. Federal utility-type regulation would hurt consumer interests whether applied only to the larger producers or to all producers. It would discourage entry of gas into interstate markets. It would divert higher-cost gas to interstate markets and lower-cost gas to intrastate markets. It would boost consumer costs as volumes decline.

1. How many Companies Would Be Regulated?

Senator Douglas says that regulation would be limited to 197 independent producers, on the basis of the organization of the industry existing in 1954. He suggests that his count of "number of producers" is subject "to some small adjustment ...". The "small adjustment" to which the Senator refers, amounts to more than 100 per cent. In other words, more than one-half of the separate vendors who sold 2 billion cubic feet or more to pipeline companies in 1954 are omitted from Senator Douglas's calculations.

The annual reports of the pipeline companies to the Federal Power Commission were not prepared for the purpose for which the Senator has used them. In the many instances where purchases by pipeline companies are from unitized fields, or the vendor is an operator or any kind of a joint-interest arrangement, the reports set forth only a single name.

It is the name of the operator who handles gas owned by several - a score - or even a hundred independent producers selling under separate contracts. Nevertheless, these quantities have been added to the quantities reported as purchased from the named vendor in other locations.

To say that the number of independent producers selling more than 2 billion cubic feet in 1954 is well over 400 does not tell the whole story. That figure includes nothing for the hundreds of producers in unitized fields.

2. Regulation Would Have To Recognize Individual Transactions.

The Senator from Illinois commented that, "it is a regulation of sales transactions that we are debating" (page 1060). This comment seems to mean that total sales by each given vendor throughout the United States are to determine whether or not the enterprise is subject to regulation, but that the regulation is to be applied to each separate producing property regardless of volume of production or sales at each location. The regulatory responsibility would be spread to thousands of contracts.

The scattered operations of the independent vendors who would be subject to regulation in some 1300 fields in the United States are under widely diverse conditions. The gas varies in quality and distance from market. All these diverse factors are equated by the competitively determined prices. They would have to be ignored if a common price were fixed for all gas produced by a company. It would be discriminatory, for example, to fix prices for Appalachian delivery based primarily on costs incurred by the company under fortuitous conditions in the Southwest producing area.

The fact is that the volumes which Senator Douglas related to 197 producers represent a total of 1,539 sales situations as reported by the pipeline companies which in turn are based upon an almost infinite number of contractual arrangements with individual producers in given fields or in arrangements for casinghead gas for processing. The Federal Power Commission would have to go to the underlying contracts.

3. Regulation by Size Means Wide Price Disparity

The public utility formula will result in a wide disparity of prices among regulated producers in the same fields. Should one "small" producer's lease bring him the competitive market price, while the larger producer owning an adjoining tract is paid a "cost plus" price which might be either much lower or much higher? This is discriminatory regulation.

4. Landowners Would Insist Upon Protection From Regulation

Landowners would require protection against the possibility of royalty returns below the reasonable market value of the gas. They might, if necessary to avoid adverse effects of regulation, insist upon separate sales privileges for their respective portions.

5. Regulation Would Be Applicable to a Changing Number of Companies

Identification of the subjects of regulation is a first step in the exercise of any regulatory responsibility. The difficulties encountered when it is necessary to go behind each transaction suggests the enormity of the regulatory task which would confront the Commission.

The Federal Power Commission would find it necessary to review all contracts for interstate sales frequently to determine whether or not any new sales contract resulted in the vendor becoming or being no longer subject to the regulation. Review of the continuously changing conditions will result in a morass of regulatory burden, a magnification of price changes compared with those in the past, and continuous reshuffling of the constant price disparities among and within fields.

Prudent owners of both existing and newly discovered reserves will take advantage of all the available means and opportunities to avoid burdensome and disadvantageous regulation. Contracts for sale of additional supplies will be written in such a manner as to remove more and more producers entirely from Federal regulation. Future discoveries will be sold outright or otherwise "spun off" as an obvious means of escaping the burden of regulation and of assuring receipt of the competitively determined price.

It is no wonder that the Federal Power Commission, in reporting on the Douglas proposal, declared that it "would be administratively difficult, if not unworkable, and would of necessity be uncertain."

6. <u>The Regulatory Lag</u>

Regulating producers will require a review by the regulatory body and the issuance of a Certificate of Convenience and Necessity before new sales can be made from new producing properties. There is a regulatory lag of approximately two years between time of entry and time of approval of rate cases, such as would be involved in the review and determination of the price that should be applicable to the gas produced by a new well of a regulated company. On the other hand, a nonregulated company could drill an off-set well on an adjacent piece of property and not being subject to regulation could sell and connect to the interstate carrier immediately and drain the reservoir from under the regulated well for a period averaging two years before the regulated company could do business.

7. The Inevitable Cost Problem

Quite aside from all this, how can a utility cost formula possibly be applied in regulation of individual gas sales transactions. In all but a relatively few situations dry gas suitable for delivery to pipelines is produced jointly with oil, gasoline, or other liquid hydrocarbons. All the costs of exploration, development, and production are joint among the several products. No method of allocating such joint costs is available. None can be made available which is more than an arbitrary question-begging formula.

Even if costs associated with successful exploration, discovery, and development were measurable, how are costs associated with the failures to be treated when the regulation is applied to the individual transaction or producing property. Unsuccessful ventures, wherever they may be, do not result in sales transactions.

8. Regulation Would Discourage Growth

As producers approached the arbitrary line of demarcation of 2 billion cubic feet of annual gas production they would tend to refrain from additional drilling in order to escape the burdens of federal regulation.

* * * * * * * * *

Limitation to larger producers would in no way set aside the disastrous results which a utility cost-plus type of regulation would bring to interstate consumers. Additional supplies to the interstate market would tend to be limited to those available from those larger producers who have higher costs or from the smaller producers who would not thereby subject themselves to Federal regulation.

February 2, 1956

3

Kilgore

THE KILGORE "CONSERVATION" AMENDMENT

The amendment we are now debating has been labeled--or I should say, mislabeled--a "conservation" amendment, and the unknowing person could be taken in by it on that ground. But, let me assure you, gentlemen, it is anything but that. The effects of the amendment are far-reaching and contrary to all that you and I know are best and good for our beloved nation. This proposed amendment would give the Federal Power Commission jurisdiction over the conservation of gas all the way back to the producing reservoir, and the power to control at the distribution end the uses to be made of this fuel.

Here are a few of the things that the innocent-sounding words in the amendment would bring about:

-- Destruction of the long-established rights of the states to regulate in the interests of conservation.

-- Perversion of the clear intent of Congress in passing the Natural Gas Act in 1938.

-- Establishment through federal control of gas production federal control over oil production.

-- Negation of much of the effect of the Fulbright bill now before us.

-- Upset of the whole concept of natural gas regulation.

-- And, under the guise of conservation, federal control of the end use of natural gas.

Now, let's examine those points a bit closer.

Nothing was more clear in the Natural Gas Act, in its legislative history, and in subsequent court decisions construing and applying the Act, than this point: The states were to retain all of the powers which they ever had. The Act was complementary to state regulation and was in no way to interfere with the exercise of state regulatory power.

Prior to passage of the Natural Gas Act, many states had adopted comprehensive systems for regulating the drilling for, and production of, crude oil and natural gas in the interest of preventing waste and conserving these natural resources. Many other states have adopted similar systems since that time. Under these systems, the states govern, in great detail, the activities of the oil and gas producing industry.

The Kilgore amendment would completely destroy the progress which has been made by the states in conserving oil and gas. It would completely reverse all of the history in respect to the conservation of oil and gas. This it would do by taking these traditional powers from the various states and placing them in the hands of the Federal Power Commission. I mention both oil and gas advisedly because the power to conserve gas necessarily carries with it the power to regulate the production of oil, since both products are usually produced from the same well.

This amendment would go a long way toward accomplishing what many advocates of centralized federal government have been trying to foist upon us for years. It would subject oil and gas production and distribution of gas to federal regulation.

Bills similar to the amendment now being discussed have been introduced in Congress in the past. I am thinking notably of S. 2001 proposed by Mr. Kilgore and H.R. 4943 proposed by Mr. Staggers. These bills, fortunately, were rejected after due consideration by the committees. Still, the amendment we have under discussion goes even further--much further--than either of those two proposed bills, in that it <u>supersedes</u> rather than <u>complements</u> state conservation regulation.

Those of us who have followed this legislation closely know that the main object of this amendment is to prevent natural gas from being used for industrial purposes in competition with coal; and, in turn, as a necessary corollary, to cause natural gas to command higher prices for domestic uses. In other words, this is an amendment designed both to legislate natural gas out of competition with coal and other fuels, and to bring about federal control of the end use of natural gas.

Throughout the debate on the Fulbright bill, the opposition frequently asserted that it wanted only to protect residential consumers of natural gas against what it falsely claimed would be out-of-proportion price increases permitted by the bill. The opposition contended that the industrial use of gas helps to keep down the price to residential consumers. And it claimed that if the Fulbright bill passes, the price of natural gas will increase to such a point that industry will stop using this source of energy and revert to an alternate fuel. Such an action on the part of industry would--so the opposition says--increase the price of gas to the residential user.

Those of us who favor the Fulbright bill certainly can not agree that passage of the bill will result in unjustifiable price increases that would, by themselves, cause industry to turn to another fuel. But there can be no difference of opinion among either proponents or opponents as to the situation that would result if the Kilgore amendment, limiting the use of gas for industrial purposes, is accepted.

If we pass the amendment, we will have limited, if not eliminated, the industrial use of gas. Thus, we will have brought about, by legislative enactment, the very situation which the illustrious senior senator from Illinois and others who are aligned with him against the Fulbright bill have suggested would be a danger to the residential consumer. We will have destroyed, or seriously curtailed, the very industrial market for natural gas which the opposition claims is such a protection to the residential consumer.

I submit, Mr. President, that it is inconceivable that any senator who opposes the Fulbright bill on this basis could favor the Kilgore amendment. Obviously any opposing senator who votes for this amendment would be voting against a protection of the residential consumer he claims now exists.

It is generally recognized that high labor costs have brought about a situation whereby coal is not competitive with natural gas or oil for some purposes. But it is not the American way to legislate the American people out of better or cheaper products simply to protect one competitive industry against another. The horse-drawn carriage industry felt the competitive impact of the automobile. The railroads felt the impact of the bus and truck. All other forms of transportation felt the impact of the airlines. But you can look in vain for any Act of Congress designed to head off this progress. You will find, however, Acts that were intended to encourage and stimulate the growth of the newer, competitive industries. It would not be in keeping with the spirit of America for the Congress to intervene in the present competition between gas, on the one hand, and coal, on the other. But that is precisely what it would be doing if it adopted the proposed amendment.

Fortunately, Congress has traditionally refused to create a monopoly in favor of coal and against gas. We should continue to refuse to grant that monopoly.

Fortunately, Congress has traditionally refused to set up any regional discrimination which would limit industries in their choice of fuels. We should continue to refuse to provide for such discrimination.

Fortunately, Congress has traditionally refused to discriminate against one producing area in favor of another. We should continue to refuse to permit such discrimination.

Fortunately, Congress has traditionally refused to deny to consumers their right of free choice among competing fuels. We should continue to reject any such restrictions.

It will be a sorry day indeed for the nation when a federal bureau sitting in Washington tries to regulate the daily activities of the thousands of gas and oil producers in this country. Still that is exactly what would happen if this amendment prevails.

It would be impractical, if not impossible, for the Federal Power Commission to regulate the oil and gas producing industry in the many respects now exercised by the states in aid of conservation. Do we want the Federal Power Commission to tell each producer or would-be producer when and where and under what conditions he can drill? Or what amount of oil and what amount of gas he can take from his wells? Or whether he can sell or use the gas, or whether he must return it to the reservoir? Definitely, we don't. These are a few of the things that the states have been doing--and doing well--for these many years. Neither I nor anyone else could offer one logical reason for the Federal government to take over these purely local functions.

It is an elementary principle of law that when the Federal government preempts a field involving interstate commerce, the states are ousted of their power. The proposed amendment would preempt the field of conservation of natural gas insofar as the gas moves in interstate commerce. Perhaps the states would retain their powers in respect to oil or gas which does not leave the state, but that would serve no useful purpose. Such a situation would only result in greater chaos, for we would have a state body regulating one well but another body regulating a neighboring well. I ask you, gentlemen, how chaotic can you get?

My illustrious colleagues, I urge you again: Be not misled by the "conservation" label that has so erroneously been attached to this amendment. Do not be taken in by its innocent-sounding words. Recognize the amendment for what it is: An indefensible attack on our traditional system of conservation by the states and a barefaced effort to revolutionize the entire concept of natural gas regulation and bring about Federal control of the end use of this fuel.

2/3/56 (3) ##

Langer

Pastore

INSERTION OF "NO OBLIGATION TO PAY"
PROVISION AS REGARDS NEW CONTRACTS
(Pastore Amendment)

The distinguished Senator from Rhode Island has asked for an explanation of the different treatment accorded in Section 3 of the Fulbright Bill to existing contracts and future contracts as regards the price to be paid to producers by pipeline companies. By this Amendment he would eliminate such difference.

The explanation, we believe, is apparent from the Bill itself when considered in connection with the facts. It is but another effort to be fair to all concerned, and thus to protect the consumer.

For consumer protection, the Fulbright Bill provides that a pipeline company cannot pass on to the distributor, and thus to the consumer, a field price in excess of what the Federal Power Commission finds to be the "reasonable market price" of the gas in the field.

Under some existing contracts the pipeline companies might be called upon, under certain escalation clauses, to pay more to the producer than the Federal Power Commission would approve for rate purposes. They would thus be caught between the producer and the distributor. When these contracts were made there was no procedure under which the pipeline company could obtain a prior determination as to whether the field price to be paid would be approved by the Federal Power Commission. Neither was there the restriction provided in the Fulbright Bill that only the "reasonable market price" of the gas as determined by the Federal Power Commission could be used by the pipeline company as an operating cost for rate purposes.

As the result of Committee hearings, it was felt that since it was proposed to change the law by imposing specific restrictions on what the pipeline companies could include in costs for purchased gas, it was only fair to relieve them of the obligation under existing contracts to pay more for the gas than they could recoup. This could only be done at the expense of the producer, and under the Fulbright Bill it is done in that manner.

The situation and equities, however, will be different as regards new or renegotiated contracts entered into after the passage of the Fulbright Bill.

Any pipeline company entering into a gas purchase contract after the effective date of this Bill will do so with full knowledge of its rights, limitations and obligations. It will know that it can include in its costs for rate purposes only the "reasonable market price" of gas as determined by the Federal Power Commission. It will also know that under Sec. 3(c) it has the right, before entering into a purchase contract, to go before the Federal Power Commission and find out in advance whether the price it proposes to pay will be approved and can be included in its costs. There is thus no chance for it to be involuntarily caught price-wise between producer and distributor for it will act with full knowledge of the law and its rights thereunder.

Therefore, the equity that justifies the restriction on payment to the producer under existing contracts does not exist as regards new contracts.

The difference in the payment provision between existing and future contracts is also most important in assuring an adequate future supply of gas.

Under existing contracts the producer is bound to continue to deliver gas to the interstate pipelines, and this is true even though he is to be paid only what the Federal Power Commission finds to be the "reasonable market price."

The producer, however, is not obligated in any manner to make new contracts to commit new supplies to interstate commerce, and unless he can know in advance what his price will be he will not make additional committments. He will not sign up for 20 years and leave his price to be fixed at a later date by a regulatory body.

One other fact should be noted. Consumer protection does not require the adoption of this Amendment by the distinguished Senator from Rhode Island. Regardless of the price paid to the producer by the pipeline company there could never be passed on to the consumer more than the Federal Power Commission finds to be the "reasonable market price" of the gas. The consumer is thus protected in all events.

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2/3/56

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PASTORE AMENDMENT

Insertion of "the protection of the interest of the consumer."

Sections 3 and 4

As presently written, the Fulbright Bill contains all of the provisions usually considered necessary to protect the interest of the consumer against unreasonable prices.

It provides that in determining whether a contract price for gas in the field is the "reasonable market price" the Federal Power Commission shall consider, among other things (1) whether such price has been competitively arrived at, (2) the effect of the contract upon the assurance of supply, and (3) the reasonableness of the provisions of the contract as they relate to existing or future prices.

These are all consumer protective provisions and are the basic yardsticks that would be used to test the reasonableness of the price to be paid for any product in an effort to protect the consumer. Let us look at them separately.

(1) Competition has always been recognized as one of the greatest protections to the consumer against unreasonable prices. When a contract price for the purchase of gas by a pipeline company has to fulfil the requirement of "being competitively arrived at," and the federal regulatory body is the judge, it cannot be said that the consumer is not protected.

(2) Assurance of supply is another most important factor from the standpoint of protecting the consumer. A low arbitrary price does not help the consumer if, because of such arbitrary price, the product is in short supply and cannot be obtained. The consumers' real protection against high prices is an abundance of supply. When the Fulbright bill provides that the federal regulatory body shall test a price to see whether it will or will not result in an abundant supply, the consumer is certainly getting the protection that he needs to protect

him against scarcity and resulting high prices.

(3) Under the Fulbright bill as presently written the federal regulatory body must also test the reasonableness of the provisions of the contract as they relate to existing and future prices. Here again the consumer gets the protection not only against unreasonable prices at the present time, but against contract provisions that would lead to unreasonable prices in the future.

What it all sums up to is that the three yardsticks set out in the Fulbright bill are all "for the protection of the interest of the consumer" and for no other purpose. Having enumerated the important protections to the consumer, nothing would be added to the bill by merely inserting a statement of the purpose for which the enumeration is made. No new yardstick is suggested by this amendment -- merely a restatement of that which is already covered.

This was apparently recognized by the distinguished author of this amendment while the matter was in Committee, for nowhere in the minority report signed by him is it ever suggested that the insertion of the now proposed words would extend to the consumer any greater protection than will be extended by the three yardsticks enumerated in the Fulbright bill.

February 2, 1956

3

Watkins

Watkin's Amendment to the Fulbright Bill
(S. 1853)

The proposed amendment provides:

> "It shall not be deemed to be consistent with the public interest to authorize the exportation or importation of natural gas in any case where the Commission finds that such exportation or importation will result in unemployment or injury to competing fuel industries of the United States."

This wording is identical to that which appeared in the Hunt Bill (S. 1287, 83rd Congress) to amend the Natural Gas Act except that "economic dislocation" was included by Senator Hunt just prior to "unemployment." Hearings were held on that bill, but it was never reported out of committee. It would appear that the principle considerations on this amendment are:

1. The amendment establishes a principle that is so rigid in application as not to permit consideration of the over-all public interest so far as the Federal Power Commission is concerned.
2. This amendment would for all practical purposes deny all applications for certificates of convenience for the import of natural gas since any importation of energy is bound to have at least a slight adverse effect upon a domestic energy source.
3. The General Agreement on Tariffs and Trade has an escape clause which permits restriction of imports in case domestic industry suffers or is threatened with serious injury from imports. Thus the purpose of the amendment is already adequately covered.

4. The amendment would require violation of General Agreement on Tariffs and Trade which could jeopardize certain reciprocal trade concessions of benefit to the United States.

5. The importance of hemispheric trade to the country's overall economic and security interests was most recently illustrated by Office of Defense Mobilization's call for reduction in crude oil imports. In considering the volume of imported oil subject to reduction, the quantities brought from Canada and Venezuela were excluded. Under present technological developments all imports of natural gas will come from our neighboring countries of Canada or Mexico. This amendment would be counter to the building of sound hemispheric trade and security relationships.

6. The amendment would deny the consumer, both industrial and residential, freedom of choice in the fuels he uses. In effect, the consumer would be denied the right to choose the lowest cost fuel as between gas and coal.

7. It hardly seems likely that imported gas will be any more injurious to competing fuels than domestically produced gas inasmuch as the cost delivered at the borders, which varies from 22¢ to 25¢ per Mcf for Canadian gas to 14.2¢ for Mexican gas is higher than the average field price in the United States.

8. The amendment would deny additional gas to areas already using large volumes of natural gas. For example, the California

market would lose gas supplies in the San Juan basin to the Pacific Northwest pipeline simply because Pacific Northwest could not import gas from Canada. At the same time, Pacific Northwest's customers might have to pay a higher price for the domestically produced gas than for the imported gas because of the long haul.

January 31, 1956

POSSIBLE
AMENDMENTS

Just and
Reasonable

REASONABLE MARKET PRICE V. JUST AND REASONABLE PRICE

The proposal to amend the Fulbright Bill to specify "just and reasonable" instead of "reasonable market price" is a trap for the unwary. Some of its advocates are innocent victims of the design of the opponents of this legislation to wreck it.

To the uninitiated, it may seem incredible that anyone could object to prices that are "just and reasonable" -- any more than one could fail to be against sin. But the fact is that these words are words of art in law and are used to prescribe rates for public utilities and have an accepted meaning of cost plus a reasonable return on investment, usually 6 per cent per annum. This is made clear by the memorandum of the assistant legislative counsel introduced by the Senior Senator from Massachusetts (Vol. 2, Congressional Record, p. 1325). It is also confirmed by the recent opinion of the United States Court of Appeals of the District of Columbia in two cases styled City of Detroit, Michigan v. Federal Power Commission and County of Wayne, Michigan v. Federal Power Commission (Nos. 12351 and 12359, respectively). There the United States Court of Appeals of the District of Columbia struck down the order of the Commission allowing Panhandle Eastern Pipeline Company a field price for the gas it produced and held that the Commission must consider costs. This means, therefore, that the Commission will be duty bound to inquire separately into individual costs of each independent producer or of pipeline-produced gas as a part of its determination of prices for gas sold by them if the words "just and reasonable" are substituted for "reasonable market price."

Experience has shown the effect of the application of the cost principle in determining the amount that pipeline carriers would be permitted to charge as expenses for natural gas they themselves produced. Under this system, pipeline-produced gas fell from 49 per cent of total volume carried in 1947 to 20 per cent in 1954. In 1947, the pipeline companies purchased from affiliated producers 16 per cent of the gas that such pipelines transported and sold but in 1954, they purchased from such affiliates only 8 per cent of such gas.

The Junior Senator from Maine, in a very excellent dissertation on January 27, 1956, pointed out "the great disservice to the consumer" which is done by those who recommend a cost-plus means of regulating the producer's price of natural gas. He gave numerous examples of how impractical, if not impossible, it is to apply such a formula in determining the producer's price for gas.

Gas producers have none of the characteristics of a public utility. They cannot be regulated as such. Any attempt to so regulate them will only force a considerable amount of gas out of interstate commerce. Already, half of the gas produced is consumed within the states of production. Utility regulation will deny to the consumer states adequate gas supplies and will result in only high cost gas being sold interstate.

The quantity of new reserves of natural gas--both from private vendors and from the reserves owned by the carriers themselves--that was committed for sale to interstate lines had dropped two-thirds from the 1952 level by 1954, the year of the Phillips decision. Nine of sixteen major pipelines had to take more gas out of their own reserves in 1954 than they were able to replace by new commitments. The deficit of these lines in that year totaled 1.1 trillion cubic feet--in other words these lines had to overdraw their reserve bank account to that extent.

In 1955, under utility-type cost regulation, gas well completions were down 9.2 per cent from 1954, although oil well completions were up 6 per cent. Wildcat wells completed as oil wells were up 13.4 per cent, while wildcat wells completed as gas wells were down 11.2 per cent. Development oil well completions were up 5.6 per cent while development gas well completions were down 8.9 per cent. This illustrates clearly the depressive effect that utility-type regulation is already having on industry operations.

Gas discovery and production is a risky, competitive venture. Only one wildcat well out of nine results in discovery of oil or gas. It cannot be open to question that a 6 per cent return on successful ventures and no return on unsuccessful ventures would result in the drying up of risk capital for such ventures.

If gas producers are to be allowed a return on their unsuccessful ventures, then efficiency and low cost are not rewarded and inefficiency and many dry holes are not an economic disability. This would, of course, mean that the high-cost operator would sell his gas in interstate commerce where his inefficiency would be rewarded, but the low-cost operator would seek intrastate markets where he could get the going price, instead of a price determined on a utility basis.

The poorer the well and the greater the expense required to drill and operate it, the greater would be the price of gas.

What about gas produced by different operators from the same field? Operator A may have paid very little for his wildcat lease and his first well may have found gas. Operator B may have bought his lease for a high price after gas discovery. Then is B to receive a much higher price than A for gas from the same reservoir sold to the same buyer?

Gas from older wells, the cost of which has been paid out, would be confiscated because six per cent of zero is zero.

Quite aside from all this, how can a utility-cost formula possibly be applied in regulation of individual gas sales transactions? In practically all cases natural gas suitable for delivery to pipelines is produced jointly with oil, gasoline or other liquid hydrocarbons. All the costs of exploration, development and production are joint among the several products. No method of allocation of such costs is available. None can be made available which is more than an arbitrary question-begging formula.

These are some of the fantastic problems resulting from attempting to apply a utility rate base method of placing a price on gas. Even those who oppose the "reasonable market price" yardstick have not suggested any solution to the problem of how to determine investment--or "cost" on which to predicate a rate of return in this hazardous industry.

The term "reasonable market price" is thoroughly discussed in the Report of the Senate Committee on Interstate and Foreign Commerce on S. 1853. Your attention is directed to page 5 and pages 39-42 inclusive. The Report of this Committee makes legislative history in construing the Act. It points out that the term "market price" has a well-established legal meaning and that if the bill confined itself to the use of the words "market price" there would be little need for the exercise of administrative judgment or discretion, as the Commission would merely determine the market price of the gas in a field or area where there is an open market between buyers and sellers equally free to bargain. The Report, however, points out that the addition of the word "reasonable," plus the requirement that the price be determined at the point where the gas is delivered into the transmission facilities of a natural gas company, plus the statutory provisions as to what the Commission "shall consider, among other things," in arriving at the reasonable market price, permits the Commission to look at all factors which are properly relevant. A number of these factors are stipulated and explained in the Report. Thus the price which the Commission determines is the reasonable market price at a certain point of delivery will apply to the low-cost operator's gas as well as to the high-cost operator's gas. Such price will apply to the unlucky operator's gas as well as the lucky operator's gas. The Commission will not base its determination on cost because this would be impractical of application.

The proponents of the "just and reasonable" lose sight of the fact that the cost of finding and producing gas can have no bearing on its value. This Justice Jackson stated succinctly in the Hope case when he said:

> "Let us assume that Doe and Roe each produces in West Virginia for delivery to Cleveland the same quantity of natural gas each day. Doe, however, through luck or foresight or whatever it takes gets his gas from investing $50,000 in leases and drilling. Roe drilled poor territory, got smaller wells, and has invested $250,000. Does anybody imagine that Roe can get or ought to get for his gas 5 times as much as Doe because he has spent 5 times as much? The service one renders to society in the gas business is measured by what he gets out of the ground, not by what he puts into it, and there is little more relation between the investment and the results than in a game of poker."

Further, no Congressional committee, or any other committee, that has ever studied this matter has ever recommended the application of the utility cost-plus means of regulation to the production of natural gas.

February 2, 1956

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Long Line

PIPELINE AMENDMENT

I feel that the provision of the Fulbright Bill which encourages pipeline companies to undertake gas exploration campaigns is one of the best features of the Bill. I believe that it would be a serious mistake to adopt the proposed amendment.

Those of us who favor passage of the Fulbright Bill recognize that hunting and drilling for natural gas are not utility operations and that the imposition of rigid utility-type controls on a person in this business seriously hampers the ability of that person to help meet public demands for natural gas. The risks and problems of exploring for gas are just as great for one person as another. To say, on one hand, that gas exploration and production is risky for independent producers but that, on the other hand, it is not risky and full of problems for pipeline companies is obviously fallacious reasoning.

There are many benefits which will accrue to the public through our encouraging pipeline companies to explore and drill for natural gas. For one thing, I am sure that we shall add a great deal of vigor to the overall exploration efforts of the nation. The more people who hunt for gas, the more gas we are likely to find. Thepipeline companies would seem to be particularly well equipped to do a thorough job in this field. They are certificated by the Federal Power Commission to supply given areas with gas and are probably more familiar with the needs of these areas for gas than any one else. Through their constant efforts to purchase gas, they have acquired substantial geological data and, in many cases, have the best information on gas reserves of any organization. In other words, they know public needs for gas; they are responsible to the public to fill those needs, and they are equipped through intimate knowledge of gas production to do an outstanding job of exploration and development. They will undoubtedly add a great deal to the nation's exploration programs.

It certainly will help the pipeline companies to drive the best bargains possible in the purchase of natural gas if they have significant reserves which they own. When an expansion program is first planned the pipeline company begins to bargain for reserves to support that program. If that company has significant reserves available under its own ownership, it can take its time and bargain a little harder than if it is completely dependent on outside purchases. It is like a man hunting for a job. If he already has work, he can be very careful in agreeing to take a new job. If he does not have work, however, he is likely to have to take the first opportunity that comes along. Ownership of gas by pipeline companies will help hold field prices down.

Ownership of gas reserves by pipeline companies will be of vast importance to maximum utilization of casinghead gas, a by-product of the production of oil. For example, casinghead gas is frequently dissolved in oil and when that oil is brought up out of the ground, casinghead gas bubbles out of it just as carbon dioxide bubbles out of soda pop when a bottle of that beverage is opened. Because casinghead gas is produced only when oil is produced, the volumes of casinghead gas available vary according to the market needs for oil rather than the market needs for gas. In most months oil wells will produce in the first eighteen or twenty days of the month all of the oil that is needed for the entire month. Therefore, toward the last of the month oil wells are shut down and the volumes of casinghead gas available are almost non-existent. Now you can't deliver gas just in the first part of the month. The pipelines, in order to take casinghead gas into their systems, must be able to call on reserves of dry gas when needed to meet the fluctuations.

There are many other reasons for encouraging pipelines to explore for gas. But these three, in themselves, are sufficient justification. The provision of the Fulbright Bill that will encouragepipelines to explore for gas will add materially to the volumes of gas which are discovered, it will be a major factor in strengthening the pipelines' bargaining position and hence tend to hold prices down, and it will assist in the efficient utilization of casing-head gas. For these reasons I urge that we vote against this proposed amendment and pass the bill reported so overwhelmingly by the Committee.

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2/3/56

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Minimum
Price

AMENDMENT RELATIVE TO STATE MINIMUM PRICE LAWS

This Amendment, like others that have been proposed, has no real bearing on the issues involved in this legislation, does nothing to solve the problems before us and merely represents another round in a continuous effort to defeat this bill by a circuitous approach.

It seems a bit odd that this Amendment should be submitted at this late stage of this legislation. The distinguished Senator from Rhode Island, (IF HE ACTUALLY INTRODUCES) author of the amendment, was the Acting Chairman of the Committee on Interstate and Foreign Commerce which held extensive hearings on this bill last session. Although the Senator made known his opposition to this bill on many occasions and upon many grounds, he never saw fit to submit to the Committee for its consideration the amendment now proposed, and the issue raised by this Amendment was not even considered by the Committee. As you know, the Committee favorably reported this bill by an 11 to 4 majority after it had made far-reaching amendments in an effort to extend extraordinary protection to natural gas consumers.

It is clear under the opinions of the United States Supreme Court that state law or regulation cannot interfere or impede the action of the Federal Power Commission in the areas covered by this bill. Nothing in a state law and nothing that a state regulatory agency may do can control, affect or restrict the Commission in determination of reasonable market price under the provisions of the Fulbright bill.

In a recent decision of the Supreme Court (Natural Gas Pipeline Company of America v. Panoma Corporation, et al, 349 U. S. 44, 75 S. Ct. 576) the Court held that an attempt by Oklahoma "to fix a minimum price to be paid for natural gas, after its production and gathering has ended, by a company which transports the gas for resale in interstate commerce" could not be sustained as such "sale and transportation cannot be regulated by a state but are subject to the exclusive regulation of the Federal Power Commission."

In an earlier case (Cities Service Gas Co. v. Peerless Oil and Gas Co. et al, 340 U. S. 19, 71 S. Ct. 215) the Supreme Court had upheld an order of the Oklahoma Commission fixing the minimum gas price. The order was attacked on the ground that it violated certain provisions of the United States Constitution but, as the Court pointed out, no contention was made "that the order conflicted with federal authority asserted by the Natural Gas Act." In this connection, the Court said:

> "The Commerce Clause gives to Congress a power over interstate commerce which is both paramount and broad in scope . . . a state may regulate matters of local concern, over which federal authority has not been exercised, even though the regulation has some impact on interstate commerce."

Subsequent to this case, the Circuit Court of Appeals for the Eighth Circuit held, in State Corporation Commission of Kansas v. Federal Power Commission and Northern Natural Gas Company v. Federal Power Commission, 206 Fed (2d) 690, that as Congress had empowered the Federal Power Commission to regulate "the charges natural gas companies may make for the gas they sell in interstate commerce for resale," under those conditions "there is no room for the exercise of any local power to obstruct or prevent the lawful functioning of the federal agency entrusted with the federal power of regulation." The United States Supreme Court denied a writ of certorari (346 U. S. 922, 98 L. Ed. 203) and denied motion for rehearing (74 S. Ct. 862).

The Fulbright-Harris bill requires the Commission to determine the reasonable market price of gas at the point at which it is delivered into the interstate transmission facilities. This must be determined in connection with escalator clauses in existing contracts and all price provisions under new or renegotiated contracts. It must be determined in connection with passing upon applications for certificates of convenience and necessity by interstate gas transmission companies. The Act stipulates three things that the Commission must consider in determining the reasonable market price. However, the Act is clearly worded so as not to restrict the Commission to these three considerations. The words "among other things" used in this connection gives discretion to the Commission to consider other pertinent factors bearing on the question of reasonable market price. The Senate Committee, on pages 5 and 39-42, of its Report on the Fulbright bill lists a number of these factors which should be considered.

Under the above authorities, no action by a state legislature or administrative body will be sustained by the United States Supreme Court to the extent it conflicts with this authority granted the Federal Power Commission.

February 3, 1956

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REBUTTAL ARGUMENTS

Captive Consumer

THE "CAPTIVE" CONSUMER

Opponents of the Fulbright bill have constantly referred to "captive consumers." Because a consumer has elected to use gas for fuel we are led to believe that he has become the "captive" of thousands of separate and competing producers many miles and several sales transactions removed from his burner tip.

This line of reasoning is without substance because:

1. Consumers of any fuel are not captives of that particular fuel. They can and do shift from one fuel to another as motivated by economic or convenience considerations. If this were not so, then electric ranges would have had no market except new homes. There would be no advantage in advertising natural gas for house heating via conversion at very low cost. This is a very common utility practice.

   There is no such thing as a captive consumer to any particular fuel or product if competition can supply a better product on a more economical basis. Competitive energy sources available for residential use include oil, coal, electricity, butane and propane, as acknowledged by distributor representatives testifying at Senate hearings.

2. Of the 26,304,600 residential consumers of gas services in 1955, more than one-half had gas service prior to 1933, and nearly three-fourths had gas service by 1945. A considerable portion of the total consumer investment was made for utilization of manufactured gas, before the widespread introduction of natural gas in metropolitan consuming areas. Moreover, conversion of

equipment from manufactured to natural gas utilization was done at extremely modest cost. This cost was in most instances made up in a matter of months by the savings associated with reduced rates resulting from the use by distributing utilities of low-cost, high-quality natural gas in place of high-cost, low-quality manufactured gas.

3. Consumers purchase gas service on a month-to-month basis. They can terminate the service any time they choose. Aggregate demand for gas was not born in a day and will not be displaced in a day. Changes of the total market are reflected gradually in new equipment and in replacement equipment. If the trend of new or replacement equipment is heavily toward gas, demand is stimulated. If the trend is away from gas-consuming equipment, supply tends to outrun demand and gas price adjustments are instituted. This is the working of competition which grants to the consumer the greatest possible protection. The consumer is not "captive" in the aggregate but benefits from or is adversely affected by other consumers moving into or out of the market with new and replacement equipment.

4. Investment in gas-burning appliances was made voluntarily by consumers, after they freely made their decision to select gas service. Consumers are equally free to change to other appliances using other fuels. The fact that they are now using gas appliances, and have an investment therein, is not fairly an indictment of the producers as having

"captured" the consumers, nor does it prohibit consumers from changing.

5. Opposition is using arguments that are contradictory. They say first, consumers are captives, and second, gas prices are getting so high gas will price itself out of the market. These arguments disprove each other. If consumers are captives, gas cannot price itself out of the market. If gas can price itself out of the market, consumers must be free to switch to other fuels, and hence are not captives.

6. Distributing utilities voluntarily switched from manufactured to natural gas when adequate supplies became available because it was to their financial advantage to do so. Annual reports of the distributors to their shareholders disclosed that natural gas resulted in increased sales, decreased operating costs, increased earnings, and made it possible for them to expand their service without the financial investment necessary for building additional mains. The latter was possible because natural gas has twice the heat content of manufactured gas; thus through the use of natural, it is possible to distribute twice the heat energy although using the same volume of gas.

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Depletion

The 27½% Depletion Allowance and Utility Regulation

Opponents of the Fulbright-Harris Bill contend that the gas producer has no basis for complaint against utility-type regulation because under such regulation he is entitled not only to a 6% return on capital investment but to a 27½% statutory depletion allowance, making a total of 33½%. This statement has no basis in fact and can only be based on a lack of understanding.

When a natural gas producer is subjected to utility regulation, his rates are set at a figure which will provide sufficient income to pay costs of operation, including estimated income taxes, plus the permitted return on capital investment. Since income taxes are a part of the cost considered in fixing rates, any reduction thereof reduces costs and also rates. Therefore, if income taxes are reduced by the 27½% (limited to 50% of net income from each property) the natural gas company's costs and the rates necessary to return its costs are reduced. Hence, under a utility rate-making procedure, a statutory depletion allowance designed to reduce income tax payments is completely nullified as an incentive toward exploration and development of new supplies.

January 30, 1956

Escalation

ESCALATION--EXTENT OF FPC REGULATION

In New or Renegotiated Contracts

The control of the Federal Power Commission over prices in new or renegotiated contracts is upon the purchaser--the pipe line company. The control goes farther than escalation. It covers the original price as well. The control is exerted indirectly by providing that the prices paid under such contracts shall not be allowed to be the basis for increased rates by the pipe line company to the extent that they exceed the reasonable market price (Sec. 2(b)). Provision is made for the Commission to determine in advance whether the price to be paid under any new or renegotiated contract is the reasonable market price of the gas. (Sec. 2(c)). As a practical matter, pipe line companies will not enter into binding contracts to purchase significant quantities of gas or renegotiate existing contracts covering significant quantities without obtaining the Commission's approval of the prices to be paid. If they proceed without FPC approval, only the stockholders of the pipe line company can get hurt--certainly not the consumer.

The power of the Commission to determine the reasonableness of prices includes the power to reject any price provisions which are deemed contrary to the public interest. The Commission could reject any contract containing "favored nations," "commodity index," "spiral" or other types of escalation provisions and refuse to approve the proposed prices as long as such provisions remain in the contract. In fact, the Commission will have a wide latitude in respect to any contractual provision having a bearing upon prices to be paid.

By leaving the pipe line companies free to make binding contracts for the purchase of new supplies of gas and placing brakes upon the amount they can pass on to their customers, the bills provide the necessary flexibility for proper operations of the pipe lines without affecting the consumers. In many instances, the pipe lines may be able to make or save money by paying prices above the reasonable market price in order to obtain additional supplies. Bear in mind that it costs little or no more to operate pipe lines at capacity than at half capacity or less. Conceivably a pipe line could double its producer price and, at the same time, reduce its unit costs substantially if by so doing it could double the volume handled through the same facilities.

There may be emergencies wherein a pipe line would be doing a humanitarian act to buy small quantities of gas in order to provide heat during extreme cold weather. And it might be willing to absorb any loss in so doing. It would be a queer provision in a statute that would make such an act a crime or even illegal.

In Existing Contracts

The control of the Federal Power Commission over producer prices in existing contracts is limited to escalation clauses, but the control extends to the producers as well as to the pipe lines. The producers are prohibited from receiving and the pipe lines are prohibited from paying more than the reasonable market price of gas under all provisions for indefinite increases, except one. The exception is in respect to increases to reimburse the seller in whole or in part for increased taxes on the production or sale of the gas. These restrictions apply only when they are made the basis for increased pipe line rates. (Sec. 2(d) (e)). There is also excepted from FPC control increases under provisions for specific amounts at definite dates in the future. (Sec. 2(d)).

Under these provisions, when an application for rate increase filed by a pipe line company is based in whole or in part upon an increase under any escalation clause in an existing contract, except the two exempted, the Commission must determine whether the increased prices are within the reasonable market pric . If it decides that the whole or any part of the increase takes the price abo the reasonable market price, the pipe line company is prohibited from paying and the producer is prohibited from receiving the sum in excess of the reasonable market price and the producer is prohibited from terminating his contract because of the enactment of these control provisions over his prices. (Sec. 2(d) (e))

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2/3/56

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Pipeline
Production

Price Scare

THE "BIG SCARE"

Mr. President, we have had extended and courteous debate on the pending legislation, and I want to take this occasion to commend all those who have participated on either side for conducting the discussion on such a high plane. The members of this body have demonstrated afresh that they can differ with each other sharply on an issue without falling into recrimination and invective.

I feel compelled to point out, however, that some of the opponents of this legislation, instead of focusing their discussion on the real and central issues, have instead employed what we might call the "big scare" technique. I do not for a moment doubt their utter sincerity, but I certainly question the validity of their claims. In fomenting unwarranted fears and in beclouding urgent issues, they have regaled us with such scare phrases as "gouge," "monopolistic profits," "windfall benefits," "unconscionable," "astronomical increases," "captive consumer," "holdup," "charging all the traffic will bear," and many more horrendous cliches. Such terms seem designed on the one hand to discredit the natural gas producers and on the other to incite the homeowner against the producers for any increase in his bill. Let us examine the big scare.

Here on the floor of the Senate my distinguished colleague from Illinois has stated, "A 20-cent rate is being paid even now in some cases and would, sooner or later. . .become the prevailing price. In fact, a 25-cent rate is quite possible. If the Fulbright bill passes, these prices will become the prevailing prices. . .a 10-cent increase would increase the cost to the consumers by at least $600 million more per year and a 15-cent increase would cost them at least $900 million per year. . .The increase in the value of the reserves would be at least $18.9 billion if the price per thousand cubic feet went up by 15 cents or to a new average of 25 cents. . .Applied to all reserves, these increased field prices would boost the value by almost $30 billion."

Let us apply this sort of argument to some other industries and see what the results would be. In each case I shall use 1946 as the base year for comparison with 1954.

Bituminous coal is competitive with natural gas as an energy source. The Bureau of Mines reports that bituminous coal sold at the mine for $3.44 a ton in 1946. In 1954, the price was $4.82 and consumption was 363 million tons. At this increased price this would be equal to $500 million greater annual "profits" to the mine owners. Applying this increased price to the January 1, 1953, estimated recoverable reserves of 574,492 million tons, there has been a "windfall profit" to the owners of these reserves of $793 billion. Now if bituminous coal goes up as much in the next ten years as it has in the past ten, then the value to the owners of the reserves would have to be written up by another "windfall profit" of $800 billion.

If we followed the scare doctrine, we would conclude that consumers must be protected against such gouging by the "coal barons." Consequently, we would regulate bituminous coal as a public utility to prevent this unconscionable windfall of "profits."

Bituminous coal is important as an energy source in the production of steel. The price of steel in 1946 was $60.00 a ton. The price in 1954 was $106.60. We were consuming steel at an annual rate of 60 million tons in that year. Hence the consumers of steel are paying the steel producers a fabulous price increase of $2.9 billion a year. Now if this trend continues for another ten years, the American people will have to face a further increased toll to steel producers of approximately $3 billion a year. Such increased prices will reach down to every family in the nation, since toilets, bathtubs, kitchen equipment, and beds all utilize steel. Under the scare doctrine, we would surely have to classify steel production as a public utility.

But steel depends upon iron ore. The average price of iron ore in 1946 was $4.80 per ton; by 1954, it had risen to $9.90 per ton. Thus there has been, based on measured and indicated reserves, a write-up of $17 billion in value. The "windfall profits" that would result to the large steel companies developing reserves from Labrador to Venezuela defy the imagination. Certainly, if we pursued the argument to the end, the housewives must be protected from such exploitation by public-utility status for iron ore production.

Remarks made on the Senate floor often are reported in hundreds of daily newspapers throughout the nation. The paper on which these newspapers are printed is, of course, made from wood pulp. Here the price changes are indeed threatening. Newsprint sold for $72.29 per ton in 1946; in 1954, it was $125.72, and consumption was 4,700,000 tons. If this increase continues for another ten years, as well it may, then the increased cost to the daily reader of the newspapers will go up by still another $250 million a year. The increased cost will fall first on the publisher, who will have no choice but to pass it on to his readers.

This may be the main reason why your paper now costs 5 cents, when a few years ago it cost only 3 cents. Of course, this is only 2 cents a day, but multiply it by the total circulation of 55,000,000 and you will find that all these small rivulets have come together in a vast Niagara that is sweeping billions of dollars in"windfall profits"into the grasping hands of a few owners of timber lands. Clearly, our forests must be made public utilities.

To what lengths shall we go to try to scare people away from the real issues and the facts? I have applied the scare technique to only a few commodities. I know, and you know, that a similar approach can be made to practically every item of any importance in our economy.

The scare amount of $800 million seems to vary with the fancy of whoever picks it out of the air; none has any basis in fact and lately their talk has been in vague terms, like "billions."

It would take a field price of approximately 31¢ per thousand cubic feet on all interstate sales to bring about such increased revenue. In the light of the fact that most contracts have from 16 to 17 more years to run, this becomes an absurdity. Even without the contracts, such increases are impossible under the Fulbright bill.

It would have to be borne, says the opposition, by the residential consumers. If the billion dollars per annum is to be borne by interstate residential consumers, it would increase their prices by 73¢ per thousand cubic feet.

The average price reported by the Bureau of Mines for residential consumption for the entire nation in 1954 was 89.3¢. An increase of 73¢ would represent an increase of 82% in charges to the consumer in the interstate market. A comparison of competitive fuel costs in the major cities of the United States with charges for natural gas increased by 82% indicates that such an increase would result in competitive fuels under-selling gas in the residential market virtually throughout the United States. Hence, price increases to the residential consumer of the magnitude discussed by the opposition to the Fulbright bill would not take place. On such a basis, the gas industry would be so shortsighted as to commit economic suicide.

To contemplate making our decisions upon such baseless fears is, however, an altogether different thing. I should like therefore to turn from this pattern of fear to the basic principles that are in danger of being overlooked. Let us therefore get down to the real and important issues. They fall into five broad categories.

1. <u>How can development of supplies of natural gas be stimulated?</u>

Certainly one of the most urgent considerations before this nation is how to obtain additional supplies of this energy source. Can we best achieve this by increasing government control, or by permitting maximum freedom of the individual? It isn't adequate to hold that individuals looking for oil fortuitously discover gas, which they must sell in whatever market. If that were true, the disturbing results of 1955 would not be haunting us today. I refer to drilling activity as reported by THE OIL AND GAS JOURNAL in its January 23, 1956, edition. Here are the results reported:

Oil well completions	- 6.0%
Gas well completions	- 9.2%
Wildcat wells completed as oil wells	-13.4%
Wildcat wells completed as gas wells	-11.8%
Development oil wells	- 5.6%
Development gas wells	- 8.9%

This sharp decline in the drilling of gas wildcat and development wells merits special comment and concern. Virtually every company engaged in the producing segment of the oil and gas industry holds some acreage which yields predominantly oil and some which seem to offer possibilities only for natural gas. Each such producing company almost invariably has also a backlog of more drillable locations in each of these two types of proved acreage than it has the money to drill. The producers have elected to put their drilling money into prospective <u>oil</u> development wells rather than prospective gas development wells. They know oil still sells in a free market, whereas the gas presently will have to be sold on a utility-type, cost-plus basis if it enters interstate commerce. Faced with the clear alternatives either of operating in a competitive market or of becoming enmeshed in all the red tape of public-utility status, an American businessman will almost invariably turn to the free competitive market.

The availability of natural gas depends almost entirely on the economics of the situation. Gas development wells historically have been drilled only when the economic outlook was favorable. For example, oil men have known for many years that there is gas in western Wyoming, but drilling in this area did not begin until the price for the gas justified development costs. Gas fields in many areas - notably the great Hugoton Field - increasingly have been developed and extended as higher field prices have made marginal production economical.

These facts cannot be dismissed lightly. If the decline in gas well drilling is a reflection of what may happen over a longer period if present utility-type controls continue - and I believe it is - and if we in the Senate permit the law to remain unchanged, then we must accept the responsibility for our inaction. We shall have committed a serious disservice to gas consumers. We must take action that will help reinvigorate the search for and development of natural gas supplies.

2. <u>How can producers be encouraged to sell in the interstate market?</u>

The opinion that producers must have an interstate market appears to be subject to serious question in the light of recent trends of new reserve commitments to 16 of the largest carriers of natural gas from the Southwest. These commitments fell sharply in 1953, while the Phillips case was before the courts, and plummeted again in 1954, the year of the Supreme Court decision. Nine of these 16 transmission companies had to take more gas out of their own reserves in 1954 than they were able to recommit. The deficit of these nine lines in that year totaled 1.1 trillion cubic feet - in other words, these lines had to overdraw their reserve bank account to that extent.

In the aggregate these 16 transmission lines secured the following commitments from independent vendors plus their own reserves committed by years:

Year	Annual Additions to Supply (in Billions of Cu. Ft.)	Per Cent Change Compared With Previous Year
1949	11,500	--
1950	18,900	+ 64%
1951	12,100	- 36
1952	18,800	- 55
1953	10,100	- 46
1954	6,000	- 41

The aggregate is certainly most disturbing to me. There would appear to be a decided desire on the part of the producers to be free from economic dependence upon the interstate market. This perfectly understandable desire could lead to the gradual liquidation of these tremendous transportation systems, with mounting unit costs which the consumer would have to bear. I, for one, cannot be a party to continuing the system that is creating this situation.

3. How can the interstate customer best be protected on supplies?

The interstate consumer of natural gas secures his supplies directly from a distributing company, which secures its gas from an interstate carrier. This carrier buys gas from the independent vendor in the field. Thus the pipeline buys the gas for the consumers in the northern consuming states.

Half of the gas produced in the seven Southwest states is consumed within these states. Prices paid for natural gas consumed within the state of production are not regulated but reflect free market behavior.

The other half of the gas is sold for interstate movement. The price paid for that gas in the field today is subject to utility-type regulation. The purported objective of this regulation is to secure supplies at a lower price than would exist in a free market. Hence opponents of the Fulbright bill would, in effect, be sending the pipeline companies into the gas-producing country to buy gas but not to pay the going, competitive price for it. What they buy they must secure at less than the free market price.

Let's be realistic. The interstate pipeline buyer just isn't going to get all the gas he wants under such restrictions. Present contractual quantities may be delivered. Beyond these contracts there will be little more gas committed for interstate movement. The interstate consumers will have been victimized by their self-appointed, misguided leaders. Pipelines will operate at less than capacity. Their unit costs of transportation will go up. Consequently, price increases to consumers will follow reduced supplies and higher unit transportation and distribution costs. The growth of demand will be stopped, and even reversed.

How can the interstate customers best be protected on supplies? Obviously by being granted an equal opportunity with the intrastate consumers to buy gas at reasonable market prices.

4. How can the consumer be protected on prices?

The allegation has repeatedly been made that producers have been overzealous in seeking the highest possible price. This may or may not be true. But it is apparently the desire of Congress to enact laws to prevent exploitation. How can this be achieved and guarantee to the interstate buyer that prices paid for natural gas in the field are not excessive?

One school of thought holds that the only way such protection can be extended to the consumer is via regulation on a cost basis plus a "fair" return on investment. Thus far the record is silent on what kinds of costs are to be recognized. If "original cost," the industry vigorously insists that this cannot be determined. If "fair value" or "replacement cost" is recognized, determination will at best be arbitrary and subject to prolonged court tests and challenge. Personally, I accept the condition that costs associated with production of natural gas are so entwined with those associated with oil and with the hazards of the industry that arbitrarily-determined cost would constitute a meaningless guide.

The other school holds that the best protection for the consumer would be to establish the Federal Power Commission as an umpire to make certain that only the reasonable market price can be assessed against the consumer. Doesn't this make sense? Isn't this the only way that the interstate customer will have an equal chance of securing his desired supplies? The interstate consumer cannot expect to buy for less than the reasonable market price as paid by consumers in the intrastate market. The producer cannot expect to get a price above the reasonable market price.

This seems to me a realistic view of this part of the problem.

5. How can the wounds be healed?

The natural gas industry has grown by leaps and bounds. Its growth in the total energy market has made substantial contributions to our health, convenience, happiness, industrial output, and national security. The Supreme Court handed down a decision that brought about a series of most disturbing conditions. This decision has brought strife and conflict into the industry. Distribution companies oppose distribution companies, some distributors are fighting their carriers, and others are fighting the producers. What was once a strong, healthy, and growing industry is now filled with doubt, fear, uncertainty, and animosities.

I am, of course, concerned about the future of the industry, but I am more concerned about the future of consumers. Unless we act, the interstate consumer will pay the penalties for the unfortunate decision of the Supreme Court. The enfranchised, or present, user of gas will pay his part of the bill through higher prices because of scarcity. The disenfranchised consumer will not be able to purchase his desired supplies. I am convinced that the interstate and the intrastate consumer must be placed on an equal basis. We must ensure a continued free flow of commerce among the states. The distributor, the carrier, and the producer must have an equal chance for economic reward and incentive in keeping with the varying risks assumed. I am convinced that all segments of the industry and of the economy must have a chance to regain their strength.

My plea to the members of the Senate is that we reject the "big scare." Consider the issues, pass intelligent remedial legislation, and let us move to other urgent matters. I am convinced that the best cure thus far offered is the pending legislation.

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2/1/56

Conforming

DIFFERENCES BETWEEN FULBRIGHT AND HARRIS BILLS

I

Section 1 of the Fulbright Bill should be eliminated to conform with the Harris Bill.

1. Explanation of Differences: Section 1 of the Fulbright Bill amends the definition of "interstate commerce" contained in Section 2(7) of the Natural Gas Act, by expanding the definition to include commerce "between any point in a state and any foreign nation." The language which would be added by this amendment is shown by the underscoring:

> "(7) 'Interstate commerce' means commerce between any point in a State and any point outside thereof, or between points within the same State but through any place outside thereof, or between any point in a State and any foreign nation, but only insofar as such commerce takes place within the United States."

2. To Conform: On page 4, line 21, eliminate all of Section 1 and renumber consecutively the succeeding sections.

3. Reason for Eliminating Section 1: It is not necessary to amend the definition of interstate commerce by including commerce between any point in a state and any foreign nation. The Act as presently written gives the FPC jurisdiction over importation and exportation of natural gas. Commerce between a foreign country and the United States is specifically dealt with in Section 3 of the Act. This section reads as follows:

> "SEC. 3. After six months from the date on which this act takes effect no person shall export any natural gas from the United States to a foreign country or import any natural gas from a foreign country without first having secured an order of the Commission authorizing it to do so. The Commission shall issue such order upon application, unless, after opportunity for hearing, it finds that the proposed exportation or importation will not be consistent with the public interest. The Commission may by its order grant such application, in whole or in part, with such modification and upon such terms and conditions as the Commission may find necessary or appropriate,

> and may from time to time, after opportunity for hearing, and for good cause shown, make such supplemental order in the premises as it may find necessary or appropriate."

Before anyone can export gas to a foreign country or import gas from a foreign country, he must obtain an order of the Commission granting him authority so to do. The Commission may issue the order only if it finds the exportation or importation is consistent with public interest.

In its order the Commission may grant the application in whole or in part and it has the right to modify the application and to grant it "upon such terms and conditions" as it may find necessary and appropriate.[1/]

There can be no doubt that under the provisions of Section 3 of the Act, the Commission can inquire into and take into account the price at which the gas is proposed to be imported into or exported from the United States. The Commission can refuse to grant an import or export application if it deems such price not to be "consistent with the public interest," the standard provided by Section 3. Moreover, while the matter has never been the subject of judicial decision, it would appear that, if the Commission can refuse permission to export or import because of its conclusion that the price, as proposed, is not "consistent with the public interest," it may -- rather than deny the authorization -- grant permission upon condition that the price be adjusted so as to meet the statutory test of consistency with the public interest.

The proposed amendment of the definition of interstate commerce is, in fact, surplusage. The sole justification advanced anywhere (see Senate and House reports) for the amendment lies in the decision in Border Pipe Line Co. v. Federal Power Commission, 171 F. 2d 149, where one Court of Appeals concluded that the Act's definition of "interstate commerce" did not include "foreign commerce." In other litigation in the same year before another Court of Appeals, a Commission order was under attack which assumed that the Act's definition did include "foreign commerce." The order was sustained in Cia Mexicana de Gas v. Federal Power Commission, 167 F.2d 804. In such a context, it is highly significant that both the Federal Power Commission and the Department of Justice, speaking through the Solicitor General, have made it clear that they do not accept the Border case as sound. This appears at page 38 of the government's brief filed in the Supreme Court of the United States in Federal Power Commission v. East Ohio Gas Company, October Term, 1949 No. 71. To date there is no decision of the Supreme Court on this question.

But a consideration of the definition itself which defines interstate commerce as commerce "between any point in a state and any point outside thereof***but only insofar as such commerce takes place within the United States" would seem clearly to cover that part of foreign commerce which takes part within the borders of the United States. The point outside the state involved in interstate commerce is not restricted by the definition to points within the United States.

II

Section 4 of the Harris Bill is not contained in the Fulbright Bill. If Section 1 of the Fulbright Bill is eliminated (see previous discussion) the Fulbright Bill will contain only three sections unless a section 4 is added to conform with the Harris Bill.

1. Explanation of Differences: Under the Natural Gas Act the Federal Power Commission has the right to suspend for a period of five months a rate increase by a natural gas company, except that it cannot suspend a rate increase on gas sold for resale for industrial use only. Under Section 4 of the Harris Bill, the Commission would also have the power to suspend a rate increase where the gas is sold for resale for industrial use only. Unless this Section 4 is added to the Fulbright Bill, the Commission will not have this additional power of suspension.

2. To Conform: On page 10 of the Fulbright Bill, add the following new section at the end of line 14:

> "SEC. 4. Subsection (e) of section 4 of the Natural Gas Act is amended by striking therefrom the following: ': PROVIDED, That the Commission shall not have authority to suspend the rate, charge, classification, or service for the sale of natural gas for resale for industrial use only;'".

3. Reasons for Adding New Section: Under Section 4(e) of the Natural Gas Act the Commission can suspend for a period of five months all rate increases by a natural gas company, except rate increases on gas sold for resale for industrial use only. If, at the end of the five months period, a rate hearing has not been concluded the increase can be put into effect, provided the natural gas company gives a bond guaranteeing any refund which the Commission may order on account of such increase. The power of the Commission to suspend rate increases and to order refunds is necessary to protect residential and commercial consumers and the same protection should be afforded to industrial users on gas sold for resale. Without this protection the industrial users would be compelled to pay the higher rate until the Commission concluded the rate hearing and even though the rate were reduced, the industrial user would not be able to obtain a refund for gas purchased between the time of the increase and the final conclusion of the rate hearing.

1/ In authorizing Pacific Northwest Pipeline Corp. to import and export natural gas (Opinion No. 289, in Re Pacific Northwest Pipeline Corp., et al., Docket Nos. G-8932, et al.), the Commission subjected such authorization to terms and conditions including the condition that the authorization "hereby granted may be modified from time to time or terminated, after opportunity for hearing, upon further order of the Commission, ***." Similar conditions have been imposed upon granting export or import authorization in Docket Nos. G-102, G-103, G-104, G-107, G-228, G-513, G-595, G-612, G-1368, and G-1462.

In Re Reynosa Pipe Line Company, Docket No. G-595 (5 F.P.C. 130) by order sustained in Cia Mexicana de Gas v. Federal Power Commission, supra, the Commission included in the authority to export gas the condition that "No change or modification shall be made in the terms and conditions of the contract" for the sale of the exported gas "without prior authorization of the Commission." Limitations of similar purport were included in export authorizations in Docket Nos. G-103, G-513, and G-612.

February 2, 1956

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Answers to
FPC

ANSWERS TO FPC'S AND KUYKENDALL'S INDICATION THAT JUST AND REASONABLE PRICE MIGHT BE USED IN BILL

Should opponents of the bill in debate on the proposed amendment to change "reasonable market price" to "just and reasonable price" call attention to statements by the Federal Power Commission or Kuykendall, as follows:

1. The Federal Power Commission's Report to the Senate Committee appearing on page 1174 of the Committee Hearings which reads in part as follows:

> "The phrase used in the bill for the Commission to consider in fixing the allowance of payments by interstate pipeline companies to producers is that the payments to producers shall not be in excess of the 'market price' or the 'reasonable market price.' This seems to be less definite than the phrase 'just and reasonable price,' and the latter appears to be proper."

2. To Chairman Kuykendall's statement appearing on page 1842 of Part 2 of the House Committee Hearings as follows:

> "I would suggest that the term 'market value' is a new phrase which does not have any particular usage in the utility regulatory field that I know of. I would suggest either the use of 'just and reasonable price' or 'fair and reasonable price,' as Mr. O'Hara has suggested."

3. To any similar statements,

the following answer is suggested:

These statements were made prior to the decision of the Court of Appeals of the District of Columbia on December 15, 1955, in the so-called Panhandle Eastern case (City of Detroit, Michigan v. Federal Power Commission, No. 12351, United States Circuit Court of Appeals, District of Columbia). Prior to this decision, the Federal Power Commission was of the opinion that under the term "just and reasonable price" they had the right to allow the fair field price or weighted average field price to a pipeline company for gas it produced. The Commission has taken such action in the Panhandle Eastern case. The Court of

Appeals on December 15, 1955, struck down the price determination by the Commission. This decision of the Court of Appeals makes it clear that the term "just and reasonable" does not give to theFederal Power Commission the broad authority which the Commission thought it had prior to December 15, 1955. There can be little doubt that if the Commission had placed the interpretation on "just and reasonable price" which was placed on this term by the Court, it would not have made the statements above quoted. This is demonstrated by Commissioner Kuykendall's answer to Senator Pastore appearing on page 1207 of the Senate Hearings:

> "Senator Pastore. Are you actually saying that unless your position is preserved by the Supreme Court in the Panhandle case, which would compel you, if you weren't sustained in the Supreme Court, to revert back to your just and reasonable, strict formula, without any flexibility, that then you would be in serious trouble unless the Congress spelled out a new definition of "just and reasonable" insofar as the producers and gatherers are concerned?
>
> Commissioner Kuykendall. Yes, I would say we are in great difficulty."

And by the statement of the Commission appearing on page 1173 of the Senate Hearings, as follows:

> ". . . . . Consequently, it does not appear desirable or equitable to apply to producer prices or to production operation of interstate pipeline companies the net investment or cost principle upon which the Commission bases its regulation of rates for interstate pipeline operations of interstate transmission companies. "

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