LEGISLATION

Oil and Gas—

THE HINSHAW BILL—AMENDMENT TO THE NATURAL GAS ACT GRANTS A STATE EXCLUSIVE JURISDICTION OVER COMPANIES WHICH RECEIVE GAS WITHIN THE STATE FOR ULTIMATE CONSUMPTION THEREIN

Before its recent amendment, the Natural Gas Act [1] gave the Federal Power Commission jurisdiction over the rates and service of "natural gas companies," defined in the Act as persons "engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale." [2] The Act left undisturbed the state's jurisdiction over rates charged by the natural gas companies to consumers, as distinguished from rates charged distributors, when the sale was transacted within the consumer state.[3] To aid the state commissions in fixing these rates, the drafters incorporated § 5(b) [4] which permits the FPC, either on its own motion or at the request of a state commission (which the Act defines to include municipal commissions authorized to set rates [5]), to conduct a rate study of these companies.[6] In *FPC v. East Ohio Gas Co.*[7] the FPC conducted a § 5(b) rate study at the request of the municipality of Cleveland, despite a protest from the state commission that it had exclusive jurisdiction and was regulating the rates and service of the company in question. The Supreme Court, with two justices dissenting, upheld the jurisdiction of the FPC to conduct the rate study, on the ground that

1. 52 STAT. 821-33 (1938), as amended, 15 U.S.C.A. § 717 (Supp. 1954) (hereinafter cited to applicable section of N.G.A. and U.S.C.). The Act was passed to fill the gap in regulation left by Missouri *ex rel.* Barrett v. Kansas Natural Gas Co., 265 U.S. 298 (1924), and Public Util. Comm'n of Rhode Island v. Attleboro Steam & Elec. Co., 273 U.S. 83 (1927), which held that sales in interstate commerce for resale and transportation in interstate commerce of fuel were beyond the regulatory power of the consumer state. See H.R. REP. No. 709, 75th Cong., 1st Sess. 1-2 (1937).

2. N.G.A. § 2(6), 15 U.S.C. § 717a(b) (1952).

3. See H.R. REP. No. 709, 75th Cong., 1st Sess. 1 (1937), approving Pennsylvania Gas Co. v. Public Serv. Comm'n, 252 U.S. 23 (1920).

4. 15 U.S.C. § 717d(b) (1952).

5. N.G.A. § 2(8), 15 U.S.C. § 717a(8) (1952).

6. This would enable the state commission to take advantage of the broad investigatory powers of the FPC. For example, under N.G.A. § 6(b), 15 U.S.C. § 717e(b) (1952), the FPC may order the company to submit "an inventory of all or any part of its property and a statement of the original cost thereof, and [to] keep the Commission informed regarding the cost of all additions, betterments, extensions, and new constructions." N.G.A. § 8(a), 15 U.S.C. § 717g(a) (1952), provides for such uniform accounting and recording procedures as the FPC may require. N.G.A. §§ 8(b) and (c), 15 U.S.C. §§ 717g(b) and (c) (1952), provide for FPC inspection of accounts, records and memoranda of the company. N.G.A. § 10(a), 15 U.S.C. § 717i(1952) permits the commission to order any annual, periodic or special reports it considers necessary.

7. 338 U.S. 464 (1950).

East Ohio, although it transported and sold its gas solely within Ohio to consumers, was nevertheless engaged in the transportation of natural gas in interstate commerce, and thus was a natural gas company within the meaning of the Act, because it received its gas from interstate pipelines and transported it to distribution centers without any abatement of the original pressure.[8]

Although the language of the Act shows that Congress contemplated that § 5(b) would lead to some duplication, as the regulated company would be obliged to submit accounting and other financial reports to both state and federal commissions,[9] the resultant duplication was criticized severely,[10] and, in a subsequent decision,[11] the FPC expressed the hope that legislation would be enacted to divest it of this unwanted jurisdiction. In response thereto the O'Connor bill was proposed.[12] This bill would have exempted from the N.G.A. those companies which, like East Ohio, were subject to a § 5(b) rate study solely because of their connection with interstate pipelines; but the bill specifically would have retained federal jurisdiction over all companies which sold for resale gas received in interstate commerce.

The Hinshaw bill[13] goes much farther than the O'Connor bill, as it abrogates FPC jurisdiction over any company engaged in either the transportation of natural gas in interstate commerce or its sale in interstate commerce for resale, provided that (1) all the gas is received by the company within or at the boundary of the state in which it is ultimately consumed, and (2) the rates and service of the company are subject to state regulation. A certificate from the state commission to the FPC that

8. *Id.* at 469-70.

9. N.G.A. § 8(a), 15 U.S.C. § 717g(a) (1952), further provides "nothing in this Act shall relieve any . . . natural-gas company from keeping accounts, memoranda, or records which . . . may be required . . . by or under authority of the laws of any State." It would seem that only under § 5(b) is the concurrence of jurisdiction contemplated by § 8(a) possible.

10. Note, 64 HARV. L. REV. 464, 471-73 (1951); 98 U. OF PA. L. REV. 934, 936 (1950). See generally Lippitt, *Is the FPC Encroaching on Local Gas Regulation ?*, 45 PUB. UTIL. FORT. 13 (1950).

11. Texas Illinois Natural Gas Pipeline Co., Doc. Nos. G-1246, G-1477, July 19, 1951, SEN. REP. No. 1460, 82d Cong., 2d Sess. 3 (1952).

12. S. 1084, 82d Cong., 2d Sess. (1952). The bill passed the Senate but the session ended before the House could act. For the report on the bill see SEN. REP. No. 1460, 82d Cong., 2d Sess. (1952); for debates see 98 CONG. REC. 9488-94 (1952).

13. PUB. L. No. 323, 83d Cong., 2d Sess. (March 27, 1954), 15 U.S.C.A. § 717(c) (Supp. 1954). The new law amends § 1 by adding subsection (c) which reads as follows:

"(c) The provisions of this Act shall not apply to any person engaged in or legally authorized to engage in the transportation in interstate commerce or the sale in interstate commerce for resale, of natural gas received by such person from another person within or at the boundary of a State if all the natural gas so received is ultimately consumed within such State, or to any facilities used by such person for such transportation or sale, provided that the rates and service of such person and facilities be subject to regulation by a State commission. The matters exempted from the provisions of this Act by this subsection are hereby declared to be matters primarily of local concern and subject to regulation by the several States. A certification from such State commission to the Federal Power Commission that such State commission has regulatory jurisdiction over rates and service of such person and facilities and is exercising such jurisdiction shall constitute conclusive evidence of such regulatory power or jurisdiction."

the state commission has, and is exercising, jurisdiction over the rates and service of the company is made conclusive evidence of requisite regulation. The conclusiveness of the certificate would seem to bar the FPC from looking beyond its face to ascertain the scope of state control; therefore, it is important to determine how specific the certificate must be in showing that the state commission is regulating the rates and service. The failure of the FPC to obtain an increase in appropriations,[14] the movement in Congress to abrogate the effect of the recent landmark decision[15] which gave the federal commission jurisdiction over independent producers,[16] and the fact that the FPC favored the Hinshaw bill would spur the FPC to disclaim jurisdiction whenever possible. However, in light of the congressional intent that there be no regulatory gap, it is unlikely that the FPC would accept a general statement as sufficient to meet the certificate requirement, since that might permit a state commission to eject the federal commission although the state commission was not regulating important facets of the company's operation.[17] On the other hand, if the certificate provision is construed as requiring that the extent and nature of the state regulation be spelled out in detail, the question arises of the effect on FPC jurisdiction when the state certificate does not show commensurate state control. One alternative would be to have the FPC retain complete jurisdiction. This might prevent utilization of the Hinshaw bill by many states which, while they regulate the rates that the company charges to their consumers, do not themselves regulate the service of gas but depend on FPC and municipal regulation.[18] Since no municipality is empowered by state law to control the service of a gas company outside its corporate limits[19] or even to compel the servicing of its own area, it would seem that a serious regulatory gap would exist in the absence of FPC jurisdiction under § 7(a) of the N.G.A.,[20] which permits the FPC to order the extension of services to all areas. With federal control gone, there would be nothing to compel the gas company to service smaller and inconveniently located municipalities and rural areas when it was not profitable for the company to do so. Therefore, it would seem that a state which would avail itself of the amendment would be required to provide for state control of services. There would be no need to duplicate municipal regulation, for the state need only see that all areas are serviced adequately and leave to the municipal commissions the power to regulate the extent and nature of the services within the municipality. The other alternative would be to

14. See 53 OIL & GAS J. 70 (Aug. 9, 1954).

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

16. See N.Y. Times, Feb. 27, 1955, § 1, p. 1, col. 1, and p. 66, col. 1.

17. See *FPC Report by Commissioner Doty on H.R. 5976,* 100 CONG. REC. 2995, 2998 (daily ed. March 12, 1954).

18. See Maland & Zartman, *Limiting FPC Control Over Gas Distribution,* 53 PUB. UTIL. FORT. 413, 416-18 (1954); 1953 MOODY'S MANUAL OF INVESTMENTS, PUBLIC UTILITIES a135, a136, listing states which depend upon municipal regulation of service.

19. See Maland & Zartman, *supra* note 18, at 417-18.

20. 15 U.S.C. § 717f(a) (1952).

permit the FPC to regulate that phase of the industry which the state is not regulating. Under a strict interpretation of the N.G.A., this arrangement would not achieve a satisfactory rapprochement between state and federal jurisdiction, for once the company came under the Act it would be subject to a § 5(b) rate study. However, a court which recognized Congress' intention to prevent a recurrence of the *East Ohio* situation might hold that a company which is subject to FPC jurisdiction for the limited purpose of securing a certificate of convenience and necessity is not subject to a § 5(b) study.

The language of the amendment inadvertently invites renewal of the conflict between state and municipal commissions which was present in *East Ohio.* Since both commissions have rate-making powers, they come under the definition of "state commission"; therefore, the situation might arise where the state commission submits a certificate to abrogate FPC regulation, while the municipal commission submits a certificate showing incomplete regulation in order to utilize § 5(b).[21] In this case, even though the certificate is deemed conclusive, it would seem that the FPC must investigate to determine which certificate to honor. If the facts do not clearly support the contentions of either commission, the fact that the state commission is the plenary regulatory body in the state,[22] and that the FPC as a proponent of the bill would desire to see its scope extended, probably would lead to upholding the state certificate.

The constitutionality of the Hinshaw bill seems clear, for Congress, under its power to redefine the limits of interstate commerce,[23] often has granted a state the right to regulate interstate activities consummated within its borders.[24] However, a unique constitutional problem would arise if the FPC interpreted the language "within or at the boundary" to permit state *A,* the consumer state, to regulate a person who received gas in interstate commerce just over the border in state *B.*[25] Even here

21. In rare circumstances, it might be the state which would desire the FPC to check on alleged laxity in municipal regulation, with the municipality opposing federal intervention.

22. *E.g.,* in Ohio the municipality has the power to set rates by ordinance subject to review by the state commission. OHIO GEN. CODE ANN. §§ 614-44, 614-46 (1946).

23. This right was recognized as early as Leisy v. Hardin, 135 U.S. 100, 124 (1890); *In re* Rahrer, 140 U.S. 545, 561-62 (1891). *See* Southern Pac. Co. v. Arizona *ex rel.* Sullivan, 325 U.S. 761, 769 (1945); Prudential Ins. Co. v. Benjamin, 328 U.S. 408, 422-40 (1946). See Hartman, *State Taxation in Interstate Commerce,* 1953 WASH. U.L.Q. 233, 257-61.

24. See Dowling, *Interstate Commerce and State Power,* 47 COL. L. REV. 547, 552-60 (1947). A partial listing of statutes includes: 59 STAT. 33, 34 (1945), 15 U.S.C. § 1011 (1952) (relating to insurance): 54 STAT. 921 (1940), 49 U.S.C. § 304(a)(4a) (1952), amending 49 STAT. 546 (1935) (Motor Carrier Act); 49 STAT. 810, 811 (1935), 15 U.S.C. § 79c(a)(1) (1952) (Public Utilities Holding Company Act); 26 STAT. 313 (1890), 27 U.S.C. § 121 (1952) (Wilson Act).

25. One of the members of the committee said that in those cases where the sale by necessity took place just outside the regulating state the FPC should relinquish jurisdiction. See *Hearing before a Subcommitte of the House Committee on Interstate and Foreign Commerce on H.R. 2679 . . . and H.R. 5976* [Hinshaw bill], 83d Cong., 1st Sess. 23 (1953).

it would seem that the delegation of power should be upheld as valid: first, state *B* is deprived of no regulatory power over the person who receives his gas from the interstate pipeline, as it never had power to regulate either his rates or service or to tax the sale or facilities involved;[26] second, state *B* will not be affected adversely by state *A's* regulation, for state *B's* citizens are not consumers of the gas in question; finally, the delegation would seem reasonable in view of Congress' intent to permit the state to regulate purely local matters.[27] Of course, there is no theoretical difference whether state *A* regulates a company which receives gas just over the border or in the heart of state *B;* but the language of the amendment which requires that the reception of the gas take place "within or at the boundary" of the consumer state would prevent the latter regulation while it may be broad enough to include the sale just over the border.

In order to meet its state and federal obligations, a company subjected to a § 5(b) study often would be required to keep two sets of books[28] and to file duplicate financial and accounting reports. Although the cost of this bookkeeping would be passed on to the consumer in the form of rate increases, it would seem that the benefit they would receive from a § 5(b) study when their municipality lacked adequate facilities to make a thorough rate study would be well worth this cost.[29] Even in jurisdictions, such as Ohio, which use reproduction cost[30] rather than the original cost method of the FPC[31] to determine the value of property, a § 5(b) rate study would be useful both as a basis of comparison and as a means of checking excessive industry valuation.[32] Thus the wisdom of the Hinshaw bill's basic purpose is doubtful. In addition, the bill may be criticized for giving the consumer state jurisdiction to regulate persons who receive gas for resale within its borders. This invites the interstate pipeline to set up a subsidiary within the consumer state and sell to it for

26. See note 1 *supra.* The state can tax neither the transportation of gas in interstate commerce, Michigan-Wisconsin Pipe Line Co. v. Calvert, 347 U.S. 157 (1954), 32 TEXAS L. REV. 760 (1954), nor the receipts of the interstate companies. *See* East Ohio Gas Co. v. Tax Comm'n of Ohio, 283 U.S. 465, 470 (1931).

27. See note 13 *supra.*

28. This would be required when the state used a different rate formula. If the state used the original cost method (see note 31 *infra*), as does the FPC, there would be no need for two sets of books.

29. The cost of duplication ranges from estimates of $75,000 when the rate system is identical to $2,000,000 in the *East Ohio* case. See *Hearing, supra* note 25 at 35, 58. The latter figure seems grossly exaggerated. *See Re* East Ohio Gas Co., 74 P.U.R. n.s. 256, 263 (1947). See Benton, *Jurisdiction of the FPC and of State Agencies in the Regulation of the Electric Power and Natural Gas Industries,* 14 GEO. WASH. L. REV. 53, 76 (1945) (municipalities sponsored this provision).

30. For a good discussion on the theory of reproduction cost see TROXEL, ECONOMICS OF PUBLIC UTILITIES 292-99 (1947); BARNES, THE ECONOMICS OF PUBLIC UTILITY REGULATION 416-17 (1942).

31. Original cost is defined as "the actual money cost of . . . property at the time when it was first dedicated to the public use, whether by the accounting company or predecessors." 47 CODE FED. REGS. § 31.01-3 (x) (1954).

32. Assuming continued inflationary values, an original cost study will produce a much lower rate than a reproduction cost study; therefore, the comparison may be a potent weapon in awakening public pressure for a switch in formulas.

resale to the distributor.[33] While the first sale would be regulated by the FPC, the sale to the distributor would now come within the state's purview. If the consumer state values the pipelines and other facilities of the subsidiary by either reproduction cost or a combination of reproduction and original cost,[34] then, assuming a continued period of inflation, the rate base of the subsidiary would be increased considerably over the original rate base of the parent company formulated by the FPC for the identical property. The concomitant increase in consumer rates would be far greater than the saving to the consumer of the cost of duplication.[35]

If it is concluded that the obviating of duplicate regulation is of paramount importance, the Hinshaw bill easily can be amended to cure the aforementioned ambiguities and inadequacies. If, however, it is more important to keep § 5(b) available for municipal use and to prevent interstate pipelines from using subsidiaries to increase their rate base, then a procedure should be sought which would enable the FPC to weigh these and other relevant factors. A procedure similar to that used by the ICC in regulating interstate motor carriers is suggested.[36] The ICC is given discretion to waive its jurisdiction when regulation by a state commission is effective, and of "such nature, character, or quantity as not substantially to affect or impair uniform regulation by the federal commission." Furthermore, the ICC may revoke the exemption at any time after issuance if it becomes reasonably necessary under the policy of the Act. If such a flexible procedure were adopted by Congress for the N.G.A., the FPC would be able to grant the state exclusive jurisdiction when duplicate regulation served no useful purpose,[37] and still would permit the state and municipal commissions to utilize § 5(b) when it would aid in promulgating just rates. Moreover, the aforementioned danger of pipelines using subsidiaries to increase their rate base could be controlled simply by refusing to grant exclusive jurisdiction to those states which permitted such a practice.

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33. See *FPC Report, supra* note 17, at 2997. This would not be the first time that interstate pipelines have set up subsidiaries to escape federal regulation. See *Hearing, supra* note 25, at 53.

34. See Rose, *The* Hope *Case and Public Utility Valuation in the States,* 54 Col. L. Rev. 188 (1954).

35. Senator Douglas has estimated in one case that a shift from original cost to reproduction cost would allow an increase in a company's rate base of over $80,000,000. See 100 Cong. Rec. 3004 (daily ed. March 12, 1954).

36. 54 Stat. 921 (1940), 49 U.S.C. § 304(a)(4a) (1952), amending 49 Stat. 546 (1935).

37. *E.g.,* in those states in which the commissions were able to make a thorough rate study and did not desire FPC intervention, and where the state used the original cost method of the FPC or some other method which benefited the consumer such as "prudent investment."