In the

Supreme Court of the United States

C-2

MOBIL OIL CORPORATION,
Petitioner,

vs.

FEDERAL POWER COMMISSION,
Respondent

No. 73-437

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioner,

vs.

FEDERAL POWER COMMISSION,
Respondent

No. 73-457

MUNICIPAL DISTRIBUTORS GROUP,
Petitioner,

vs

FEDERAL POWER COMMISSION,
Respondent

No. 73-464

Pages 1 thru 68

Washington, D. C.

April 17, 1974

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Respondent.

Washington, D. C.,

Wednesday, April 17, 1974.

The above-entitled matters came on for consolidated argument at 11:38 o'clock, a.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the United States
WILLIAM O. DOUGLAS, Associate Justice
WILLIAM J. BRENNAN, JR., Associate Justice
BYRON R. WHITE, Associate Justice
THURGOOD MARSHALL, Associate Justice
HARRY A. BLACKMUN, Associate Justice
WILLIAM H. REHNQUIST, Associate Justice

APPEARANCES:

CARROLL L. GILLIAM, ESQ., Grove, Jaskiewicz, & Gilliam, 1730 M Street, N.W., Washington, D. C. 20036; for Petitioner Mobil Oil Corporation.

GEORGE E. MORROW, ESQ., 705 Union Planters National Bank Building, Memphis, Tennessee 38103; for Petitioners Public Service Commission and Municipal Distributors Group.

LEO E. FORQUER, ESQ., General Counsel, Federal Power Commission, Washington, D. C. 20426; for the Respondent Federal Power Commission.

JOHN R. REBMAN, ESQ., P. O. Box 2180, Houston, Texas 77001; for producer respondents in opposition.

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P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear arguments next in three consolidated cases, 73-437, Mobil Oil against Federal Power; 73-457, Public Service Commission against Federal Power; and 73-464, Municipal Distributors against Federal Power.

Mr. Gilliam.

ORAL ARGUMENT OF CARROLL L. GILLIAM, ESQ.,

ON BEHALF OF PETITIONER MOBIL OIL CORPORATION

MR. GILLIAM: Mr. Chief Justice, and may it please the Court:

I argue for Petitioner Mobil Oil Corporation only. There are differences as to position and results sought by petitioners.

These cases come from the Fifth Circuit, and arise under Sections 4 and 5 of the Natural Gas Act, and involve rates for natural gas producers.

The proceedings before the Commission were to fix such rates for the Southern Louisiana area, both onshore and offshore, an area that now supplies approximately one-third of the nation's interstate supply of natural gas.

As the issues reach this Court, the subject matter involves, first, a fund of approximately $375 million, which were amounts collected by producers in the area prior to August 1, 1971.

The case also involves a rate structure that fixes charges be made by producers to pipeline purchasers of something in excess of $1 billion annually for each of the years after August 1, 1971, and under a rate structure that extends, by terms, to 1976 and 1977.

These two branches of the case became intertwined before the Commission, and the background lies in two separate area rate cases, two Commission opinions, and now two opinions by the Fifth Circuit.

The first area rate case for Southern Louisiana was initiated in 1961. This led to what is denoted Commission Opinion No. 546, issued in 1968. That was followed by review in the Fifth Circuit, and opinions that are referred to in the briefs as the Austral case or Southern Louisiana I.

That opinion was an affirmance of Opinion No. 546, but included language in the initial opinion, and in a later opinion by the Fifth Circuit denying petitions for rehearing, that give rise to the issues that are raised by the other petitioners, the Municipal Distributors Group and New York, as to the Commission's power thereafter to reopen the rates fixed by that opinion, and to revise them.

Those questions will be covered by Mr. Morrow.

The second Southern Louisiana area rate case produced the opinion which is now here, denoted Commission Opinion No. 598. This proceeding was initiated in 1969, before review of the first opinion had been completed.

At first it was restricted to rates for new contracts, for new sales from the federal offshore domain only. Later Commission orders expanded the scope of the proceeding to include all producer sales in Southern Louisiana, and after the Austral decision by the Fifth Circuit, the Commission also enlarged the docket to include the issues of revision of the rates that had been fixed by the first opinion, and to include the issues of disposition of refund liabilities that had, would have been fixed by the rates in the Commission's first opinion.

The proceeding before the Commission was before a Hearing Examiner, it was an adjudicatory type hearing. The cost data in the record are essentially the 1969 test year. There are two major types, one is what is called historical cost of flowing gas -- this ultimately became the cost used to fix rates for contracts dated prior to October 1, 1968.

The second major type of cost is the so-called current cost. This ultimately was used with reference to rates for what is called new gas, and in this case that classification is gas sold on the contracts dated after October 1, 1968.

There was other extensive evidence of economic, financial, supply-demand nature, of the type that this Court reviewed in the Permian case.

There were conferences and then hearings before the Examiner, beginning in 1969, and continuing to March 1971.

While the hearing was in progress, a settlement conference was initiated under the Commission's rules. This conference is held off the record, and all parties to a given proceeding are invited to participate.

Those conferences resulted in the filing of a motion with the Commission by a group of distribution companies, referred to in the briefs here as United Distribution Companies, or UDC.

The motion was submitted in November 1970, asking the Commission to approve a proposed settlement, which was appended to the motion. The Commission then issued notice of that and provided for the filing of comments.

The comments indicated very wide support to the settlement from major producers in the area, pipeline purchasers, distribution companies in two groups, and some State commissions.

However, the settlement was opposed by Mobil, by another major producer in the area, in some small details by other producers; it was also opposed by the Public Service Commission for the State of New York, the Municipal Distributors, the American Public Gas Association, the American Public Power Association, and the Consumer Federation of America.

On December 24, 1970, the Commission issued an order that made the settlement proposal a part of the record, and provided that opponents could present in the hearings that were still going on before the Hearing Examiner the reasons or bases for their objections.

This hearing continued to conclusion in March 1971, the Examiner's decision was omitted, briefs were filed directly to the Commission, there was no oral argument; and the Commission issued its Opinion No. 598, the opinion now here, on July 16, 1971.

This adopted the settlement proposal in its entirety. It has specific features that give rise to the issues now raised here by Mobil. As to the past, that is, this fund of collections prior to August 1, 1971, the Commission adopted a formula set out in the settlement proposal to dispose of refund liabilities.

Specific rates were fixed for the past period. Amounts collected by individual producers in excess of those rates were not to be refunded, but were to be retained as working capital and subject to future discharge by dedication of new reserves in the area.

As to the future, that is the period after August 1, 1971, the Commission adopted precisely a two-part rate structure that was set out in the settlement. Rates were prescribed for flowing gas, that is rates for sales under contracts dated prior to October 1, 1968, a fixed excalation in October 1973 was provided, and a system was included for contingent escalations up to a total of 1.5 cents up to 1977, if by that time the industry as a whole dedicates certain specified quantities of new gas in the area.

But on one of the points we raise here, that contingent escalation formula excludes from the reserves that will be counted the reserves that are used by individual companies to discharge their own refund liabilities, and it requires those of us, such as Mobil, which have small refund liabilities to, in effect, earn these escalations which are then allowed for all others.

The rate structure also includes a separate rate for new gas, that is sales under contracts dated after October 1, 1968, and a moratorium on increases in rates under Section 4 of the Act, extending to October 1, 1976 for flowing gas, and October 1, 1977 for the new gas.

Other provisions that we have raised and discussed in our briefs were included precisely as set out in the settlement.

The opponents of the settlement sought rehearing, as required by Section 19(a) of the Natural Gas Act. This was denied by Commission Opinion 598-A, in which the Commission reiterated that it adopted the settlement proposal in its entirety.

Review in the Fifth Circuit followed. The Commission's opinion was affirmed. In August 1973, however, the District of Columbia Circuit reversed the Commission as to an identical rate structure which the Commission had imposed in the Texas Gulf Coast area, finding essential elements of this rate structure in conflict with the standards of Sections 4 and 5 of the Natural Gas Act.

The proceedings in this Court then followed.

Now, the issues raised by Mobil go both to what we term the invalid end result, impact, and consequences in this case under the standards this Court set out in the Hope test in 1944, and in its review of the first area rate cases, the Permian Basin decision in 1968.

The issues we raise also go to the invalidity of essential elements of this rate structure. In our view the District of Columbia Circuit opinion, which is before this Court, is correct; this structure violates express standards of Sections 4 and 5 of the Natural Gas Act, which prohibit unjust and unreasonable rates, and also prohibit unduly discriminatory and unduly preferential rate structures.

In addition, as our briefs indicate, there are substantial parts of the Commission's opinion in this case, which do not include any of the findings that this Court indicated in both Hope and in Permian are required for valid rates under the Natural Gas Act.

Now, in particulars as to our view on the discriminatory and preferential nature of this rate structure, it begins with this treatment of refunds for the past period, and it carries on from that over into the rates prescribed for present and future.

By the treatment of refunds, the Commission has, in effect, in this case adopted a rate structure which prefers the producers who in the past collected the highest rates, who did not follow Commission guidelines and policies between 1960 and 1968. It provides those producers additional and special working capital available in the present and in the future for use in competitive bidding and other operations, and this same formula is tied to the flowing gas rates that were fixed here for the present and the future.

We cite in our briefs specific parts of the Commission's opinion which reflect that the Commission treated its present and future allowance for exploration and development capital, and the other capital allowances in the flowing gas rates, as in part satisfied by this special allowance of working capital to the few producers who owed the large refunds.

As we cited in our brief, there are -- they are quite disproportionate, they do not -- are not proportional among producers in the area, and only a handful of the producers owe the bulk of the refunds. But under this rate structure, both as to past, present and future, the incentives and the benefits the Commission has allowed are channeled straight to those few producers, and they are not allowed to the remaining producers in the area.

Now, in particular --

QUESTION: What would be the effect, Mr. Gilliam, upon the consumer? I take it they feel that the refund system will -- what -- penalize the old consumer and help the current one?

MR. GILLIAM: Your Honor, of course Mr. Morrow will address this question from the viewpoint of the consumers, but in the District of Columbia Circuit opinion, the opinion notes that this is adverse both to the interest of producers in the area, the old producers, such as Mobil, and adverse to new entrants, and adverse to the competitive structure in the area, and therefore would be adverse to the ultimate benefits that consumers should expect in the sense of the two objectives of the statute, which are reasonable rates and an adequate supply.

Now, the analysis of that in the Texas Gulf opinion, from the District of Columbia Circuit, is quite detailed. We rely on that quite heavily, and I think it does cover this problem which we raise of undue discrimination and preference, both from the viewpoint of the affected producer and from the viewpoint of the ultimate consumer.

And in that opinion the basis for the opinion by the District of Columbia Circuit rested, of course, on the statutory standard, but on the adverse impact on both of the most affected interests.

Now, in the analysis of this rate structure, everything for present and future that we attacked as being too low or not a high enough reasonable rate, not high enough current allowance, at 1969 and 1971 costs. Everything was justified all along the way by a "Yes, but we made those allowances in the treatment of refunds."

But then when you look at that, those allowances go in only a few directions, those who followed the past policy are somewhat left out in the cold, so to speak. It even comes in the opinion before the Fifth Circuit on the moratorium.

In the Permian case, this Court spelled out certain things the Commission should find when it imposes a moratorium on rate increases, such as projected stability of cost, trends as to rising costs; in this instance it would have been looking toward the Seventies.

Here we have only five lines in the Commission opinion, which establish a moratorium from August 1971 to 1976 and 1977 in one of the nation's most critical areas. There is not one word in those five lines about whether cost could be expected to rise, whether capital requirements would be greater, or so on.

And yet the Fifth Circuit opinion, in looking at our objection to that and comparing it with what this Court said in Permian, the Fifth Circuit says: Ah, yes, but somehow that is compensated for by the refund allowances that were permitted under this rate structure.

But I would suggest that is no compensation to those producers who did not collect those rates in the past and it's an intermixture, an intertwined effort to tie together a rate structure to protect refund liabilities for a handful of companies, but in so doing the Commission has mixed it up with what should be current and future just and reasonable rates for the entire area industry. It has used that also to lay down a moratorium on the whole area, and has done it in a period when even this record, which cut off in 1971, indicated that we already were in a natural gas shortage, it indicated that the heaviest demands for capital on this industry that have ever existed would arise in the 1970's, and when the drilling effort increasingly must be directed toward greater offshore distances, deeper drilling, and so on.

Now, with that we have the Commission simply adopting a rate structure that, in our view, was tailormade to benefit only a handful of people who had collected, as we say, the highest rates from 1960 through 1968.

There are other issues that we have raised that deal with particular parts of the settlement agreement, one of them I've mentioned: the moratorium.

We also have brought the question of the Commission's refusal to make an adequate allowance for our royalty payments. In Southern Louisiana, the producers' payments of royalty to others, including governmental institutions, are some 16 percent of total revenues, and the Commission has put together a rate structure here that (a) was based on an assumption years ago that its own rate jurisdiction extended to control of the level of royalty payment. That assumption by the Commission some years ago was held to be invalid, and yet the Commission still is prescribing rates on the assumption that the royalty payment is controlled, or a function of the rate fixed by the Commission.

We have submitted that the Commission errs in not allowing an adjustment clause in the rates, where the producer is required to pay government or someone on market value, if that escalation be permitted.

Thank you.

MR. CHIEF JUSTICE BURGER: We'll not ask you to split your argument on a minute and a half here; we'll let you start after lunch, unless you'd prefer to go ahead.

MR. MORROW: I have one matter before my argument, if I might take it up with the Court?

MR. CHIEF JUSTICE BURGER: Yes.

MR. MORROW: We have not yet filed a reply brief to te brief of the government and the other parties, because the government's brief was late.

MR. CHIEF JUSTICE BURGER: You will be allowed to file --

MR. MORROW: With the Court's permission, we will file one sometime today when it comes from the printer.

MR. CHIEF JUSTICE BURGER: That's of course at least one of the factors that entered into the sua sponte decision to give you a little bit more time.

I might add there's no compulsion on either of you to use all that time.

MR. MORROW: We appreciate that, Your Honor.

[Whereupon, at 12:00 noon, the Court was recessed, to reconvene at 1:00 p.m., the same day.]

AFTERNOON SESSION

[1:02 p.m.]

MR. CHIEF JUSTICE BURGER: Mr. Morrow, you may proceed.

ORAL ARGUMENT OF GEORGE E. MORROW, ESQ.,
ON BEHALF OF PETITIONERS PUBLIC SERVICE
COMMISSION OF NEW YORK AND MUNICIPAL
DISTRIBUTORS GROUP.

MR. MORROW: Mr. Chief Justice, and may it please the court:

My name is George Morrow, and I represent the Municipal Distributors Group in this case, which is a group of approximately two hundred municipal distribution systems throughout the country. And I also have the honor to speak for the New York Public Service Commission in this argument.

The Municipal Distributors and New York are here objecting to two elements of the Commission's order in this case, which relate either to gas already sold and delivered or else to gas already committed to long-term contracts.

These two elements are:

First, the drastic modification of refunds ordered by the court in this case which changed the refunds which had been ordered in an earlier case in 1968.

Secondly, a provision for four one-half-cent future escalations in the rates for flowing gas from this area. The first of which alone, when applied to the 80 trillion cubic feet of known proven reserves of flowing gas would, at one stroke, increase their value by about $400 million.

First, as to the refund issue --

QUESTION: Mr. Morrow, may I ask: Do I correctly read the Fifth Circuit opinion as suggesting that the only issue of judicial review, as they saw the case, was the universal camera problem, whether or not the order of the Commission was supported by substantial evidence?

MR. MORROW: And they kept talking -- yes, Your Honor, and they kept talking about substantial evidence on the record as a whole.

QUESTION: Yes. But your argument goes beyond that, doesn't it? It challenges the provisions of the order, not as unsupported by substantial evidence but for other reasons, doesn't it?

MR. MORROW: It challenges them as unsupported, but before we get to that, we challenge the right of the Commission --

QUESTION: That's what I thought.

MR. MORROW: -- to reopen its 1968 order.

QUESTION: And do you read the Fifth Circuit as expressly addressing that question, or as --

MR. MORROW: I did not find anything on that question in the Fifth Circuit's opinion, Your Honor.

QUESTION: No. Well, if they were right -- if they were right, in thinking that the only question of judicial review was the shorthand universal camera question --

MR. MORROW: Yes, sir.

QUESTION: -- that, if they are right about that, then our review is even more limited, isn't it?

MR. MORROW: If there were no serious questions concerning the record in this case, concerning the substantive evidence on which the record is based, then, obviously, if the Court of Appeals of the Fifth Circuit decides it on a factual basis, this Court would not review.

But we feel that there are serious legal issues involved in this case.

QUESTION: That's what I thought, yes. And you think those are open -- assuming again we were to agree with the Fifth Circuit, in its approach --

MR. MORROW: Yes, Your Honor.

QUESTION: -- do you still think those would be open to you?

MR. MORROW: I think those would be open, yes, sir.

Let me explain the first one, on the refund issue.

The Commission, in Opinion 546, which is Southern Louisiana I, in 1968 made findings as to the just and reasonable rates for gas in the Southern Louisiana area, and these findings related to gas from 1954, the inception of producer regulations, up through 1968, the date of the order.

Finding that the producers had charged excessive rates, this Commission ordered refunds, the amount of which approximated $376 million.

Three years later, in Opinion No. 598, which is now under review, and which I refer to as Southern Louisiana II, the Commission reopened its final order in the 1968 docket, which had been affirmed on appeal, and modified two elements of the cost found in that docket, modified them retroactively. And since it modified those cost items retroactively and increased them, that of course had an effect upon the refunds which it had ordered in the other case, and so it drastically modified its 1968 refund order, reducing it at one fell swoop by $226 million, and then providing for the work-off of the remaining $150 million by dedications of gas by the producers to interstate commerce in the future.

Now, our proposition in this case, the basic legal proposition is very simple. The Commission had no power by its 1971 order to reopen a final judicially affirmed 1968 order, and modify the fact findings in that final 1968 order, and change the refunds relating to the 1954-1968 period.

QUESTION: Well, Mr. Morrow, in that connection, didn't the Fifth Circuit say that in its opinion on rehearing on the first order --

MR. MORROW: Yes, sir.

QUESTION: -- it made it abundantly clear that it was not affirming, it was leaving the Commission all the authority in the world to reopen everything if it wanted to. Didn't it say that?

MR. MORROW: No, sir, Mr. Justice Brennan, it did not.

QUESTION: I see.

MR. MORROW: And that's where we come to the nub of the case.

QUESTION: Where did they use the term "experimental"? At what stage did that first enter into this?

MR. MORROW: Your Honor, that was discussed by the Court of Appeals in Southern Louisiana I. It was one of the main bases of the Court of Appeals opinion in Southern Louisiana II.

And of course in the Texas Gulf Coast case, the Court of Appeals of D.C. disagreed and said, We've passed the experimental stage now and you can't get by with that sort of thing by calling it experimental.

QUESTION: Well, but they weren't dealing with the same record, were they?

MR. MORROW: They were dealing with an almost identical record, Your Honor. Same issues.

QUESTION: The same issues, but not the same factual --

MR. MORROW: Not the same numbers, but certainly the same issues. The same type of thing.

The same settlement.

QUESTION: Yes. Let's go back for a moment to that 1961 reference to its being experimental. In what sense do you suggest that the Court of Appeals was using that term back with reference to the proceedings begun in 1961?

MR. MORROW: The '68 record --

QUESTION: The Louisiana I.

MR. MORROW: Your Honor, it was using that for the purpose of excusing some very loose findings on the part of the Federal Power Commission. In the first Southern Louisiana case, the Court said, We're not going to let the Federal Power Commission get by with basing its conclusions on such loose findings and basing findings on such vague and general factual allegations in the future. Particularly non-cost findings. In the future, if the Commission wants to put non-cost additives onto a rate of return -- onto a rate, it's got to show what those additives, how much they are needed and what they will accomplish.

And this is what the Court of Appeals in the Texas Gulf Coast case reversed the Commission for, because it had not shown just exactly that. That the non-cost additives were worth what they cost, in effect.

But, Your Honor, you asked what exactly what the Court of Appeals in the first case had decided; and let me read it to you.

QUESTION: Where do we find it here? So that we can follow it.

MR. MORROW: Your Honor, this is in the first case, and it's not in the record here. I happen to have a record of the first case.

QUESTION: Yes. Go ahead.

MR. MORROW: The Court said: "Since we have concluded that the Commission is on the right course now, our best course is to keep within the proper sphere of a reviewing court.

"The point is that the probability of shortage, based on new evidence, is not before us for review. All that is before us is the legal adequacy and not the wisdom of the Commission's orders.

"Finally, and most importantly, in the light of Permian, we think we are required to hold that the Commission's orders in this case are procedurally and substantively adequate under the law. Whether they are ultimately wise is a question to be presented, not to the court but to the Commission."

And again, in a later page, which I don't see right now, it says: "We hold that Permian requires affirmance."

And then on its opinion on rehearing it reiterated, "This is an affirmance and not a remand."

So what happened was that -- and, incidentally, this is the sole basis on which the Commission now rests its case. If this order in Southern Louisiana I, says the Court of Appeals, is not valid, then the whole defense of the Commission, of its refund orders, must collapse.

QUESTION: Do you have on hand -- I'm looking for it and can't find it -- in the opinion before us now, on the order, on the judgment under review, where they address whether or not they left these things open on the petition for rehearing in the first case?

MR. MORROW: Yes, sir.

QUESTION: I can't seem to find that.

I thought I read something in it which is contrary to the implications of what you read us from the first opinion.

MR. MORROW: I'm looking in the Appendices to the Petition for Cert.

QUESTION: Well, don't -- don't let me waste your time, Mr. Morrow. I'll find it.

MR. MORROW: All right, sir.

QUESTION: Mr. Morrow, if in that first proceeding the Commission's order had been open-ended or tentative, so to speak, an affirmance by the Court of Appeals of that order wouldn't destroy the open-ended or tentative character of the Commission's order, would it?

MR. MORROW: If it had not been a final order, then I presume it would not have been a final order, Your Honor; that's correct.

But this was a final order, and the Commission defended it before the Court of Appeals as a final order and successfully defended every single finding in that case.

Now, what the Court of Appeals did was, first, to affirm, because it says, "We have to affirm. The Commission's opinion is based solidly on evidence in the record and we have no choice but to affirm."

It then went on to say that with respect to this lawful order, we make -- it says, "We rely upon the broad remedial powers that inhere in a court of equity and," acting pursuant to its equitable powers it stated: "We make it part of the remedy in this case that the authority of the Commission to reopen any part of its orders is left intact."

Now, our position is very simply that if the Commission order was lawful in all respects,there was no basis for the Court of Appeals to provide a remedy, a judicial, equitable remedy for a perfectly lawful order.

Once the Court of Appeals found that the Commission order was substantially supported by facts and findings in the record, its jurisdiction was at an end with respect to that order.

And this Court said so in Natural Gas Pipeline vs. FPC, which is cited in our reply brief. The Court said this, referring to the Court's review of a Commission order: Once a fair hearing has been given, proper findings made, and other statutory requirements satisfied, the courts cannot intervene, in the absence of a clear showing that the limits of due process have been overstepped.

And again this Court, in SEC vs. Chenery Corporation, said that it's the duty of a reviewing court -- that the duty of a reviewing court, quote, "is at an end when it becomes evident that the Commission's action is based upon substantial evidence and is consistent with the authority granted by Congress.

This is the crucial distinction between this case and the Ford Motor case and all the other cases that are cited along that line by the Commission and the Intervenors in this case.

In the Ford Motor case, the agency had committed legal error. Someone's rights had been violated. A wrong, a legal wrong had been perpetrated. And this called upon the equity powers of the court, the remedial powers of the court to provide a remedy for the wrong, to provide relief for someone who had received legal injury.

In the present case -- or, rather, in Southern

Louisiana I, there was no legal wrong. The Commission's opinion was affirmed in all respects upon the special request of the Commission. And therefore the court had no power under the Natural Gas Act, as part of its reviewing power under the Natural Gas Act it had no power to go ahead and provide a legal equitable remedy, judicial equitable remedy for a perfectly lawful order.

But if the Commission had no power to change that order, which was perfectly lawful, then it certainly had no power to use its equitable remedial rights to invest such an unprecedented power in the Federal Power Commission.

QUESTION: Mr. Morrow, I found finally what I had in mind. It's at page 30 of the Appendices to the Petition.

MR. MORROW: Yes, sir.

QUESTION: Dealing with flowing gas, at the bottom of page 30, where Judge Brown says -- after referring to the first order, the 18.5 and then the 19.5-cent rates: "Although we pointed out that our mandate was an affirmance of these rates, we poignantly emphasized that our opinion did not foreclose the possibility of change. On rehearing we reiterated: 'We wish to make crystal clear the authority of the Commission in this case to reopen any part of its order that circumstances require the reopen.'"

MR. MORROW: Yes, sir. That's correct. That's what the Court purported to do.

And it's our position that the Court simply could not do both.

QUESTION: I see.

MR. MORROW: It cannot affirm, and at the same time provide a judicial equitable remedy for a perfectly valid order. And that's what it purported to do in this case.

Now, there's a -- the New York Commission emphasizes this point, that in that Southern Louisiana I the Court had carefully and exhaustively reviewed every single fact-finding of the Commission. And it had affirmed every fact-finding of the Commission. And, regardless of how you construe the Commission's final order in the case, it is not reasonable to construe it as having the Court say, We've just reviewed all of these facts and costs, we affirm them all; no, Federal Commission, go and change them.

In other words, if the Court was leaving anything open validly in the Southern Louisiana I case, it was leaving open matters with respect to non-cost additives.

But that brings us to the second leg of our case, of our position here. And that is that even if the Commission's reopening of its 1968 opinion were lawful, the manner in which it did so is totally, totally unsupported on the record.

This is not just a matter of conflicting findings, this is a matter of a misanalysis of the facts. The sole basis upon which the Commission made its change in the 1968 refund order was on its finding in the 1971 case, that it had committed error, factual error in the previous case.

The Commission said, Opinion 546 did not afford an adequate return and it understated the requirements for exploration and development. In the light of these inadequacies, the Commission said, we find that the rates of 20.625 cents and 21 and a quarter cents as the base for refunds are reasonable and in the public interest.

So the only basis for the finding as to the refunds was that the 1968 order was in error with respect to rate of return and allocation of exploration and development costs.

The rate of -- but the fallacy here is that the Commission never reviewed its 1968 record. It never went back to determine whether the fact-findings in that record were wrong. What it did was to use its findings in the new case, its rate of return based on the 1971 decision, and using the economic conditions and the capital conditions of the 1971 decision, to find a rate of return there, and it took that rate of return and said because this is higher, this is 13 to 16 percent, therefore we find that the 12 percent rate of return that we ordered in the 1968 opinion is inadequate.

And it's our contention that the rate of return in the second case is no evidence as to the inadequacy of the rate of return in the first case. The same thing is true with the other cost element, which is the major cost element. The allocation of cost as between dry-hole costs or exploration and development costs, between oil and gas. It used a new method in Southern Louisiana II, but it never applied that method to the costs in Southern Louisiana I.

So, regardless of the result that it reached in Southern Louisiana II, it could not use that result as evidence that it had been wrong, erroneous or inadequate in Southern Louisiana I.

So there was no evidence to support the court -- the Commission changing of its rates in the earlier opinion, and therefore no evidence to support the change of its refunds in that period.

I haven't had a chance to get into the escalation provisions, which, as I say, the first one-half cent escalation provision amounts to $400 million. There are three additional escalation measures.

Now, Mobil, in its brief, has discussed in great detail the discriminatory aspects of these. I only want to say this about them, there is no evidence whatsoever in the Commission's opinion to support them. There is no evidence that there's going to be anything like that kind of fact, of cost increase in the future.

This gas is the gas that's already been found. This gas they've already had the lease costs, the dry-hole costs, the drilling costs, all of the costs have been expended in the past, except the cost of sitting there and letting the gas flow from the well-bore into the pipeline.

And, as New York points out in its brief, those cash costs actually decreased between 1968 and 1971; and there is no finding in the future that those costs are going to increase in any perceptible degree, and no conceivable possibility that those costs will increase in the realm of hundreds of millions of dollars, as is involved in these half-cent increases.

The Commission never made any finding as to how much good these half-cent increases were going to do, whether they were needed, in the first place, and if they were needed, there was no balancing of the hundreds of millions of costs versus the probable new reserves that would be gotten as a result of them.

So there is, under the -- this is what disturbed Judge Leventhal, too; Judge Leventhal, addressing this precise issue in the Texas Gulf Coast case, concluded that since the rates for new gas had been expressly found by the Commission to be adequate alone, the rates for new gas alone, and to induce capital investment in the area, there was no basis for an extra allowance to rates for old gas to accomplish all over again identically the same thing.

Your Honor, I'd like to reserve the rest of my time for rebuttal, if I may.

MR. CHIEF JUSTICE BURGER: Very well, Mr. Morrow.

Mr. Forquer.

ORAL ARGUMENT OF LEO E. FORQUER, ESQ.,

ON BEHALF OF THE FEDERAL POWER COMMISSION

MR. FORQUER: Mr. Chief Justice, and may it please the Court:

I would like, first of all, to take a little time to give a chronological resume of what happened in these cases. It may duplicate certain things that have been said before, but I think it gives a better perspective on it.

The first Southern Louisiana case was initiated in 1961, and was decided in 1968, shortly after this Court's affirmance of the Commission in the Permian case. The rates established in that proceeding were based on 1960 costs, and were lower than the guideline and the in-line rates which the Commission had previously established for Southern Louisiana.

The Commission devoted very little discussion to the gas supply situation, but concluded that its rates would induce adequate supplies. It said that findings to production and reserves to production ratios were not significant in helping to determine reasonable rates.

Among the many applications for rehearing presented to the Commission was one by the pipeline purchasers group, that indicated they were having difficulty purchasing sufficient supplies of gas to meet their customers' demands, and that the rates were inadequate to increase that supply.

While the Commission denied rehearing, it recognized the inadequacy of the cost and reserve data, particularly that with respect to the offshore federal domain area of Southern Louisiana.

Accordingly, it lifted the indefinite moratorium that it had imposed on price increases in that area, to the extent necessary to permit certain limited increased rate filings for gas sold under contracts dated after October 1, '68, and it limited the moratorium on similar onshore sales to five years.

At the same time it instituted a new proceeding which was to re-examine the rate for offshore Southern Louisiana, establish a new just and reasonable rate for that area. This was the beginning of South Louisiana II, the case which is now before this Court.

Later that same year they expanded the proceeding so that it encompassed the entire area involved in the first Southern Louisiana case.

In September of 1969, before this case, the first Southern Louisiana I,was submitted to the Court for review, the staff of the Federal Power Commission issued a report indicating that the national gas supply situation had deteriorated, the reserves-to-production ratio and the findings-to-production ratios had declined sharply.

They concluded that unless aggressive action was taken to increase the finding of gas, supplies would soon not be adequate to meet demand.

They pointed out that the findings in 1968 were less than production, and that there would probably be regional supply deficiencies as early as 1973.

They were much too optimistic, because as early as late fall 1970, one or more pipelines were curtailing supplies of gas to firm customers.

In its review of South Louisiana I, the Court below indicated its misgivings with respect to the Commission's consideration of the supply situation and their lack of any attention to the reserves-to-production or findings-to-production ratios.

However, they felt that with the presently pending South Louisiana proceeding now before the Commission, that it would serve little purpose to remand or to reserve, or to set aside the order which was before them, since the same thing was being investigated.

They said, however, that it's possible that the Commission may find it advisable to immediately modify its order, or it might set aside the order affirmed here. They said the Commission has the power to take these actions, if it finds them appropriate.

Petitions for rehearing were filed with the Court, and it was argued that the Commission had no authority to set aside orders which they had finally issued, and the Commission itself, in response to a request from the Court, said: We have no authority to make retrospective changes in rates which we have established and which are finally affirmed, unless this Court tell us that we can do so.

And in its order on rehearing, the Court made this -- and I wish to quote this statement:

"We wish to make crystal clear the authority of the Commission" --

QUESTION: Where are you reading from now, Mr. Forquer?

MR. FORQUER: Sir, this is the order on rehearing, where --

QUESTION: Where is it in here?

QUESTION: Page 5 of their brief.

QUESTION: Is it in the Appendix, too?

MR. FORQUER: It's in the brief at page 20, the bottom of page 20 of the government brief.

"We wish to make crystal clear the authority of the Commission in this case to reopen any part of its order that circumstances require be reopened. Under Section 19(b) of the Natural Gas Act, this Court has the broad remedial powers that inhere in a court of equity, and pursuant to our equitable powers we make it part of the remedy in this case that the authority of the Commission to reopen any part of its orders, including those affecting revenues from gas already delivered, is left intact. The Commission can make retrospective as well as prospective adjustments in this case if it finds that it is in the public interest to do so."

I might say that the rates which were established by the Commission in Southern Louisiana I, either through Court or Commission stays, were never made effective.

Petitioners for certiorari were filed with this Court and were denied in December of 1970, and in the same month the Commission reopened South Louisiana I, and consolidated it with South Louisiana II.

In the meantime, pursuant to an order of the Presiding Examiner, and also consistent with the provisions of the Administrative Procedure Act, and the Commission's rules, settlement negotiations were being conducted by the parties to this proceeding.

I might point out that the Commission staff participated in all of these conferences, a member of the staff presided at the conferences, and the staff supported the settlement which came before the Commission in this case.

The Commission issued its opinion and order in

July of 1971, and its order was affirmed by the court below.

Now, as we see it, there are two legal issues that are presented to the Court in this case.

QUESTION: As respects SoLa No. I -- you call it SoLa No. I.

MR. FORQUER: How's that, Your Honor? I'm sorry.

QUESTION: As respects SoLa No. I.

MR. FORQUER: The issue as to SoLa --

QUESTION: Yes, concerning that case --

MR. FORQUER: Yes.

QUESTION: -- who stands -- Mobil does not stand opposed to that?

MR. FORQUER: No, I don't think so, Your Honor.

QUESTION: What parties are?

MR. FORQUER: It's New York and MDG, I think that -- they support SoLa I and say that the Court had no authority to give us the authority, the Commission the authority to do --

QUESTION: And the parties who stand against SoLa are --?

MR. FORQUER: Against SoLa I are the -- all the people who joined in the settlement proposal in SoLa II.

QUESTION: Except Mobil?

MR. FORQUER: Mobil, that's right. Well, they didn't join it, they opposed it consistently, Your Honor.

QUESTION: I see.

MR. FORQUER: The first issue that, legal issue before the Court is whether the Commission did have authority, or rather whether the court below had the authority to authorize the Commission to take another look at its decision in the first Southern Louisian case, and make retrospective as well as prospective adjustments.

QUESTION: Do you know, Mr. Forquer, whether that question was raised on the petition for cert here from --

MR. FORQUER: Indeed it was, Your Honor, it was the primary issue that was raised before the court at that time, under the petition.

Under Section 19(b) of the Natural Gas Act, the Court of Appeals of course has authority to set aside an order in whole or in part, or it could order additional evidence to be heard by theCommission upon such terms and conditions as it seems proper.

Now, the court below was greatly troubled by the Commission's failure to discuss supply and demand, and its lack of concern with the reserve and the findings ratios. They felt that the decision with respect to the validity of Southern Louisiana I should be made by the Commission who made the original decision, because they had the data which would indicate what the supply situation was, and only they had the expertise to evaluate that data, and to evaluate the impact of the Southern Louisiana I rates on supply.

It seems to us that that's entirely consistent with this Court's opinion in the Ford Motor Company case that Courts of Appeals in these instances are vested with equity powers, and that, as the Court said in that case, that while the Court must act within the bounds of the statute and without intruding upon the administrative province, it may adjust its reliefs to the exigencies of the case in accordance with equitable principles governing judicial action.

We think that is what the court below did in this case, and gave the Commission the authority to reopen its previous order.

If that is true, the argument made by certain of the petitioners that the Commission was granting reparations by its order in this case obviously is not correct.

Now, the second legal issue concerns compliance by the Commission with the three criteria established by this Court for review in the Permian case.

One, did the Commission's order abuse or exceed its authority?

Two, were each of the orders essential elements supported by substantial evidence?

And three, can the order be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interest?

Now, as had been the Court's concern in Southern Louisiana I, the Commission's concern in Southern Louisiana II was directed to the supply situation for gas, and the demand for it.

The Commission pointed out the steady decline in both the reserves-to-production and the findings-to-production ratios, and stated that their minimum objective in the case was to halt the downward trend of the reserve-to-production ratio.

They pointed out that the estimated demand in South Louisiana would increase from an annual figure of six trillion cubic feet per year to nine and a half trillion cubic feet in 1975.

And in this connection, this Court said in Permian: We do not suggest, nor did the Commission, that the Commission should not continuously assess the level and success of exploration, or that the relationship between reserves and production is not a useful benchmark of the industry's future.

Now, the Commission indicated that it was unable to quantify the volumes of gas which would be elicited by a particular rate, that they did find that there was a strong positive relationship between price and supply or exploratory efforts.

They also pointed out that capital formation for gas exploration and development had been declining since 1957, and that the industry's capital requirements had increased and that the costs of producing gas have continued to climb.

QUESTION: May I ask, Mr. Forquer, I gather the Fifth Circuit did apply the three criteria of judicial review under Permian.

MR. FORQUER: That's correct, Your Honor.

QUESTION: And concluded that --

MR. FORQUER: They had met all tests.

QUESTION: -- they had been satisfied.

MR. FORQUER: That's right.

QUESTION: Now, what's the scope of our review of that determination of the Fifth Circuit?

MR. FORQUER: Well, if you followed my --

QUESTION: Are we to redo the job that the Fifth Circuit did?

MR. FORQUER: Not in our view, Your Honor.

QUESTION: What do you think we should do?

MR. FORQUER: I think that you should look at the general result of the Commission's rate order to find out that if the ultimate conclusions the Commission arrived at were appropriate and reasonable, but not to weigh the evidence as the Court of Appeals was required to do.

Now, in an attempt to meet the problems of declining supply and inadequate capital formation, the Commission approved a rate-designed formula which encompassed several facets, all of which were directed to an attempt to increase the supply of gas available to the consumers in this country.

This formula included base area rates, it included fixed and contingent escalations, it included refund write-off provisions. And each part of the rate design was directed to the problems facing the Commission. The rate design had to function for the entire area, and apply to many producers in differing circumstances, and the record showed that the industry had placed great reliance and had expanded internally generated funds to finance its exploratory efforts.

The basic finding that the Commission made was that a portion of the funds required for further exploration and development in South Louisiana will be generated by the increased cash flow from the higher rate for flowing gas, and from the operation of the contingent escalation provisions.

Flowing gas resources represent an important source of capital to the industry. The additional resources from higher new gas rates, and the escalations allowed will also contribute to the total of needed capital.

Now, in their approach to designing these, the Commission felt that they could not and should not be restricted to encouraging an increased supply solely by one method, and that was by the area rates which they established, particularly the rates for new gas.

However, they discussed, as had been done in Permian, the cost, current cost data which was before the Commission in the determination of the new gas rates. They indicated that the lack of precision in these costs, and the difficulties involved in making allocation procedures, made it desirable that they indicate a range of costs based on reliable and credible data.

As a matter of fact, this Court, in a footnote in the Permian case, said that by one estimate the costs of non-associated gas are 45 percent separate, 31 percent joint, and 24 percent common. So there are great areas for differences in judgment with respect to those.

Accordingly, they examined the cost data, and established what they considered a range of reasonable costs, and utilized a staff witness presentation in that respect, who had recommended a rate of 25 cents per Mcf; and in order to be assured that there would be enough in this to encourage additional supplies, the Commission indicated that the rates for lease -- the costs for lease acquisition and for drilling were all going up and they should be increased slightly. They approved a rate, as found just and reasonable, for 26 cents and said it should operate to elicit additional supplies of gas.

It used a similar method for flowing gas to that which was approved by this Court in the Permian case. The only difference was that they had a direct assignment of exploration and development costs because there was evidence in the record which justified that use. And it approved the settlement rate of 22 and three-eighths cents.

The Commission, however, at the same time, pointed out that under this conditional old gas costing method, that the exploration and development allowance too often indicates the cost of exploration under past periods rather than the current increased costs, and it added a non-cost component to the old gas rate, to increase the cash flow to producers for an increased exploration and development effort.

QUESTION: How was that used?

MR. FORQUER: It was a -- the figures, if I recall correctly, Mr. Justice Brennan, were from approximately 20 cents to 25 cents -- 24 cents, I think it was. The rate which the staff had developed was 21.18 cents and they increased it to 22.375.

Now, probably one of the things that has been most vigorously attacked here by the petitioners are the provisions for refund write-offs.

This was really the second leg of the Commission's attempt to encourage additional supplies to South Louisiana. The Commission, first of all, went back and looked at the rates which had been established for past periods, and established new rates for gas delivered under contracts dated prior to 1961 and to 1965 and from '65 to the date of their order, and established rates which were consistent, the first with what the Commission had used in certificating sales of gas prior to that time in Southern Louisiana and secondly their guideline policy statement prices.

But it also reflected back from the 26 cents for new gas a reduction which was consistent with the increased costs of gas which the record in this case reflected.

The determination of the total of $150 million of refunds was obviously, in a sense, a compromise with -- by the parties who had participated in the settlement conference, but they resulted from these rates which the Commission established.

QUESTION: This was a re-establishment of just and reasonable rates that had been established in SoLa I?

MR. FORQUER: For refund purposes, Your Honor.

QUESTION: And -- just for refund purposes?

MR. FORQUER: Yes. Well, they determined what the amount of the refunds would be.

QUESTION: They would be. Anything that collected over that they had to refund, and that happened -- had ended up being $150 million?

MR. FORQUER: That's right, Your Honor.

Now, rather than have the cash --

QUESTION: You mean they just didn't pick the 150 million out of the air and say that was a fair figure?

MR. FORQUER: Well, what happened was that the 20.625 rate for the first period would generate so much, and the 21 and a quarter for the next period would be so much, and then the final period up to January 1, 1971, was placed in a percentage of the difference between the SoLa I rates, and SoLa II rates to equate to $150 million.

QUESTION: Well, nevertheless, I suppose to have the authority to reduce the refund, you had to raise -- the Commission had to raise the just and reasonable rate.

MR. FORQUER: That's correct.

QUESTION: Now, what are you going to do with the work-off?

MR. FORQUER: Well, that -- that's the point. The work-off of the refunds was related directly to the finding of new gas supply.

QUESTION: Well, I know, but does the -- all right, but they can work off the remainder of the refund, can't they?

MR. FORQUER: That is correct.

QUESTION: And every time they work off a little bit of it, the just and reasonable rate goes up.

MR. FORQUER: Well, there's no change in the rate, but the effect, I guess, is --

QUESTION: Then, I didn't realize you had -- are you asserting the Commission may find, may suspend rates or let rates go into effect subject to refund, which they did in SoLa I, right?

MR. FORQUER: That's right.

QUESTION: And then establish just and reasonable rates lower than what the rates were, and yet forgive a refund?

MR. FORQUER: Lower than they were, or higher than they were?

QUESTION: Lower than had been charged.

Let's assume that they file rates and the Commission lets them go into effect subject to refund.

MR. FORQUER: Yes, Your Honor.

QUESTION: Then they have a proceeding and they establish what the just and reasonable rate is, and it is lower than what has been charged.

MR. FORQUER: That's right.

QUESTION: Now, do you say that they have discretion if they find that the just and reasonable rate is lower than what has been charged to forgive a refund?

MR. FORQUER: I think that they do have authority given a proper --

QUESTION: Where is the authority for that?

MR. FORQUER: Well, first of all, the Natural Gas Act itself says that they may order refunds, it doesn't say that they must. Section 4.

QUESTION: So you -- so why did they even go to the trouble of resetting just and reasonable rates?

MR. FORQUER: To establish the refund level.

QUESTION: Well, they didn't have to, they could just say --

MR. FORQUER: Well, but, as a matter of fact the staff witness in the case suggested that no refund should be ordered, that the -- that those who had charged excessive rates would be better off if they retained these amounts and therefore had additional capital.

QUESTION: Well, do you have some legal, some judicial authority for the fact that the Commission may forgive refunds, even though it finds that the rate has been charged -- that has been permitted to go into effect subject to refund is higher than what the just and reasonable rate is. Is there some --

MR. FORQUER: In the Hugoton-Anadarko case, Your Honor, one of the Commission's area rate proceedings, the

Ninth Circuit so held.

QUESTION: That they could just -- needn't order a refund, even though the --

MR. FORQUER: Well, they did not require certain portions of it, to be paid back. But it seems to me that the Commission has a discretion to do what is in the public interest with respect to these refunds. If, in an appropriate case, they would find that, for instance, the ordering of refunds would cause such great damage to the industry that the ultimate consumer, really, would suffer; I think that they have the authority to so excuse them.

QUESTION: Well, you certainly are putting the -- you certainly are charging old consumers a lot of money for future exploration.

MR. FORQUER: Well, the -- one of the -- if you don't do that, perhaps, Your Honor, they won't have any gas. This was again an attempt to get a greater supply of gas, and under the refund --

QUESTION: Even though the Commission might have even set a higher price for new gas?

MR. FORQUER: That's right.

QUESTION: Or for flowing gas.

MR. FORQUER: They did include an element in the flowing gas to encourage additional exploration and development, but they didn't want to rest on simply the new gas rate as the sole incentive to bringing forth new supplies of gas.

Now, in these $150 million of refunds, if in fact those owing those amounts do not find and dedicate new supplies of gas, they must pay these refunds in cash.

QUESTION: For a hundred and fifty million?

MR. FORQUER: Yes, sir; yes, Your Honor.

QUESTION: Not the old amount.

MR. FORQUER: Not the old amount, no, indeed, because the Commission said that the 4, 546, opinion 546, Southern Louisiana I, had not given them a proper rate of return or properly reflected exploration development expense.

QUESTION: And anybody with flowing gas, I suppose, and with a refund obligation, the larger the better now, I guess, has got quite an incentive, or quite an advantage in exploring -- in bidding for new gas, I suppose.

MR. FORQUER: Well, the only way -- he's not getting any additional revenue by this, he's not having to pay out something that he might otherwise, but he has a very heavy responsibility, if he has large refunds, to find very large quantities of gas and dedicate it to the interstate market or he will have to pay this amount.

QUESTION: Well, yes, but the -- forget the refunds for the moment.

MR. FORQUER: All right.

QUESTION: The person with flowing gas, the prices for that flowing gas has been increased.

MR. FORQUER: It has been increased to 22 and three-eighths cents.

QUESTION: For not -- to cover non-cost item, exploration items?

MR. FORQUER: There's a small component in there for that, yes, Your Honor.

QUESTION: And it's going to be escalated for that purpose, too?

MR. FORQUER: It's going to be escalated once, because of the increasing costs that the Commission found were involved, and then there are the contingent escalations to flowing gas rates in the event that additional dedications are made.

And these dedications do not count until the refund requirements are paid off for those producers who are involved in refunds.

QUESTION: So your suggestion is that we -- that it's perfectly all right for the Commission to tell old consumers: Well, you've been paying unjust and unreasonable rates, but, nevertheless, we're not going to order a refund because we think we should stimulate further exploration.

MR. FORQUER: We think it -- they could say, I think quite properly: We think it is much more in the public interest that additional supplies of gas be furnished, so that you will continue to have gas, than it is that you get these amounts of dollars in refunds. And if we don't get the gas --

QUESTION: Well, why put it on just the people who have been buying old gas? I mean, they've been paying unjust and unreasonable rates, and the larger -- and the more unjust and the more unreasonable they are, the more they're going to be charged for future explorations.

MR. FORQUER: Your Honor, there was no other source to get these additional supplies of gas, unless you were going to realize solely on the rate for new gas. New gas wasn't in existence, it had to go back to be tied with those who were presently in the business, who presently had reserves, who presently were delivered gas,to encourage them to go forward and find additional supplies.

QUESTION: Well, this -- has it been a traditional function of rate-making to finance expansion?

MR. FORQUER: Well, I think that this Court certainly --

QUESTION: And to build up internal sources of capital.

MR. FORQUER: This Court indicated in Permian that it was entirely --

QUESTION: I know, but I said traditional.

MR. FORQUER: Traditional, not in the utility sense.

QUESTION: I mean, I agree with you, I know what *Permian* said.

MR. FORQUER: Traditional -- not in the public utility sense, it certainly is not traditionally --

QUESTION: Yes.

MR. FORQUER: -- true. But this is a situation wholly different, again as this Court pointed out in *Permian*, where the gas producing industry is an entirely different situation than the ordinary public utility.

One other item, and the third leg of the Commission's attempt to increase gas supply, were the contingent escalation provisions which were definitely keyed to new dedications of gas in Southern Louisiana. By that provision, if, after refunds had been paid off, producers dedicated up to 15 trillion cubic feet of gas, there could be increased rates as high as a cent and a half.

Now, if the refund write-off provisions were completely taken care of, and if the contingent escalations were completely taken care of, there would be 30 trillion cubic feet of gas supplied for the interstate market.

I'd like to comment about one other thing, and that is the argument that there was discrimination as between producers, because some of them had earlier settled their obligations and would have much lesser refunds. In connection, for instance, with Petitioner Mobil Oil Company, they made a settlement in 1964 in which they were excused from refunds of approximately $14 million, and subsequently, when a moratorium, which they proposed in their settlement had expired, they chose to continue with those rates and not make any additional filings.

Now, these were management determinations, these were things that if they wanted to make a settlement in 1964 and get their $14 million then, if they chose not to make increased rate filings in which there were no moratoria, that was entirely up to them, and did not require this Commission to take all of those aspects into consideration.

What they tried to do was make broad general rules covering all the producers in this wide area, but primarily in an attempt to bring forth additional supplies of gas.

QUESTION: I haven't found that Ninth Circuit Court of Appeals --

MR. FORQUER: Hugoton-Anadarko is --

QUESTION: What was the name of it?

MR. FORQUER: Hugoton-Anadarko Area Rate case, it's 466 F. 2d 974. And I think the refund provisions are discussed at page 990.

QUESTION: Thank you. Their page 46 and 56.

MR. FORQUER: Yes, Your Honor.

No petitions for review were filed in this --

QUESTION: 466 at 974?

MR. FORQUER: 466 F. 2d, the Ninth Circuit.

Thank you.

MR. CHIEF JUSTICE BURGER: Mr. Rebman.

ORAL ARGUMENT OF JOHN R. REBMAN, ESQ.,

ON BEHALF OF THE PRODUCER-RESPONDENTS

MR. REBMAN: Mr. Chief Justice, and may it please the Court:

I want to address my first and earlier remarks very briefly to the argument with respect to the question of the powers of the Court of Appeals to provide the Commission, in turn, with the power to set aside and reconsider the first Southern Louisiana decision.

I want to call attention to --

QUESTION: Well, it was a little more than that, wasn't it?

Didn't they -- the result was that consolidation of the first case and the second case, and the hearing on the two combined?

MR. REBMAN: Yes, indeed, Your Honor. That's quite true. And your question ties to the point that I wanted to make and call the Court's attention to that portion of the Fifth Circuit opinion on appeal, on rehearing, where the court indicated -- and this is at 428 F. 2d 445 -- that their disposition of the case was influenced by the existence of a new proceeding which the Commission itself had already commenced, and their specific statement was that in fact the existence of the new proceedings, which, as we understand them, will take into account many of the issues whose absence has concerned us here,"has been one of the factors we have considered in deciding to affirm the Commission's decision." And that's the end of the quote.

Now, I think that the important thing about this is to tie into this Court's opinion in the Ford Motor Company case, where the Court regarded as a contention without substance whether the court below, Court of Appeals, set aside the opinion or whether it allowed the agency, there the NLRB, to set aside the opinion.

And the Court characterized the contention on that ground as one without substance.

This is the situation, I think, where the Court of Appeals found the Federal Power Commission, in an era of transition, because to read the two opinions of the Court and the Commission side by side, reflects an enormously different outlook about the gas supply situation in this nation.

In the first opinion it was of little or no concern to the Commission; in the second opinion, three years later, it had become virtually an overriding consideration.

Turning, if I might, next to the questions with respect to the refund discharge, and the questions raised by you, Mr. Justice White, I think it's very necessary in looking both at the refund discharge and contingent escalation questions, to start at the beginning of the book and not in the middle of the book, as petitioners have done here.

The beginning of the book is this Court's analysis in Memphis and Mobile in the early 1960's of the functions of Sections 4 and 5.

And there the Court pointed out that this is a peculiar sort of regulation in this respect. The buyers and sellers, the parties who are regulated, start out in the first instance with individual contracts, which they make according to their own evaluations of the bargain.

Then, superimposed on top of that, becomes the regulatory powers of the Commission.

Now, this, I think, is the source of a good deal of the argument and confusion with respect to the refund write-offs.

What this Commission was working on in the Southern Louisiana case was a multitude of contracts by a multitude of parties that had been negotiated and entered into at a variety of different levels.

Some of these were affected by refund order, some were not.

The important -- sir?

QUESTION: But no company's costs were known.

MR. REBMAN: That's correct, Mr. Justice Douglas, they're -- in fact the Commission --

QUESTION: And you're bound to have in this order some discrimination?

MR. REBMAN: That's right. In fact, the Commission excluded from evidence some offers of individual company proof by some companies.

QUESTION: Didn't the Permian Basin opinion indicate that there was, either by inference, that there was the potential for built-in discrimination?

MR. REBMAN: That's absolutely correct, Mr. Chief Justice, and in that --

QUESTION: By arbitrarily drawing area lines.

MR. REBMAN: Area lines, and also the utilization of composite costs. And this was thought by the Court there to be simply an unavoidable aspect of group regulation, that the agency itself was not required to look at the individual financial impacts on each entity being regulated.

QUESTION: And now the chicken has come home to roost.

MR. REBMAN: According to some parties.

Here, I think, carrying forward the concept of the impacts on these individual companies, I think the Court should be very interested in looking at some of the materials in the Volume V of the Appendix, because there one can evaluate how revenue reductions, resulting revenues and refunds, impacted on individual companies. Because you find a very peculiar thing.

We hear the greatest complaint with respect to the refund write-off from Mobil, and it's very interesting to look at the revenue impact of the Commission's decision, which gives Mobile the highest resulting average revenue, third highest of the 23 largest producers listed, and in fact the highest of the ten largest, although their refunds are relatively modest.

Now, I don't know why, and I don't think it's important why. What's important is that different parts of the order impact different producers differently.

Now --

QUESTION: But the revenue would be somewhat higher if they still had some refunds to make?

MR. REBMAN: No, sir.

QUESTION: Why not?

MR. REBMAN: The revenue under the order prospectively -- and I'm speaking of prospective revenues only -- is higher. The prospective revenues are not affected by the refund. That's a locked-in period for the past only.

And I wish I could get to some of the questions there were bothering you, Mr. Justice White, and I think perhaps --

QUESTION: I wish you could, too.

MR. REBMAN: I think perhaps there's one or two key elements here. And that is that the Commission, while it did indicate its view that the refund floors which it established for a past period were just and reasonable, it went further; it expressed the opinion that the formula, the formula -- and I'm reading from page 5 -- 654 of Volume II of the Appendix -- that the formula for determining the refund obligations during this period is found to be just and reasonable.

So I think you have to accept the Commission's view that it was dealing with a range of costs, old and new, and that there is a zone of reasonableness for just and reasonable rates, not a single point two decimal place estimate.

Now, carrying the fixed amount of refund obligations forward as to its impact on the individual producers, I would commend to your reading very strongly the brief filed by Intervenor Associated Gas Distributors. This is a large group of distribution companies who took a very active part in this case. And they expressed the whole problem very well, I think.

Throughout producer regulation, from the very first, the Commission has been confronted with this confounding problem of trying to link together a certain price and a certain volume of gas. It has been unable to do it, it cannot do it, it's inherent in the nature of an industry that expends the bulk of its exploratory moneys for unsuccessful projects.

The producers in general every year spend in the neighborhood of $1 billion on what are unsuccessful projects, mostly dry holes. There's just no way you can link a specific price to two decimals to a specific volume of gas.

The Commission has recognized this, and so did the Fifth Circuit.

So what this refund does, and this is what AGD points out, this is one of the first times that the Commission has been able to provide this linkage between price and supply. This is the situation where the consumer either gets the money as a refund or he gets the new gas commitment.

And the same thing applies with respect to the contingent escalation, the consumer does not pay them unless the industry provides the total interstate dedications that are specified in the opinion.

QUESTION: Who's that? Who will get the refunds that will be made, the pipelines, or will they be passed through?

MR. REBMAN: In general, the Commission provides for a pass through from the pipelines to their distribution customers and then it's turned over to the local State agencies.

QUESTION: So we really are talking about the consumer and not just a pipeline here?

MR. REBMAN: That's correct. There's no question that the pipelines in general are under orders to flow through.

Now, the Commission itself made a judgment on the same page I cited earlier, a finding: We find that such an incentive, being the refund discharge, will be a net benefit to the consumer by obtaining additional gas supplies.

And the reason it's such a benefit is because of this direct linkage that AGD describes, between price and supply.

We think this is one of the crucial parts of the case.

QUESTION: You do, but the Commission must assume, and I suppose the Court assumes, that -- if you agree with the Fifth Circuit --

MR. REBMAN: Yes, sir, I do.

QUESTION: -- that the refunds that are forgiven, in order to stimulate exploration, will be used for exploration, or at least a good share of it.

MR. REBMAN: In fact, one can go even further, Mr. Justice White, the --

QUESTION: Well, there was no requirement for them to do it.

MR. REBMAN: And unless they -- unless -- you see, here's the thing. Those refund amounts can be expended for exploration and be unsuccessful --

QUESTION: Exactly.

MR. REBMAN: -- and the company still be left with the refund obligation.

So I think it's a --

QUESTION: But they can also not spend it for exploration at all, and still not have to make the refund.

MR. REBMAN: No, sir. That's not correct. They have to -- each individual company has to make the commitment.

QUESTION: But they've already had their refund obligation reduced by a substantial amount.

MR. REBMAN: I'm sorry, sir, you were speaking in reference of the first Southern Louisiana case, and I was speaking of the --

QUESTION: I was speaking of the ultimate foregiveness of the refund obligation that was established in SoLa I.

MR. REBMAN: Yes, sir. I think that that should be kept in the context, however, of the fact that while a Commission opinion issued with respect to that, as Mr. Forquer pointed out, that opinion never became final. And in its second decision, the Commission itself recognized its error in that regard.

And here's an interesting point about that. The -- if you look at page 277, I believe it is, of Volume V --

QUESTION: Did you say the Commission conceded that it erred in the first case?

MR. REBMAN: No. As Mr. Forquer pointed out --

QUESTION: I thought the court found that they were quite right, the Court of Appeals decided they were quite right, and even used the word "affirmance".

MR. REBMAN: They used the word "affirmance", but they used many other words, Mr. Justice White, including this remedy.

QUESTION: I'm not saying they -- I'm not suggesting they didn't have the right to reopen, but I would hesitate to say that anybody found the Commission had erred in the first proceeding.

MR. REBMAN: I don't think I said that. If I did, I misspoke myself.

But I wanted to call the Court's attention to the fact that most of the refunds, and this shows at page 277 of Volume V, that are required by the present opinion fall in the late years, the late Sixties and early Seventies, and this is why it was most appropriate for the Commission to focus on its cost computation made as of the test year 1969, not the test year 1960, which it had earlier used.

And you recall, Mobile described -- Mobil's counsel described for you the process of individual company settlements through the mid-Sixties, and these settlements themselves had eliminated most of the refund obligation by making refunds through the early -- late Fifties and early Sixties.

So we think it is most appropriate that the Commission now looks at the 1969 test year for the derivation of its present refund obligation.

One additional point, I think, should be made in this respect, and it ties back to the Court's decision in second Phillips. You will recall that Mr. Forquer pointed out that a staff witness in the second part of the case made the finding and a recommendation that no refunds at all should be required, because the revenues received during that period were less than his cost estimates, on an aggregate basis.

And this is precisely the reason that in Phillips II this Court affirmed the Commission for not requiring refunds of that company in a similar revenue cost position.

And in our view this finding gave the Commission the power to utilize this refund obligation as a supply eliciting factor in its over-all rate design.

Thank you.

MR. CHIEF JUSTICE BURGER: Yes.

Mr. Morrow, do you have anything further?

MR. MORROW: Yes, Your Honor, if I may.

MR. CHIEF JUSTICE BURGER: You've got about four minutes left.

REBUTTAL ARGUMENT OF GEORGE E. MORROW, ESQ.,

ON BEHALF OF PETITIONERS PSC OF NEW YORK AND

MUNICIPAL DISTRIBUTORS GROUP.

MR. MORROW: First, with respect to Justice Brennan's question about the standard used by CA-5 in reviewing the rate.

We contend that they used the wrong standard, and that if this Court will look at the Texas Gulf Coast rate, you will find exactly the right standard that should be used, which they --

QUESTION: Which prompts me to ask, Mr. Morrow, --

MR. MORROW: Sir?

QUESTION: -- do you think these two decisions can stand together?

MR. MORROW: No, sir, one of them is wrong.

QUESTION: But whatever we do in this case will govern what is to happen in Texas --

MR. MORROW: That case used virtually identically the same settlement provision that this case has used, yes, Your Honor. So it was modeled directly after this case. They've both got to stand or fall, it seems to me.

And we suggest that the general result that Mr. Forquer said that the Court used there, what's the general over-all result, that's not the proper standard. This Court has said that each essential element of the cost of service must be supported by evidence.

And we contend that it's not in this case.

Now, as to the matter that Your Honor raised, Justice White, as to the discretion of the Commission to order refunds. We treat of that right strongly in our reply brief, and would commend that to your attention; because we take the position that the Commission has no discretion to allow a company to remain unjustly enriched by unlawful exactions from its customers, particularly under an Act that's supposed to give complete, permanent and effective bond of protection to the consumers.

As to the compromise -- as to the $150 million of refunds, I must take issue with Mr. Forquer as to how that was arrived at. It was pulled right square out of the air. It was a result of settlement negotiations, and after that 150 million figure had been reached, then the Commission started building a floor of costs under it to support it. And it couldn't find the cost in its cost of service to support that hundred and -- that reduction to 150 million.

And that's why the Commission went back to 1968 and remodeled its 1968 opinion, in order -- and it did so by using a different kind of cost allocation method, in this case.

The cost allocation method which the Commission used in this case was one it had rejected in every other case it's ever had of producers. The only reason that this cost allocation method was used in this case was to jack-up retroactively the costs in Southern Louisiana I, so that they would meet this package deal that had been presented to the Commission.

If it please the Court, the thing that's basically wrong with this case is that we have a serious question here, a serious problem, and the Commission -- and it demands a rational, well-thought-out result.

What the Commission has done has abdicated its responsibility to a kind of regulation by negotiation by the industry itself.

And with respect to the refunds, what do you -- with respect to the whole thing, you've got negotiations between selling parties, who are the producers, controlling virtually the entire supply of gas in Southern Louisiana, and buying parties, the pipelines and the distributors, who are desperate for gas, must get it from these producers and can resell it at any rate that the producers propose to sell it to them for. And who have no interest in the refunds whatsoever, because, as Mr. Rebman pointed out, the pipelines don't keep them, they pass them along to the distributors; and the distributors don't keep them, their State regulatory agencies make them pass along.

So the negotiations that resulted in this $150 million worth of refunds were by people who were negotiating with other people's money, and that's how they got down to the $150 million.

Thank you, Your Honor.

MR. CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

[Whereupon, at 2:13 o'clock, p.m., the case in the above-entitled matter was submitted.]

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