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DAVID S. SCHWARTZ

The question of deregulation of regulated industries and formulation of the problem as to the degree or direction of deregulation presupposes a course for public policy in only one direction. Any set of policy choices, given the assumed objective of deregulation, precludes a course of action that would strengthen and improve the regulatory process as an institutional force. This paper seeks to examine and delineate meaningful regulatory reform which will pose a new set of alternatives to refocus the regulatory process.

INTRODUCTION

An examination of the critics of regulation, and the climate in which their criticism evolves, depicts disillusionment with regulators and the results of current regulation. This temporal approach which focuses on the status quo loses sight of the historical evolution of the public utility concept. In addition, it fails to distinguish between regulation as an institution and regulators as an instrument for social control. Dr. Martin Glaeser in his discussion of the historical background of regulation, stresses the development of the public utility concept from Roman times forward, and the rationale for government regulation of private industry in the context of its social evolution.¹

Specifically, he provides the historical roots for the distinction between a “just price” and the contemporaneous doctrine of “natural (market) price” which Roman law had derived from stoic philosophy. The underlying rationale for the “just price” doctrine resided in those unique circumstances, such as shortages of necessary food, in which coercion is possible in pricing unique necessities. In order to mitigate the potential exploitation in “market forces” the early Church Fathers developed the legitimacy of trading in which the producer (seller) priced on the basis of the expenses associated with production, compensation

¹ See M. GLAESER, PUBLIC UTILITIES IN AMERICAN CAPITALISM (1957).
for risk, and the cost of storage. This buying and selling was viewed as having common advantages to both parties, and the exchange at "just prices" was distinguished from that fixed in the market.²

The evolution of the public utility concept distinguished those businesses "affected with the public interest" from unregulated enterprise, and underpinned the basic right of the public to goods and services at just and reasonable prices. Before examining the criticisms of regulation, it is essential that this awareness of the regulated business as distinct from the unregulated enterprise, and the unique characteristics of public utilities, be kept in mind in evaluating the desirability of total reliance on market forces.

The attack on the regulatory agencies has come from a wide variety of critics—the administration, the Congress, academics, business users, and general consumers. The common denominator for the criticism is the ever-increasing prices and the deterioration of service. The disparate elements in the criticism reflect the self interests of the various critics. The consumers see the regulators as captives of the industry and emphasize the failure to protect the consuming interests from escalating prices and poor service. The broader criticisms of regulatory commissions concern the inflationary implications of commission activities, the failure to deal with conservation and energy problems in a meaningful manner, and the more general criticisms that regulators have been insensitive to environmental degradation and resource waste.

Undoubtedly there is some truth in all of these charges in the assessment of the current regulatory process. Nonetheless, does it justify, and will the social condition be improved, if we discard the regulatory authority? In this regard it is essential that we separate the theory of regulation and the performance of regulators. If the regulators have failed to develop and implement the necessary social controls to protect the public interest, then we must examine why they have failed, and reinforce and improve the regulatory process to overcome these failures. In the highly idealized advocacy for reliance upon the market place, in lieu of the regulatory authority, we have sublimated consideration of the unique characteristics of the regulated industries—the potential exploitative power of monopoly firms that have been entrenched as "natural monopolies."

The fundamental question still remains. What is the vitality of the public utility concept today? To answer this question we must separate the role of the regulator from the institutional alternatives for regula-

² Id. at 195–205.
Undoubtedly the deficiencies of current regulation reflect a failure to accommodate to change. This is illustrated by the CAB prohibition against charter flights which set prices lower than the scheduled airlines, the trucking cartel, and the over-protection of the railroads by the ICC. In addition, there is validity in the criticism of the regulators for failing to curb monopoly power. Instead commissions have entrenched and concentrated economic power, as manifested in the FPC's failure to deal with the small municipal systems equitable entry into pools, as well as a tolerant policy toward mergers in the past. Lastly, the enforcement of cartelization and legitimizing of monopoly power through the use of the natural monopoly doctrine as a rationalization, has resulted in higher prices, inefficient operation, and resource waste.

The remedy lies in two directions. We must insist that the regulators who are appointed to commissions recognize the regulatory agency as a "social control" vehicle, and differentiate profit maximization standards from public interest standards. Unfortunately the tendency is for regulatory commissions to define and resolve pricing and certificate (licensing) decisions in the context of existing industry structure. The second area for regulatory reform concerns the needed institutional changes which will make regulatory commissions more responsive to public policies which incorporate antitrust objectives.

Even in those regulated industries, such as transportation generally and motor transport in particular, which are considered prime candidates for deregulation there is the danger that firms can segment the market and exploit the inelastic sector. This could result in higher prices and poorer service (if not total discontinuance), than would be possible under continued regulation. As Robert Harbeson, Emeritus Professor of Transportation Economics at the University of Illinois, has pointed out, when trucking was deregulated in Britain the average rate on truck-loads dropped 20 percent, but the rates on less than truck loads increased 40 percent.³

Rather than posing the choices in terms of continuing the status quo (ineffective regulation) or total reliance upon market forces (deregulation), in my view it is preferable to continue but drastically to restructure regulation. The analytical effort that follows will delineate the procedures in the regulated energy utilities (electric and gas) that can be used as a guide in the development of public policy for continued regulation. The essential elements for strengthening regulation require a sensitivity to the need for independent measures of performance of the

regulated firm and the potential for competition in discrete markets. The use of organizational diversity, rivalry, and competitive interplay as a regulatory variable can induce the regulated firms to lower prices, greater efficiency, resource optimization, and technological innovation.

THE TEST FOR PUBLIC UTILITY STATUS

Dr. Glaeser has pointed to the "twilight zone" in which a business at one time not "affected with the public interest" would move into the context of a public utility, and contrariwise move out of "utility" status. He has detailed the essential characteristics which proscribe the firm or industry at a given point in time as "affected with the public interest." When property is dedicated to public use, such as the "common calling" under British common law, where innkeepers and wharfingers were determined to be businesses "affected with the public interest" they were required to serve all comers at reasonable rates. Obviously the public utility status is embedded in custom which grew out of common law.4

The historical test indicates the denial of public utility status for certain businesses (such as ice and theatre tickets) by legislatures, courts, or commissions, but extensions in other cases. This is true of the regulation over the price of milk5 and natural gas.6 The historical test for public utility status is what Glaeser called a "fixed concept with changing content."

Additional characteristics such as the franchise test, that is, the use of public streets and property, is another indication of public utility status. This limited (exclusive) franchise is a means of control of entry predicated on the assumption that duplication of firms or facilities would be wasteful. In addition, to distinguish the public utility enterprise, the service is usually considered necessary for life under modern conditions.

Finally, one of the most significant factors for public utility status is the monopoly test. The assumption here is that unregulated businesses are adequately competitive, substitutes are available, and goods and services are less essential than the regulated industries. The line of cases delineating those monopoly businesses "affected with the public interest" dates back to Munn v. Illinois.7 The "natural monopoly doctrine" postulates the need for a public authority to determine price in industries that are subject to economies of scale, decreasing costs, and can provide economic benefits from a single supplier. The complemen-

4 See M. GLAESER, supra note 1. See also M. GLAESER, OUTLINES OF PUBLIC UTILITY ECONOMICS (1927).
7 94 U.S. 113 (1877).
tary argument is that excessive competition may result in loss or serious deterioration of essential services. Lastly, there is an implicit conservation of resources in the prohibition of unnecessary, usually very large capital investments, for two or more utility firms.

In the development of the public utility concept certain rights and duties have been defined. The duties usually involve the obligation of the utility to provide adequate service to all without discrimination at reasonable rates. The rights have included eminent domain, the privilege of the exclusive franchise, and adequate compensation for rendering service. These are the benchmarks of public utility status and the historical and conceptual rationale for services that are "quasi-social goods."

REGULATORY REFORM

Independent Performance Measures and Refocusing

Regulatory Objectives

Regulatory commissions conceive of ratemaking in the context of cost-of-service and a rate base framework. The policies that have been designed to determine prudent costs essentially reflect an effort to assure full coverage and a fair rate of return. This cost-plus approach provides very little incentive for efficient and optimal use of resources. The corollary is disincentives for seeking lowest cost (price) levels of operation. Regulatory commissions must free themselves from the revenue requirement approach which primarily underpins the expectancies of the monopoly firm and insulates the firm from risk. Regulatory commissions can accomplish this by opening regulated markets to competition, and by developing independent measures of performance.

The regulated firm will seek to eliminate uncertainty by using the political process to influence the appointment of commissioners sympathetic towards the objectives of the firm as a profit maximizer. In addition it will seek to restrict entry (territorial exclusivity) and to pursue those procedures which will insulate the firm against uncertainty.

An examination of the recent modifications in the traditional cost of service rate base regulatory framework indicates a marked and over-riding predisposition on the part of regulatory commissions to insulate the regulated firm from risk and to reinforce the monopoly power of the regulated firm. An examination of the changes in the revenue requirement practices reflects the entrenchment of the regulated firm by using the following regulatory procedures:
1. The tendency to use the projected (future) test year instead of the historical test year which in a period of inflation biases rates upward.

2. The shift to year-end rate base instead of average rate base which biases rates upward.

3. The inclusion of construction work in progress in the rate base instead of capitalizing the interest on funds used during construction, which biases rates upward.

4. The adoption of the fuel adjustment clause, and in at least one instance an indexing approach for other automatic adjustments, which has the tendency to bias rates upwards.

5. The current concern with the difficulties of electric utilities to raise capital (which in fact may reflect inefficient management and lax regulation) has resulted in significant increases in the allowed rates of return on investment above previous levels. In fact, increases which may not be associated with the attendant risks of utility operation.

These distortions in the regulatory process reflect a shift of business and operating risk from the firm to the consumer and embody a built-in predisposition towards higher prices. In addition, there are a wide range of financial programs advocating public subsidies relative to tax reductions through special concessions such as increasing the investment tax credit, and government guarantees underwriting utility debt and other assurances of low cost capital.

To escape the fixed framework of past regulatory distortions there is a need for the regulatory commissions to sense the importance of independent measures of performance. This will permit an objective basis for regulatory review of a cost of service and rate base presentation that can be evaluated in terms of improved efficiency over time of the firm, as well as a comparison of performance with similar firms in the industry.

In this regard the Office of Economics of the FPC developed a number of statistical indicators to measure the performance of private electric companies in the years 1963-70. This data permitted intercompany comparisons as well as year-to-year changes for more than 200 private electric companies. The study consisted of 17 classification items and 20 operating and financial ratios to permit an evaluation of cost trends and cost comparisons.

Building on the earlier FPC study, the National Association of Regulatory Utility Commissioners, reacting to rising electric bills and

concern about the performance of the electric industry, developed the so-called "red flagged" approach to the analysis of utility efficiency. The National Association of State and Federal Regulatory Commissions in sponsoring the study sensed the importance of pressuring regulated firms to levels of efficiency by independent comparisons. In the introduction of the study the point is made that electric utilities function as monopolies, and questioned whether there are adequate incentives for these firms to operate at maximum efficiency.

The "red flagged" approach rated the top 25 percent and the bottom 25 percent of electric companies in each of 8 of the 22 performance categories. The eight categories used were those under the control of the individual company managements and their performance was evaluated on the basis of the following:

1. Capacity utilization;
2. Heat rate;
3. Production expense per Kwh generated;
4. Net utility plant investment per Kwh sold;
5. Total operating expense per Kwh sold;
6. Total operating expenses per Kwh sold (excluding federal, state and local taxes, cost of fuel and purchased power);
7. Total operating expense per Kwh sold (excluding federal, state and local taxes); and
8. Productivity of labor, annual Kwh Sales per employee.

The statistical data on the remaining 14 categories are provided for each company but is not used for comparison purposes because these factors are beyond the control of the individual company managements.

It is essential that regulatory commissions go beyond the use of these rudimentary tools to measure performance in order to refocus the regulatory process beyond the cost of service-revenue requirement context of today's decisionmaking. External information is critical to evaluate the regulated firm's performance and to provide regulators with the basis for insisting upon improvements in those circumstances where they are warranted. Undoubtedly more sophisticated quantitative techniques can be developed in the future to measure cost and production functions of the regulated firms. These will provide additional independent measures for comparisons, and permit regulators to objectively monitor performance of the individual firms.

In lieu of the protective procedures which shift the operating and financial risk of the firm to the consuming public and the ensuing un-

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DEREGULATION OF INDUSTRY

reasonable higher prices, performance yardsticks can move commission activity closer to the public interest standards of a social control mechanism in redefining the regulatory role. The discussion of market structure changes and the use of a competitive regulatory variable that will be developed subsequently should be considered in conjunction with the previous discussion concerning the perfection of independent performance measures to promote efficiency on the part of regulated firms by regulatory commissions.

ANTITRUST AND PRICING IN THE ELECTRIC UTILITIES INDUSTRIES

A review of recent court decisions indicates that the courts symmetrically interrelate the antitrust statutes and regulatory objectives. Since the El Paso case, where the Supreme Court found that the acquisition of Pacific Northwest Pipeline was in violation of Section 7 of the Clayton Act, the objectives of removing antitrust violations and the regulatory determination of public convenience and necessity under certification authority have been joined. As we will see, the courts have prodded commissions to remove anticompetitive conditions and provide opportunities for developing competitive interplay in the regulated electric and natural gas markets.

An examination of the potential for competition, when we look beyond local markets (residential service), indicates a wide range of competitive opportunities for wholesale and industrial sales which can be opened to competition among the regulated electric utilities. It is important that regulatory commissions promote competition as a complementary force to induce improved performance and to provide an environment conducive to greater efficiency and lower prices. Instead of commissions seeking to limit the areas of competition in these discrete markets they should encourage rivalry and competitive interplay.

For years the wholesale tariffs filed by larger private electric companies with the Federal Power Commission contained provisions which were restrictive in their pricing terms and conditions. These tariffs prohibited "full requirements" customers from obtaining power from other utilities. In addition, these tariffs contained provisions prohibiting the purchasers, usually municipal systems, from reselling that power. In effect, this precluded the possibility that the purchasing municipal system would compete for industrial load. It was only the vigorous efforts of various municipal systems that forced Boston Edison to remove these

10 California v. FPC, 369 U.S. 482 (1962).
12 See Municipal Light Bds. v. Boston Edison Co., 45 F.P.C. 1047 (1971); Municipal
restrictions by threatening, and actually pursuing various suits in the courts, that provided for the ultimate modification and removal of these onerous terms.

Again, the question of market foreclosure arose in a proceeding involving the cities of Anaheim and Riverside, California which were tied to "full requirements" by the Southern California Edison Company. Ultimately these restrictions were removed on the basis of settlement of the parties, but the FPC did not in this instance, as in the others, play an important role in removing these restrictive provisions.

An allied issue concerning the "price-squeeze" allegation made by more than half-a-dozen municipalities before the FPC relates to the larger private systems' practice of filing wholesale rates at levels equal to or greater than the same private utility charges industrial customers. The FPC took the position that it did not have jurisdiction over retail (industrial) rates and therefore could not consider the "price-squeeze" issue.

In a recent court decision the District Court of Appeals held that the Commission should evaluate the wholesale rate with a sensitivity to the industrial rate level, and while setting the wholesale rate within the zone of reasonableness it should attempt to modify any anticompetitive implications.

Specifically, the court said:

Petitioners do not ask the FPC to modify or to authorize the modification of retail rates. They have only asked that the interstate rate increase proposed by AP&L be rejected or reduced if the anticompetitive allegations are found to have merit.

It is clear that the court viewed as an important consideration for the FPC determination of wholesale rates the "price-squeeze" implications in setting rates within its regulatory ambit: The court pointed out that the "Federal Power Act does not contemplate that the Commission is to operate in an airtight chamber, insulated from non-jurisdictional factors." In directing the Commission's attention to the importance of competition in the electric wholesale market, the court noted that: "The electric power wholesaler may in fact be seeking to put the retailer out of business." Lastly, the court explicitly charged the Commission with


14 Id. at 720-22.

15 Conway Corp. v. FPC, 510 F.2d 1264 (D.C. Cir. 1975).

16 Id. at 1271 (emphasis in original) (footnotes omitted).

17 Id. at 1272.

18 Id. at 1269 n.6.
the consideration of anticompetitive effects of the regulated aspects of interstate utility operations, and concluded:

On the issue before us, we see a statute that confers plenary jurisdiction to review the interstate wholesale rate and to provide relief addressed to such wholesale rate in order to further the public interest. The Commission has latitude to address the matter in consultation with, and after joint hearings with, the state commission. But it cannot wash its hands of the public interest problem as one totally beyond its jurisdiction.\(^{19}\)

In the decision on a petition by a number of California cities seeking review of a decision by the California Public Utilities Commission granting a certificate to the Pacific Gas and Electric Company to obtain power from geothermal steam sites in Northern California, the court again emphasized the need to consider antitrust implications in evaluating the public convenience and necessity.\(^{20}\) The court held that a close nexus existed between the antitrust allegations raised by the Northern California Power Agency (Cities) and the application for a certificate to construct facilities and to exclude the California cities from participation. The court concluded that the Commission could not ignore antitrust factors on the grounds that they were collateral to the issue of public convenience and necessity.

In a precedent-setting case, the cities of Lafayette and Plaquemine, Louisiana, challenged a routine request by the Gulf State Utilities Company for approval of the issuance of debt securities under Section 204 of the Federal Power Act. The cities raised a number of unique questions concerning the prospective use of the funds by Gulf States to further alleged anticompetitive interconnections and pooling arrangements with other private companies which they contended would preclude competition to the detriment of the cities.\(^{21}\)

The FPC had refused to hear the complaint, and ruled, in a narrow context, that the financing terms and conditions met the requirements of Section 204 and that the complaint was not germane to the requirements under the Act. In effect, the Commission ruled that the question of the use of the funds, and the related activities, was beyond the scope of security approval.\(^{22}\)

The Supreme Court ultimately reversed, remanding the case to the Commission and ruling that it must consider the antitrust and anticom-

\(^{19}\) Id. at 1272.
\(^{22}\) Id. at 1525–26.
petitive issues. The Court stressed that the Commission should serve as the “first line of defense” against those practices that might later be in violation of the antitrust laws. The Court emphasized that the sensitivity to antitrust implication was particularly important in reviewing and approving security issues under Section 204, because at this incipient stage potential complex transactions that could ensue in the future could be avoided.\footnote{Gulf States Util. Co. v. FPC, 411 U.S. 747, 757-62 (1973).}

In this regard, the earlier mentioned $El~Paso^24$ case should have prompted the FPC to foresee the difficulties of permitting an anticompetitive arrangement which ultimately would be overturned by the courts. The Justice Department as early as 1958 had requested the FPC to delay any review of $El~Paso$'s proposed merger with Pacific Northwest until the completion of the antitrust suit which Justice had commenced in 1957.\footnote{California v. FPC, 369 U.S. 482 (1962). See note 10 supra & text accompanying.} The failure to do so necessitated 13 years of agonizing effort to accomplish divestiture, and a needless waste of time and money in complex transactions that were consummated after the merger had been approved by the Commission.\footnote{The FPC had ignored a similar request by the California Attorney General’s office, 20 F.P.C. 357 (1958).}

In $City~of~Paris~v.~Kentucky~Utility~Co.$,\footnote{See, e.g., California-Pacific Util. Co. v. United States, 410 U.S. 962 (1973); Utah Pub. Serv. Comm’n v. El Paso Natural Gas, 395 U.S. 464 (1969); Cascade Natural Gas Corp. v. El Paso Natural Gas Co., 386 U.S. 129 (1967); United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964).} the Commission refused to order Kentucky Utility Company to transport power from a co-op to the city. At the time Kentucky Utilities was the sole supplier of the city of Paris. The power offered by the co-op was at lower rates and would have provided part of the city’s requirements, but it would in addition have broken Kentucky Utility’s exclusive hold as sole supplier. This would have injected competition for future load growth of the city. The FPC, with its usual perception, again served the interests of the large private firm and failed to sense the importance of promoting competition in this market.

This same perceptiveness was reflected in $Otter~Tail~Power~v.~United~States$.\footnote{38 F.P.C. 260 (1967); City of Paris v. Kentucky Util. Co., 44 F.P.C. 45 (1969).} The Commission had initially refused to order Otter Tail to wheel Bureau of Reclamation power to the Village of Elbow Lake, Minnesota. The FPC, as in $City~of~Paris$, concluded that as a matter of law they could not compel Otter Tail to transport power for

\footnote{410 U.S. 366 (1973).}
Elbow Lake. The District Court's remand of this decision to the Commission pointed out that Otter Tail's activities constituted illegal monopolization under Section 2 of the Sherman Act: the refusal to sell (once the FPC had ordered Otter Tail to interconnect its system with Elbow Lake) or wheel power to the municipal system was a violation of the antitrust statute. More importantly, the court stressed—almost as an object lesson—that the antitrust statutes do apply to the electric utilities industry.

The District Court analysis was ultimately affirmed by the United States Supreme Court.

This landmark decision has two important implications. First, it squarely joins the application of the antitrust laws to the regulated electric utilities. Secondly, at a minimum it encourages, if not mandates, that the FPC foster competition in the regulated utilities. It is critical that the FPC take this important opportunity to promote competition, and that it acknowledge the broad benefits in pricing and performance to be obtained from a more flexible market structure. In this regard, the Commission must resist the current efforts by Otter Tail to exact an unreasonable rate for the wheeling of the power to Elbow Lake. If this pricing strategy succeeds, it will undoubtedly frustrate the benefits from wheeling, and undermine the prospects for competition and lower prices to ultimate consumers.

If the Federal Power Commission and state commissions are to promote a greater range of competitive pricing options in the wholesale and retail markets, it is essential that smaller private and municipal systems have access to a wider range of low cost bulk power. In hearings before the Securities and Exchange Commission, the Atomic Energy Commission (Nuclear Regulatory Commission), and the Federal Power Commission there are numerous instances documenting the restrictive practices of the larger private electric systems in refusing to interconnect with smaller systems, wheel power, or sell economy power to the smaller systems.

One example of the problem of small private and municipal systems having access to low cost bulk power is the determination by the Securities and Exchange Commission not to evaluate the antitrust allegations raised by a number of municipal systems relative to exclusion from two nuclear power projects in New England. In the remand of the case to the SEC the Supreme Court indicated that the Commission had

20 However, the Commission did order a temporary interconnection, 40 F.P.C. 1262 (1968) and later a permanent one, 46 F.P.C. 675 (1971).
22 410 U.S. at 372-75.
too narrowly framed the question of approval of the issuance of securities in the establishment of a separate corporation for the Vermont Yankee and Maine Yankee Projects.\textsuperscript{32}

The court held that the SEC was required to look beyond the question of control by the individual participants in the nuclear projects. Further, the Commission was obligated to look beyond the Public Utility Company Holding Act and to review the evidence concerning the antitrust allegations made by the municipal systems relative to exclusion from participating in ownership of the nuclear facilities. The Court stressed that concentration and control by the large private systems over low cost nuclear power could have anticompetitive effects, and the prohibition of municipal participation would effectively block them from low cost power and preclude effective competition in the future.\textsuperscript{33}

The SEC had requested a review of the District of Columbia Court of Appeals' decision that the Commission must take into account the policy underlying the Clayton Act in deciding whether or not to approve the stock acquisition arrangements for the new nuclear corporations. The Court of Appeals explicitly stated that the statute required the Commission to take into account the policies underlying the Clayton Act in the approval of the stock arrangement.\textsuperscript{34}

The general question of access to low cost bulk power, and the implications for a more competitive wholesale and retail market, underlies the review by the Justice Department of applications for nuclear licenses before the Nuclear Regulatory Agency. Section 105(c) of the Atomic Energy Act\textsuperscript{35} requires the Attorney General to determine whether any activities under the license would create or maintain a situation inconsistent with the antitrust laws. The intervention by the Justice Department, and the review of license applications recommending a hearing, reflects a broad interpretation seeking the removal of all anticompetitive restraints by the private utility seeking a nuclear license. The Justice Department has argued that the utility must not only provide access to the new nuclear units, but must also remove all constraints on interconnection and coordination, wheeling, and access to other supply alternatives.\textsuperscript{36}

Another ramification of the general problem of access to low cost bulk power supply concerns the exclusion of, or onerous terms for, the

\textsuperscript{33} Id. at 183–84.
\textsuperscript{34} Municipal Elec. Ass'n v. SEC, 413 F.2d 1052 (D.C. Cir. 1969).
\textsuperscript{35} 42 U.S.C. § 2135(c) (1970).
\textsuperscript{36} Consumers Power Co. (Midland Plant, Units 1 and 2), Nuclear Regulatory Comm'n Docket Nos. 50–329A, 50–3302.
smaller system with regard to power pools. During the 1960's, when power pools expanded and new pools were organized to achieve greater reliability and lower cost power for the major private electric utilities, the majority of the pools denied entry to small private and municipal systems. This practice of limiting membership to the larger private electrics, for example the New England Power Pool, was subsequently modified and some of the new pooling agreements admitted smaller private and municipal systems to membership. The terms usually reflected a continuation of control in the larger private systems. (This is not to suggest that all prohibitions have been removed relative to entry by municipals or small private systems.)

The essential problem—dominance by the larger private companies of the power pools and their preferential access to low cost power from pools—still remains. While these modifications, and the acceptance of the smaller systems into pooling arrangements are important steps, it is essential that regulatory policies be designed to make power pools more democratic in terms of control, and that the discriminatory or preferential terms in the various power pooling agreements be changed to provide uniform benefits and costs to all members.

Lastly, the allocation of exclusive territory for business operation would be considered illegal in the unregulated industries, but the exclusive franchise is accepted as a matter of course in the electric utility industry. There appears to be a failure to delineate the justification in residential markets, as distinct from industrial and wholesale markets, for exclusive territorial operation. Recently the Justice Department obtained a settlement by consent decree and eliminated the territorial restrictions on the sale of bulk electric power which had been entered into between Florida Power Corporation and Tampa Electric Company. The settlement removed restrictions on the wholesale sale of power to the cities of Bartow and Sebring, Florida, by which the two private companies had agreed not to sell in each other's territory. The consent decree prohibited the private companies from allocating or imposing restrictions on the customers or territories in which each would market bulk power for resale. It is important to note that the attack on territorial division in the sale of wholesale power was pursued by the Justice Department, and not by the Federal Power Commission. In a case involving the city of Gainesville, Florida, the FPC again avoided the question of territorial exclusivity by refusing to examine the contention by the city that it had the right to extend service to a suburban area.

which the Florida Power Corporation contended was covered by its franchise.\textsuperscript{88}

\textbf{ANTITRUST AND PIPELINE REGULATION}

In the landmark \textit{El Paso}\textsuperscript{89} case the Supreme Court determined that the evidence of antitrust violations is relevant under the Natural Gas Act, and is particularly so in regard to the standard relating to "public convenience and necessity." The ultimate culmination and the divestiture of the Pacific Northwest Pipeline properties by El Paso required more than 13 years to accomplish after the initial merger was approved by the FPC in 1959. The Court found that the merger violated the Clayton Act and stressed that it significantly reduced competition in California and the Northwest generally. It is ironic that at the final stages of the lengthy litigation the FPC supported the application of an existing pipeline, Colorado Interstate Gas Company, and failed to agree with one section of its staff supporting a new entrant which would have the potential of promoting interpipeline competition.

In the precedent-making court test of \textit{Lynchburg Gas Co. v. FPC},\textsuperscript{40} the company requested a review of the FPC's procedure in authorizing a new rate schedule by the Atlantic Seaboard Corporation (a pipeline affiliate of the Columbia Gas system). The schedule provided for higher rates for resale customers who obtained less than their full requirements from Seaboard. The petitioner contended that the approval of the partial requirements distinction created an unreasonable restraint upon trade and was discriminatory and in violation of the antitrust laws as well as Section 5(a) of the Natural Gas Act.

The court determined that the Commission's approval of the partial requirements status and payment for natural gas, even if not actually used, was not supported by findings based on the record. More importantly, the court emphasized that while the FPC was not responsible for enforcement of the antitrust laws, it must consider the intent of those laws in the context of public convenience and necessity of Section 7 proceedings under the Natural Gas Act. In remanding the case to the Commission, the court stressed that it was obligated to consider whether the rate foreclosure or the tendency to foreclose competition by the full requirements provision would place a discriminatory burden on the customer.\textsuperscript{41}

\textsuperscript{88} City of Gainesville v. Florida Power Corp., 40 F.P.C. 1226 (1968).
\textsuperscript{89} California v. FPC, 369 U.S. 482 (1962).
\textsuperscript{40} 336 F.2d 942 (D.C. Cir. 1964).
\textsuperscript{41} Id. at 946-47.
In *Northern Natural Gas v. FPC* (the Great Lakes case) the District of Columbia Court of Appeals remanded the case to the FPC and criticized the Commission for failure to review the antitrust implications when they certified the Great Lakes project permitting the American Natural Gas Company a 50 percent interest in the new line. The court emphasized that the joint venture (between Trans-Canada Pipeline and American Natural) could have substantial anticompetitive effects on the marketing of gas in Michigan and Wisconsin. The lengthy court analysis of the concentration in the Michigan and Wisconsin markets and the "tight" oligopoly manifest in American Natural's dominance in the Michigan market was underscored in the opinion. The court criticized the Commission for ignoring the potential benefits of increased competition, and posed as an alternative to the FPC decision the requirement that American Natural divest itself of ownership in the Great Lakes line.43

The remand of the case to the Commission suggested that if extenuating circumstances were found, then the corporate relationships could be continued as a counterweight to the anticompetitive implications.44 The Commission subsequently delineated the special circumstances which were postulated as "extenuating" to underpin their original certification.45 Unfortunately, the Justice Department did not appeal the Commission decision and clearly force a definitive determination as to whether the antitrust statutes are overriding and require a conformity by the regulatory bodies.

**Conclusion**

This discussion of regulatory reform has articulated a middle ground between continuing the regulatory status quo and exclusive reliance on market forces. This "third choice" reflects the need to reorient regulatory objectives so that commissions define their role as the implementation of social control of business. This requires the formulation of public interest standards with clear and unambiguous differentiation from the objectives of the regulated firm.

One of the areas which most urgently requires public policy formulation is the refinement of independent performance measures to determine the comparative efficiency of the regulated firm, as well as the monitoring of performance of the individual firm over time. In addi-

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42 339 F.2d 953 (D.C. Cir. 1968).
43 44 Id. at 959-71.
44 Id. at 977.
tion, potential competition in discrete markets and submarkets suggests significant benefits for the regulatory process and provides the opportunity for inducing improved performance of the regulated firm with the attendant benefits to the consuming public.

Past commission action seemingly has postulated the objectives of regulation with an insensitivity to the antitrust statutes. The courts have continually attempted to broaden the objectives of regulation and have emphasized the need to conceive of public interest alternatives in the light of the antitrust laws. Past regulatory decisions by the FPC in the electric power and natural gas industries reflect various facets of market foreclosure, refusal to deal, entry restrictions, and a wide range of anticompetitive arrangements. It is necessary for commissions to open up market opportunities in the regulated industries and to sense the benefits to the overall consuming public of removing anticompetitive blockages that have existed in the past.

It is essential that regulatory commissions acknowledge the potentially broad public benefits of promoting the rivalry and competitive interplay which offer the promise of superior performance by firms in the regulated industry paralleling the same expectancies that exist in the unregulated sector. By subjecting the regulated firm to greater competition, the potential for greater efficiency, innovation, and more rational resource use will be achieved. It is critical that the regulatory commissions promote competition, and realize that the antitrust laws do apply to regulated industries.