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ANTI-TRUST IN THE NEW [DE]REGULATED NATURAL GAS INDUSTRY

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I. INTRODUCTION

This Article explores the evolution of a new regulatory model in the United States. The deregulation movement has produced "a reduction or substantial elimination of regulatory constraints whose scope is unprecedented in modern American history."[1] The Article uses natural-gas deregulation to consider the extent and nature of the agency oversight still needed in deregulated markets whose performance deeply affects the public interest.

Natural-gas deregulation is a good test case for several reasons. One is that gas deregulation is widely viewed as a successful process.[2] The gas example has become a major piece of evidence in the debate over govern-

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1. SAM PELTZMAN, *The Economic Theory of Regulation after a Decade of Deregulation, in* BROOKINGS PAPERS: MICROECONOMICS 1989 1 (1989).

2. Consider for instance the contented remarks of Richard Pierce, one of the major intellectual proponents of early and thorough natural gas deregulation:

> The FERC can take pride in an extraordinary accomplishment. In most respects, [deregulation has exceeded] even initial optimistic expectations. [It has produced] significant rationalization of the gas transportation and storage functions, in addition to the expected beneficial effects on the gas sales market. . . . Moreover, the participants in the post-transition market, including many who originally opposed the transition, have discovered that the post-transition market can produce good results for service providers as well as consumers.

Richard Pierce, *The State of the Transition to Competitive Markets in Natural Gas and Electricity,* 15 ENERGY L. J. 323, 323-24 (1994). *Accord,* Robert Hahn & John Hird, *The Costs and Benefits of Regulation: Review and Synthesis,* 8 YALE J.ON REG. 233, 251 (1991)(listing $.2 to $.4 billion in efficiency costs per year from gas regulation, and $5 billion in welfare transfers, which economists, of course, with their determination not to compare inter-personal utilities, deliberately refuse to value).

Though not quite as bullish, the implication of success is inescapable in the Commission's recent pronouncement in its incentive-rate order: "By regulating pipelines in a manner that seeks to ensure all shippers have meaningful access to the pipeline transportation grid, the Commission has created a regulatory environment intended to maximize competition." *Statement of Policy and Request for Comments, Alternatives to Traditional Cost-of-Service ratemaking for Natural Gas Pipelines,* Docket no. RM95-6-000, at 3 (Jan. 31, 1996)[hereinafter cited as *Incentive Rate Order*]. The Commission would not be preceding with more experimentation if it believed its earlier efforts were proving to be failures. *See also* Foster Report No. 2073, *Moler Defends FERC's FY 1997 Budget Request Against Any Further Cuts in Staffing of Natural Gas Programs*, at 1 (Mar. 28, 1996)(Chair Elizabeth Moler less cautiously claiming "billions and billions of dollars" in savings from Order 636).

It can seem as if the Commission has decided that competition should prevail as a matter of ideology, not because new proof of competitiveness has been brought to its attention. *See, e.g.*, Chairwoman Moler's announcement accompanying Orders 888 and 889, the new electricity deregulation orders:

> Today's action by the Commission will benefit the industry and consumers to the tune of billions of dollars every year. They will give us an electric industry ready to enter the 21st

ment intervention into economic activity. Trends in natural gas have great symbolic importance because gas distribution has been viewed as an archetypal natural monopoly since the last century.[3] Many now view the natural gas experience as proof that the state can leave even many components of monopolized industries to the market without encouraging abuses of power.[4]

Second, large parts of the industry have been completely deregulated. Thus natural gas offers a strong test for the implications of returning realms of activity entirely to the market. Total deregulation should make it easier to spot abuses.

Third, institutional as well as cultural reasons (i.e., the Federal Energy Regulatory Commission (FERC) also has jurisdiction over interstate electricity) ensure that reforms like open-access and unbundling will be applied to other industries, starting with electricity.[5] An imitative intrastate dereg-

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century. These rules will accelerate competition and bring lower prices and more choices to energy customers.

> The future is here — and the future is competition. It is a global trend, and in North America, we are at the forefront in embracing it. There is no turning back.

FERC, *News Release: Commission Orders Sweeping Changes for Electric Utility Industry* (Apr. 24, 1996). The fact that something is a "global trend" has never been a reason to embrace it. The issue has been and must remain, what do we know about these markets, how can we tell if they are working, and what do administrative agencies need to do to make those judgments?

To some extent, success at achieving deregulating is being confused with the success of deregulation. Many economists have become sure that traditional regulation cannot be an efficient way to govern markets. *See* Michael Fix & George Eads, *The Prospects for Regulatory Reform: The Legacy of Reagan's First Term*, 2 YALE J. ON REG. 293, 294 (1985)(observing that as early as end of Carter Administration, "a consensus had emerged among many economists and policymakers that economic and social regulation was overly expensive, inflexible, arbitrary, and ineffective"). To some, getting the government out of business decisions is cause enough to proclaim victory. They may overvalue the immediate savings from jettisoning the regulatory structure without considering the risks as pipelines adjust their strategies, prices, and products. They avoid getting dirtied in the empirical question of whether the effects of government withdrawal have been beneficial.

3. Natural gas distribution has a respectable history as the archetypal "natural monopoly" case. *See* Richard Pierce, *Reconstitution the Natural Gas Industry from Wellhead to Burnertip*, 9 ENERGY L.J. 1, 2-4 (1988)(discussing John Stuart Mill's use of London's natural gas market in his PRINCIPLES OF POLITICAL ECONOMY).

4. It probably is no accident that this conclusion comes at the same time economists have been focusing attention on the "transaction" costs underlying what once were viewed as single corporate decisions, analyzing when firms go to the marketplace for goods and services and when they produce goods and services for themselves. The major work, the founding work for economists' conscious study of the make or buy decision, is Ronald Coase's *The Nature of the Firm*, 4 ECONOMICA 386 (1937), reprinted in RONALD COASE, THE FIRM, THE MARKET, AND THE LAW 33-55 (1988). Coase is a dominant influence on Oliver Williamson, who has extended the model. *See, e.g.*, OLIVER WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALSIM (1985). Principal/agent theory and Williamson's transactions cost approach study the dynamics of institutional choice, with organizational structure (in Williamson's case, the structure of economic transactions) being an independent variable, not an exogenous constraint.

5. Congress mandated open access to electrical transmission lines in the Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776, 2905 (1992). The Commission has ensured broad open access in wholesale electricity by imposing open access in Order No. 888, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, 61 Fed.Reg. 21, 540 (1996) [hereinafter Order 888].

ulation is rippling through the state-regulated local distribution systems in both industries.

Finally, natural gas is a good case study because there is a detailed public record, with clearly articulated differences, for each step of deregulation. Congress laboriously debated the first step, the Natural Gas Policy Act (NGPA). The FERC has taken additional steps through administrative orders and rulemaking. The record is more detailed than usual because appellate courts remanded each major FERC order for additional findings. While the orders at times lack reasoned elaboration, the positions of the major participants and the Commission are spelled out clearly (if not always demonstrated empirically) in the record.

The traditional American regulatory model was intrusive. An agency approved filed rates to prevent exploitation of market power. Regulators oversaw "just and reasonable" and nondiscriminatory rates as proxies for competition.[6] They limited entry and exit.[7] They also protected returns on

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Richard Pierce cautions against fully equating the painful but now largely complete natural gas experience with electricity, for reasons including the much larger size of "transition" or "sunk" costs and the vertical integration of electricity companies which, he predicts, will prevent them from imposing as much of these costs on their suppliers as pipelines successfully fobbed off on producers. Pierce, *supra* note 2, at 335-37; for a modest proposal to focus electrical competition on service for new business, see Jeffrey Leitzinger, *Why Deregulate Electric Utilities?* Speech at National Association of Regulated Utility Commissioners (New Orleans, November 1995). One major change in electricity is the Commission's decision to let utilities recover all their stranded costs, *News Release, supra* note 2, at 1, Fact Sheet 1. If the Commission is serious, this rule may avoid litigation like the natural gas take-or-pay experience, but it will mute and delay the impact of competitive forces. It also will put tremendous pressure on utility customers to identify arguments of imprudence or on other bases that let them challenge pass-through of what often will be overpriced, unnecessary facilities.

Richard Pierce makes the surprising argument that, in contrast with what he believes of electricity, the "structure of the gas industry prior to the transition to a competitive gas market did not differ significantly from the optimal post-transition industry structure." Pierce, *supra* note 2, at 342. This may be true of pipelines, which could be transformed by open access, but it leaves out the differentiation of marketing and field services from transportation and the difference those changes have made.

For a demonstration of how closely the electricity issues will track natural gas, see the reliance on natural gas examples in the six articles on the transformation of the electric industry 64 ANTITRUST L. J. Winter 1996.

Institutional adjustments to the commonalities in these two markets continue. The Natural Gas Clearinghouse, claiming to now operate under an "energy store" concept, has "modified our trading and marketing activities toward the ultimate convergence of markets for natural gas, electricity, and other energy commodities," in part by setting up Electric Clearinghouse as well. Stephen Bergstrom & Terry Callender, *Gas and Power Industries Linking as Regulation Fades*, OIL & GAS J., Aug. 12, 1996, at 59. In Bergstrom's view, "[t]his process of one industry learning from another is inevitable as electricity and natural gas come to be traded in a nearly unified energy market." A necessary caveat is that the Natural Gas Clearinghouse has a big bone in this fight; it proposes that "independent system operators" be set up to run the "commercial transportation transactions," though not the physical operation of pipelines. *Id.* One can guess which company would be ideally situated to begin providing these services. Pipelines understandably are not going to jump at the chance to be demoted to mere mechanics.

Concurrent deregulation does raise the interesting question whether the mmbtu prices of alternative fuels will converge, in the way that it once seemed that oil and gas prices reflected an underlying heating value (a linkage that became harder to see with the distortions of gas wellhead regulation).

6. The Natural Gas Act requires that all gas sold under its jurisdiction be sold at "just and reasonable" rates and deems all rates and charges not satisfying this requirement "unlawful." Section

capital but made monopolists commit to service levels in exchange. The justification for government intervention was the still-accepted economic theory that given economies of scale, rational companies have the incentive and power to set too high a price, produce too little, and appropriate gains that would have gone to consumers in more competitive markets.[8]

In most markets, the antitrust laws, rather than direct standard-setting, defined unacceptable uses of power from conspiracies to fix prices and divide markets to such unilateral attacks on competition. Unregulated companies with monopoly power were allowed to flex their muscles even if very high prices resulted. Congress capped the rates and limited entry only in industries it deemed too important to risk monopoly abuses. These industries tended to have economies of scale characteristics that helped big companies keep competitors out of the market.

This national pattern embodied an industry-by-industry trade-off between antitrust enforcement and government regulation. The combination of antitrust laws in some markets and cost-of-service ratesetting in others (with those markets retaining some antitrust exposure) formed a single but modulated, economy-wide system of handling market power.[9]

4(a), 15 U.S.C. § 717c(a)(1976). It forbids granting any "undue preference or advantage" or maintaining "unreasonable difference[s] in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service." *Id.* section 4(b), 15 U.S.C. § 717c(b)(1976).

7. The FERC has authority to compel expansion of natural gas facilities (as long as it does not "impair [the pipeline's] ability to render adequate service"), to prohibit abandonment without Commission permission, and to prevent building new facilities unless the Commission issues a "certificate of public convenience and necessity." § 7, 15 U.S.C. § 717f.

8. For an overview of the traditional economic justification, see F.M. SCHERE & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 21-29 (1990). In the traditional justification, government should intervene when "the size of an efficient enterprise is so large relative to the size of the market serviced that competition fails adequately to discipline costs, prices, and product qualities." *Id.* at 9. F.M. Scherer notes that "few industries satisfy the criteria for class public utility regulation unambiguously. Scherer immediately follows this introductory part of his book with a section on "qualifications and doubts," *id.* at 29-33, and on the theory of the second best, 33-38, reminding his readers at the outset of the complexity of fitting the economic world to the theoretical constructs underlying government regulation. *See also* ALFRED KAHN, THE ECONOMICS OF REGULATION 153, n.109 (1988).

Direct government intervention has been more frequent than cost concerns would dictate because of other kinds of market imperfections; because of regulation occurring for political rather than economic goals; and because of capture problems. SCHERER & ROSS, *supra*, at 9-11; *see also* KAHN, *supra*, at 3-12 (noting that regulation initially was justified as regulating companies that operated under government franchise, but tracing expansion of areas of regulation and including in economic rationales the "importance of industries," measured by size and "influence, as suppliers of essential inputs to other industries, on the size and growth of the entire economy"; natural monopolies; and industries where "for one or another of many possible reasons, competition simply does not work well."). For a more cynical capture view of regulation, see generally ROBERT BRADLEY, OIL, GAS AND GOVERNMENT (1996).

9. Though antitrust "often is viewed as a form of government regulation," there are "major philosophical differences" between it and formal regulation:

> Traditional regulation usually requires a continuing relationship between regulator and regulatees as market conditions change and compel price and capacity adjustments. Antitrust, on the other hand, is ideally episodic—more like surgical intervention than the steady administration of medicine to treat a chronic disease. Conduct rules are articulated, and

Deregulation will shift the regulatory balance towards the antitrust laws. In market after market, from airlines to banking, trucking to telephones, electricity to natural gas, the cost-of-service edifice has been wholly or partly dismantled. The received wisdom behind these changes is the cost-of-service regime is too inefficient and markets are more vigorous and irrepressible than formerly believed. This ideology of deregulation is both political and economic. More often it is a matter of belief rather than demonstrated analysis. Yet it has pushed deregulation into the farthest reaches of formerly regulated activity.[10]

The pattern of deregulation has varied by industry and can be institutionally very intricate. To consider the risks of the natural gas market, the first section of this Article details how the FERC has injected competition into the natural gas business. It treats the stream of Commission orders as an organizational experiment and focuses on its competitive rationale. The rationale is important because it suggests that if market power reappears, the justification for deregulation will support a return to some kind of controls.

One element of the new regime will be an emphasis on information. Virtually every deregulated market suffers from a lack of information. The dismantling of the administrative apparatus is drying up the flow of cost, revenue, and profit information that customers and regulators once used to measure the state of the market. Natural gas is no exception. The FERC has left producers and consumers very little information to determine how well the new world is working.

To illustrate the kind of information problems that can exist and the direction in which continuing government oversight should head, Part Two undertakes a case study of the gas gathering operations of Williams Field Services in the San Juan Basin in northern New Mexico. The example shows how great market power can exist after deregulation. When it does, information imperfections will defeat customers who suffer injury and regulators worried about consumer welfare unless they have a government-provided source of data.

Part Three turns to one substantive basis for any effective system of post-regulation controls, the antitrust laws. This traditional tool against abuses of market power will assume new importance as regulators seek lighter-handed standards. Yet many of the economic theories supporting deregulation seem to support a narrowing of antitrust protection. Part

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violations are penalized at a frequency and intensity just sufficient to achieve adequate deterrence. Or the antitrust authorities intervene to maintain or alter market structures so that good conduct and performance are expected to follow automatically, without further government involvement.

SCHERER & ROSS, *supra* note 8, at 11-12; *cf.* MARTHA DERTHICK & PAUL QUIRK, THE POLITICS OF DEREGULATION 14 n. 34 (1985)(arguing that phone and transportation deregulation was to substitute antitrust for public utility regulation, so "it was a change in technique rather than retrenchment, yet for most industries most of the time, antitrust supervision is a less penetrating and pervasive form of intervention . . . ").

10. For a summary of the accrued arguments against the traditional regulatory model, *see infra* note 118; for the similar arguments against antitrust intervention, *see infra* section V.C.

Three examines these theories and discusses the extent to which antitrust protections still should sway regulators and courts. In addition, it discusses the causes of action most likely to apply in deregulated markets.

Private antitrust enforcement cannot police deregulated markets without assistance because private parties will lack the information to prove abuses of power. Part Four discusses how administrators can make enough information available for injured parties to determine what has happened to them and act accordingly. The FERC's rapid abandonment of its jurisdictional responsibilities and the lesser resources of state regulators make it unlikely that either body alone will maintain effective measures. This section discusses institutional measures, including a F.E.R.C./state board under the FERC's joint-board power and combined state action under the Interstate Oil and Gas Compact Commission, that could oversee deregulated gas markets most efficiently.

The deepest question of every deregulated market is whether its natural tendency is toward concentration once all transitional dislocations are over. Will these markets end up as monopolies, perhaps a collection of geographically monopolized submarkets? At the price level, will companies be able to reimpose discriminatory prices and charge monopoly rates? Part Five argues that the FERC and state administrators cannot abandon their responsibility for the evolving market. In the short run, this may mean state complaint structures that require open access and outlaw discrimination and certain anti-competitive contract terms. In the long run, the states and the FERC will need to remain concerned with overall market dynamics, define competition in high economy-of-scale markets, and determine whether the experiment is working.

II. Administrative Competition-Forcing and Natural Gas Deregulation

Institutions get short shrift in much economic analysis, but the structure of regulation and the path of its removal are key facts for understanding the way the FERC has stimulated competition and the risks created by its decisions. Particularly noteworthy is the Commission's frequent failure to support its assumption of competitiveness of the deregulated markets, and the near certainty that at least parts of them will not be competitive.

A. The Ancient Regime

The predominant fact in the history of the Twentieth-century natural gas industry in the United States is monopoly. Interstate natural-gas distribution was regulated in the Thirties to cure market abuse committed by large energy holding companies. Decreasing costs gave first entrants an advantage unrelated to efficiency. This cost structure remains important because, as in some other deregulated markets, nothing has removed the advantage of large systems. The costs of laying pipe vary with many factors, including terrain and climate as well as efficiency, but overall there are large economies of scale in the fixed costs of gas transportation and low

variable costs.[11] Established companies have an incentive to drop their prices as far as possible to exclude competition. Removing government controls over entry, exit, rates, and terms of service may lead to gradual concentration, as the larger companies adjust to market cultures and begin to flaunt their power.

Natural gas markets developed more slowly than oil because there was no way to transport gas cheaply over long distances. Gas pipelines expanded after the development of steel pipe in the Twenties.[12] In the Thirties, studies by the Federal Trade Commission found a high level of power and market abuse that led to regulatory controls on interstate gas transportation in the Natural Gas Act (NGA).[13]

Congress excluded "production and gathering" from NGA regulation.[14] The Supreme Court nonetheless would read the NGA as applying to gathering, processing, and even to the wellhead price of gas as long as it moved in interstate commerce.[15] By the Fifties, regulated pipelines domi-

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11. Pipelines generate great economies of scale. F.M. SCHERER, INDUSTRY STRUCTURE, STRATEGY, AND PUBLIC POLICY (1996). Costs fall sharply as volumes increase, so large pipelines should be able to undercut new entrants even while keeping their prices above their own costs.

The threat of lower costs can impose a barrier to entry even if the pipeline does not actually cut prices, as long as potential market entrants are aware of the power the pipeline possesses to do so and perceive this risk as a credible threat. *See generally* Steven Salop, *Strategic Entry Deterrence,* 69 AM. ECON. REV. 335 (1977).

12. Until the Twenties, trillions of cubic feet of natural gas were flared into the atmosphere as an undesirable and potentially dangerous companion to oil production, just as today in Alaska huge volumes of gas are reinjected into wells or used to fuel oil production, pending someone's building a gas pipeline to get the gas to large consumer markets.

13. The story is told briefly in RICHARD VIETOR CONTRIVED COMPETITION, 98-105 (1994); Pierce, *supra* note 3, at 4-8.

14. Passed at a time when the commerce clause on occasion still was read restrictively, the Natural Gas Act seemed to apply to gas moving in interstate commerce but exempted gas gathering and production. 15 U.S.C. § 717(b)(Supp. 1996).

15. Three Supreme Court cases generated the expansive reading that even the gathering, processing, and production of gas in interstate commerce was regulated, as the reach of price regulation became as extensive as an expanding commerce clause.

In Colorado Interstate Gas Co. v. FPC, 324 U.S. 581 (1945), the Supreme Court held that the Commission could include the gathering and processing facilities of "mixed" interstate and intrastate gas in a regulated rate base. Two years later, in Interstate Nature Gas Co., Inc. v. FPC, 331 U.S. 682 (1947), the court extended federal rate regulation to sales by a producer and gatherer, all of whose activities lay in a single state because the gas was bought for shipment into other states.

The *Interstate* facilities seemed to have a fairly direct link with interstate commerce because other affiliates of the petitioner operated the interstate pipeline that moved the gas in interstate commerce. Even this link was broken in Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954). Phillips did not own a pipeline; it only operated intrastate gathering and producing facilities. The Court nonetheless found Phillips' wellhead prices regulated, as well as its gathering, because once Phillips sold its gas the gas was consigned for resale in interstate commerce. *Id.* at 685. That was all it took to expand jurisdiction. (The jurisdictional crutch for this holding is the NGA's definition of a "natural-gas company" as including companies that sell gas in interstate commerce "for resale." 15 U.S.C. § 717a(6)). The decision led to twenty years of administrative struggles over how to set wellhead prices.

Congress tried to override this result. President Truman already had vetoed a pre-*Phillips* bill that would have blocked the Court's expanding Natural Gas Act reading. President Eisenhower did the same to a post-*Phillips* amendment early in his administration. Neither veto seems to have been based on the merits. For this history, see VIETOR, *supra* note 13, at 104-06. Federal regulation of wellhead

nated the interstate markets. These companies performed all the services needed to buy gas in the field and bring it to market. They bought gas, took title at the wellhead, and assumed the sales risk in consumer markets. Pipelines gathered, processed, stored, transported, and marketed natural gas. They brought it thousands of miles to their customers. They "bundled" these services into a single service and price. The pipelines were not open access;[16] instead they owned virtually all of the gas moving through their pipes. This unitary service remained fully regulated until the early Eighties.

The FERC set pipeline rates to achieve an allowed rate of return upon the pipeline's ratebase, the depreciated cost of its capital. Cost-based rates had distinct incentives. First, rate-of-return pricing created an incentive to install costly plant. Total allowed profit increased with the ratebase.[17] Second, the pricing structure removed pressure to keep certain costs low.

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prices would last, in spite of many critics, until the 1978 Natural Gas Policy Act included provisions to phase out regulated prices over most interstate natural gas.

16. In contrast, Congress required open access oil pipelines in a 1906 statute designed to limit the power of Standard Oil Company, which had been building and acquiring pipelines to enforce its monopoly in oil processing and distribution. *See generally* Farmers Union Central Exchange, Inc. v. FERC, 734 F.2d 1486, 1492-85 (D.C. Cir. 1984)(surveying background to oil open access before striking down market-based open access rates); DANIEL YERGIN, THE PRIZE, ch. 2 (1993). Open access was not enough to constrain the tremendous market power that John D. Rockefeller captured in his refining and distribution empire. In 1911 the Justice Department secured a conviction for antitrust violations and a decree splitting Standard Oil into a series of regional companies. Standard Oil v. United States, 221 U.S. 1 (1911).

Richard Pierce argues that the initial plan for gas regulation was an open-access, common-carrier structure, but that pipelines sought "a form of government intervention that would protect them from competition in both the transportation and the sale of gas" instead. Pierce, *supra* note 3, at 6. For a more general complaint about pipelines dominating the process of regulation, see BRADLEY, *supra* note 8, at 855-57 (arguing utilities were primary supporters of early state regulation), 863-71 (pipelines were not "unfavorable" to regulation and liked entry barriers).

17. The pressure to install too much capital is known in economics literature as the "A-J-W" effect after Harvey Averch, Leland Johnson, and Stanislaw Wellisz. It is discussed in II ALFRED KAHN, *supra* note 8, at 49-59. One of the seminal articles by Wellisz was on natural gas—Stanislaw Wellisz, *Regulation of Natural Gas Pipeline Companies: An Economic Analysis,* LXXI J. POL. ECON. 30 (1963).

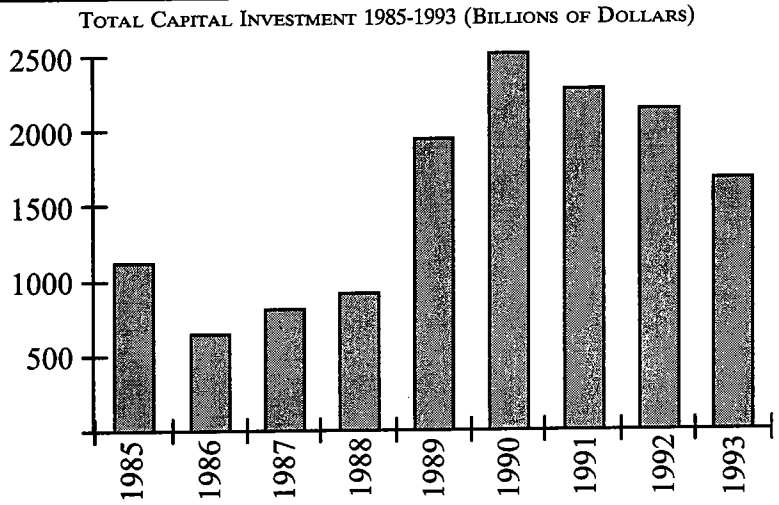
Some countries have adopted incentive pricing, the best known the RPI-X price structure, in which pipelines have their rates set with a shrinking return, so they must increase their efficiency to do well. For a discussion, see M. Beesley & S. Littlechild, *The Regulation of Privatized Monopolies in the United Kingdom,* 20 RAND J. ECON. 454 (1989). Only pipelines that can generate efficiency savings will make substantial profits in this structure.

The increase in investment and in acquisitions following deregulation draws into question whether regulation led to overinvestment, at least in this industry. For mergers, see *infra* note 204; on investment, the following is a chart compiled in 1994 on the 21 largest interestate pipelines, using data from their annual reports. It shows that reported investment appears to have increased in the early years of deregulation, and leveled off and then fallen somewhat after 1990. The overall increase is striking.

Unlike capital expenditures, gas costs "passed through" to customers.[18] Pass-through muted incentives to be careful. Third, the structure arguably shielded pipelines from economic failure. Pipelines could be relatively comfortable that the Commission would set rates high enough for them to recover their capital costs, plus a "reasonable" rate of return.[19] This was an added institutional reason why pipelines did not have to think through the worst-case scenario for decisions like their take-or-pay purchases.

B. The Take-or-Pay Crisis and the Impetus for Change

Natural gas deregulation is intimately tied to the gas purchasing structure. Regulated prices did not respond effectively to the energy crises in the Seventies. Probably as much blame should fall on regulators and consumers as on the pipelines; not only did regulation mute market signals, but regulators probably never would have allowed the rapid price increase that was needed to bring interstate gas prices in line with world energy prices. Allowing agencies vote on prices encourages the consideration of costs as political variables, rather than as reflections of true supply constraints.[20]



18. The Commission would refuse gas pass-through only if it determined the costs were violated a fraud-or-abuse standard. For a discussion of the standard in a take-or-pay case, see Office of Consumer's Counsel v. FERC, 783 F.2d 206, 277 (D.C. Cir. 1986). Richard Pierce has argued that this standard, which is more deferential to the pipelines than the standard prudency standard, is one of the factors that distorted pipeline purchasing practices. Richard Pierce, *Reconsidering the Roles of Regulation and Competition in the Natural Gas Industry,* 97 HARV. L. REV. 345, 359-62, 366-68 (1983). He was pessimistic, however, about whether shifting to ordinary prudence review would cure the problem. *Id.* at 373-86.

19. *Id.* at 363-65 (citing pipelines' presumption of protection as one of many imperfections of old system). Pierce's influential article listed other reasons why regulation sent pipelines the wrong signals: barriers to entry, the shelter of fraud-and-abuse standards, the distortions of average cost pricing, the incentive to buy gas from high-priced affiliates under the "*Mid-La*" standard that applied to affiliate purchases, and the incentive to use high-priced capital even if cheaper gas or facilities were available. *Id.* at 357-70.

20. Though this is a problem with regulation, not a fatal disease, it is one place where the largely exaggerated criticisms in Richard Bradley's big book have some grounding. *See* BRADLEY, *supra* note

(And, of course, without competition as a mediator, the prices regulators see often are artificially unhinged from true costs in the first place.) Natural gas would not be the first example of regulation fitting relatively stable prices and technologies better than rapidly shifting markets.[21]

8, at 875 (criticizing making rates "susceptible to *political* rather than *economic* determination"). One of the subtler dangers of regulation is that all involved may lose the ability to see the line between these modes of value formation.

21. Neoclassical critics of regulated markets tend to focus on the inefficiencies that can occur in regulated companies because they are not subjected to the whip of competition. Yet a regulatory climate distorts incentives and encourages denial among its other participants, too. Consumers and regulators may no longer view prices as binding constraints produced by the intersection of demand and supply. Instead prices and other conditions of service become political variables. They suddenly seem very malleable. The harshness of economic scarcity appears open to easy improvement as if one can vote away resource limitations, technological constraints, and the pull of sunk costs.

In addition to these problems, regulation removes the incentive to innovate because rate-of-return ceilings limit the profit that can be captured in successful innovation. Lack of experimentation, in turn, reduces the information available to the regulated, the regulators, and consumers in determining how the market should be structured. As the conditions in effect when regulation was imposed grow more distant, the link between the factors of production and the price signals needed to ensure efficient resource use grows ever more frayed.

The difficulty of imitating market behavior seems to be one of the sad lessons of the disintegration of Eastern Europe's planned economies. That catastrophe has strengthened the climate for deregulation in unplanned economies. The long-standing critique of market economies was that central planners cannot absorb enough concrete information to make efficient economic adjustments. F.A. Hayek expressed this strength of unintegrated planning as follows:

> Fundamentally, in a system where knowledge of the relevant facts is dispersed among many people, prices can act to coordinate the separate actions of different people in the same way as subjective values help the individual to coordinate the parts of his plan. . . . There is no need for the great majority of them even to know where the more urgent need has arisen . . . . The whole acts as one market, not because any of its members survey the whole field, but because their limited individual fields of vision sufficiently overlap so that through many intermediaries the relevant information is communicated to all. The mere fact that there is one price for any commodity . . . brings about the solution which (it is just conceptually possible) might have been arrived at by one single mind possessing all the information which is in fact dispersed among all the people involved in the process

F.A. Hayek, *The Use of Knowledge In Society,* 35 A.E.R. 519, 526 (1945). Hayek continues:

> . . . The most significant fact about this system is the economy of knowledge with which it operates, or how little the individual participants need to know in order to be able to take the right action. In abbreviated form, by a kind of symbol only the most essential information is passed on . . . .
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> . . . But I fear that our theoretical habits of approaching the problem with the assumption of more or less perfect knowledge on the part of almost everyone has made us somewhat blind to the true function of the price mechanism and led us to apply rather misleading standards in judging its efficiency. The marvel is that in a case like that of a scarcity of one raw material, without an order being issued, without more than perhaps a handful of people knowing the cause, tens of thousands of people whose identity could not be ascertained by months of investigation, are made to use the material or its products more sparingly, *i.e.,* they move in the right direction. This is enough of a marvel even if, in a constantly changing world, not all will hit it off so perfectly that their profit rates will always be maintained at the same constant or 'normal' level.
>
> I have deliberately used the word 'marvel' to shock the reader out of the complacency with which we often take the working of this mechanism for granted. I am convinced that if it were the result of deliberate human design, and if the people guided by the price changes understood that their decisions have significance far beyond their immediate aim, this mechanism

When demand increased during the energy crisis of the Seventies, interstate prices did not adjust; instead, they lagged unregulated intrastate markets. Gas disappeared from the interstate market as producers lost interest in these low-priced contracts. Pipelines ran so short of gas, the FERC made them file curtailment plans listing customers by priority.[22]

Gas deregulation began in 1978, when Congress passed the NGPA. The NGPA deregulated the wellhead price of various categories of natural gas, which Congress found to be competitive, in hopes of bringing supply back into balance with demand.[23] After all the debate, wellhead prices were the only thing Congress changed. The later dismantling of traditional regulation was *not* part of a farsighted, unified plan in the NGPA. In fact,

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would have been acclaimed as one of the greatest triumphs of the human mind. Its misfortune is the double one that it is not the product of human design and that the people guided by it usually do not know why they are made to do what they do.

Id. at 526-27.

Another problem with central planning is corruption. It is very difficult to maintain "hard" ties between the regulators and the regulated. In regulatory theory, concern tends to focus on the risk of capture, in which the organized, focused interests of the regulated enable them to capture the decision-making of the regulators. For lead articles, see George Stigler, *The Theory of Economic Regulation,* 2 BELL J. ECON. & MANAGEMENT SCI. 3 (1971); Gary Becker, *A Theory of Competition Among Pressure Groups for Political Influence,* 98 QUARTERLY J. ECON. 371 (1983); Sam Peltzman, *Toward a More General Theory of Regulation,* 19 J.L. & ECON. 211 (1976).

In planned economies, adjustments can be very hard to implement. For instance, the central state needs some mechanisms to correct errors in planning. If it underestimates the demand for certain products or their cost, it may have to supplement the resources allocated to those sectors of the economy. But it is hard to limit correction just to efficiency enhancing errors. Companies come to view their annual plans as "soft constraints," which they know will be supplemented if they get into trouble. Jan Kornai, *The Soft Budget Constraint,* 39 KYKLOS 3 (1986); *see* Joseph Berliner, *The Informal Organization of the Soviet Firm,* 66 QUAR. J. ECON. 21 (1952). Rigor is particularly difficult to maintain in regimes with ideologies of full employment and no bankruptcy mechanism: even firms that consistently miss their targets remain funded and lack any incentive to improve. While many in the West view the demise of these planned economies as a victory for market systems, the failure of economic regimes with public policies of full employment and secure provision of most life essentials is a human tragedy. See the more complex discussion in LINDA COOK, THE SOVIET SOCIAL CONTRACT AND WHY IT FAILED (1993).

22. See for instance the Columbia Gas Pipeline annual report cited in footnote 26 *infra.*

23. The gas categories in the NGPA are not the product of bureaucratic logic, but of a lot of horse trading. Thus the description in text does not explain the many nuances of NGPA pricing, but it is the overall reason for the end product of deregulation. For a more detailed history, see Note, *Legislative History of the Natural Gas Policy Act: Title I,* 59 TEX. L. REV. 101 (1980); Pietro Nivola, *Energy Policy and the Congress: The Politics of the Natural Gas Policy Act of 1978,* 28 PUB. POL. 531 (1980). For a somewhat despairing picture of the [mis]use of data in this debate, see MICHAEL MALBIN, UNELECTED REPRESENTATIVES, ch. 9 (1980).

Martha Derthick and Paul Quirk describe the NGPA debates as a flawed process (as does Malbin), in which the Carter Administration just missed securing a bill that would have retained price caps. DERTHICK & QUIRK, *supra* note 9, at 210-11. They claim that one reason for resistance to reform was the "limited credibility of academic analysis." *Id.* at 210. In other words, both Congress and much of the public was skeptical about whether this market really would operate competitively.

Derthick and Quirk wrote in 1985. What is ironic about their remarks is the fact that deregulation was only beginning. The FERC soon would have matched the edge-of-the-envelope bullishness they describe in Alfred Kahn as he cut the CAB's powers. Most of the FERC's changes seem to rest on the view, one that has gained supporters as the reforms have progressed, that the natural gas industry can stand competition in almost all of its component parts.

the NGPA was the battered, compromised fruit of a lengthy debate. It is easy to forget that though there was agreement that regulation had caused major distortions, there was no consensus on whether gas markets could be competitive. The bill did not result from classic, rational policy analysis.[24]

The FERC would do what Congress could not. Its much more fundamental deregulation followed as it dismantled the natural gas business piece by piece. the FERC went far beyond Congress' decision to free wellhead gas prices. Its deregulation is an unusual antitrust story because it is so largely a case of administrative competition-forcing. The FERC was not following a statutory mandate. Commentators and the FERC like to claim that Congress mandated deregulation,[25] but one clear aspect of gas deregu-

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24. The bill had almost nothing to do with the identify the alternatives, predict the consequences, value the outcomes, and make your choice of the classic policy model. *See* EDITH STOKEY & RICHARD ZECRHAUSER, A PRIMER FOR POLICY ANALYSIS (1978).

A number of careful observers view the NGPA as stemming from a failure of the legislative process and a distorted debate that did not make good use of the knowledge that was available. In addition to the materials by Nivola, Malbin, and Derthick and Quirk cited in footnote 23, see Paul Quirk, *Evaluating Congressional Reform: Deregulation Revisited*, 10 J. POL. ANAL. & MAN'T 408, 420-22 (1991). Quirk calls the bill "an incoherent, lowest-common-denominator solution that an exhausted Congress preferred to the alternative of failing to act," but one whose staggered deregulation of new gas created "a bizarre and implausible regulatory scheme." *Id.* at 422.

25. For instance, in justifying its new policy of incentive rates for mainline transportation, the Commission claimed that Congress had urged the Commission to "improve the competitive structure of the natural gas industry in order to maximize the benefits of wellhead decontrol." Incentive Order, *supra* note 2, at 2-3. The Commission of course has every reason to want to exaggerate congressional approval and downplay the degree to which deregulation has been its own idea, because this makes its decisions more robust on appeal. *See also* Donald Santa & Patricia Beneke, *Federal Natural Gas Policy and the Energy Policy Act of 1992*, 14 ENERGY L. J. 1, 18 (1993)(arguing that Order 636 is a result of congressional oversight).

The degree of restructuring that the FERC has accomplished in the last two decades is unprecedented in natural gas history. It is inconsistent with the close relationship it maintained to its Natural Gas Act duties until then. While much of the impetus and courage to issue new rules no doubt came from a wider belief in markets that permeated Congress as well as the FERC and many other regulatory commissions, see generally DERTHICK & QUIRK, *supra* note 9, ch. 2 ("The Reform Idea"), what remains striking about the rules is the degree to which the Commission restructured an entire industry when its only direct legislative command was to deregulate wellhead prices.

It is true that gas deregulation was politically influenced by contacts at the staff level and by the driving force of a political climate of deregulation. (*See* the discussion by Malbin in footnote 23 *supra*). Such contacts are guaranteed by the fact that many of the Commissioners during the prime deregulation years had served as House or Senate committee staffers. The Commissioners are Moler (Senior Counsel to Senate Committee on Energy and Natural Resources); Hoecker (former FERC staff); Massey (Chief Counsel and Legislative Director for Senator Bumpers); Santa (Counsel to Senate Committee on Energy and Natural Resources); Trabandt (Chief Counsel to Senate Energy and Natural Resource Committee); Richard (Energy Legislative Assistant to Senator Bennet Johnston); Curtis (Counsel to House Committee on Interstate and Foreign Commerce, with emphasis including energy regulation); and Butler (Assistant to Senator John Tower). In addition, Commissioner Hall was a member of the Energy Policy and Planning Staff in the Executive Office of the President.

The Commission did receive support for its pro-competition push during the enactment of the Wellhead Decontrol Act of 1989. *See Natural Gas Wellhead Decontrol Act of 1989*, H.R. No. 101-29, 135 CONG. REC. 51, 56 (1989):

> A series of FERC rules, court decisions, and new industry practices that have ended the old world of inflexible long-term contracts between producers, pipelines, utilities, and consumers, and replaced it with new arrangements . . .

lation is that Congress did not order the Commission's business deconstruction. When it passed the NGPA, Congress obviously knew that pipelines provided all of the services needed to bring natural gas from the field to local distribution companies as a single unbundled service and that pipelines reserved their space for their own gas. Yet it did not pass a bill, after debate and scrutiny, making pipelines relinquish their transportation monopolies and unbundle non-transmission services. It did not mandate, as would the Commission, open access to pipelines and deregulation of gathering, storage, and processing. And no one knows if those changes could have commanded congressional majorities.

The immediate impetus for the FERC's decision to push deregulation was the take-or-pay crisis. The disputes over these contracts exposed deeper problems in the regulatory scheme. After running out of gas in the Seventies and being severely criticized by their regulatory clients for gas shortages,[26] pipelines signed up large supplies of gas under "take-or-pay" contracts. In these now notorious contracts, pipelines promised to take-or-pay for a set amount of gas, often a high percentage like 80% of a well or field's production. Many contracts set the price at the maximum lawful reg-

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> The Committee stresses that these new rules, and especially the wide adoption of blanket certificates for non-discriminatory open access interstate transportation of non-pipeline gas, are essential to its decision to complete the decontrol process. . . .
>
> Both the FERC and the courts are strongly urged to maintain *and improve* this competitive structure in order to maximize the benefits of decontrol.

Putting aside the suggestion that courts become policymakers, these comments certainly should boost the Commission in its industry restructuring. The Commission, courts and those favoring deregulation like to cite the decontrol report as if it was a statutory directive to FERC that legitimates the deregulation orders. *See, e.g.*, United Distribution Co. v. FERC, Cause No. 92-1485, slip op. at 16 (July 16, 1996).

Still, ordinarily we do not agree that an administrator can change direction just because a few congressmen say so in a committee report. Laws are supposed to travel the legislative gauntlet because voting lets all affected parties know that change is in the air and they need to protect their interests. The scope of change without a direct command from a congressional majority remains a striking and unusual aspect of gas deregulation (and the other deregulations). Favorable mention in a House Report does not change the fact that no congressional majority has voted that pipelines should lose their control over pipeline space, have to unbundle their services, or have their field services deregulated.

26. It is a macabre experience to read the early Eighties' pipeline reports today. Perhaps the best example is Columbia Gas Pipeline, a pipeline that filed bankruptcy because of its take-or-pay problems. Columbia served the North-East United States with a supply drawn from Appalachia, the first major gas producing region in the country. It was an old, established company founded in the last century.

Columbia's 1978 annual report, covering the year of the NGPA's passage, predicted that its curtailments would be over by April 1979 and that it would be able to resume adding customers. The report assumed that Columbia's major economic threat was lack of gas. Columbia took it as a sign of strength that it had "been aggressively pursuing increased gas supplies to supplement those available from non-affiliate suppliers." Columbia Gas Pipeline Company, 1978 Annual Report 3-4 (1979). In reality, Columbia was aggressively pursuing its downfall. Five years later, Columbia was refusing to honor its take-or-pay contracts and had been sued for $750 million over its refusals to perform. Columbia Gas Pipeline Company, 1983 Annual Report 5 (1984). A few years later it would be in bankruptcy.

ulated price and continued to escalate that price even after deregulation. Pipelines promised to pay for gas even if they did not take it.[27]

Pipelines entered many high-priced, high-take contracts in the late Seventies and very early Eighties. They could not have made a worse miscalculation.[28] Prices were falling within a very few years. Cheap alternative fuels, increased supply (domestic and foreign), and such factors as

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27. There are a lot of judicial descriptions of take-or-pay contracts. Perhaps the most succinct comes from the Fifth Circuit's opinion in Universal Resources Corp. v. Panhandle Eastern Pipe Line Co., 813 F.2d 77 (5th Cir. 1987). The court noted that market decline was precisely the risk that these contracts imposed on the buyer:

> The purpose of the take-or-pay clause is to apportion the risks of natural gas production and sales between the buyer and seller. The seller bears the risk of production. To compensate seller for that risk, buyer agrees to take, or pay for if not taken, a minimum quantity of gas. The buyer bears the risk of market demand. The take-or-pay clause insures that if the demand for gas goes down, seller will still receive the price for the Contract Quantity delivered each year.

Id. at 80. The court saw no reason to let the pipeline drag this undisputed issue through years of discovery and trial (all of which would put pressure on the producer to settle for economic, not legal, reasons):

> The terms of the take-or-pay clause are unambiguous, common to the gas industry, and fully enforceable. Because the clause is unambiguous, Panhandle's intentions, and the possibility that future production may be physically impossible or may violate Oklahoma conservation laws, are irrelevant.

Id. For more detail and some sample contract language, see HOWARD WILLIAMS & CHARLES MEYERS, OIL AND GAS LAW § 724.5 (1991); for a general discussion of the take-or-pay problem, see J. Michael Medina, Gregory McKenzie & Bruce Daniel, *Take or Litigate: Enforcing the Plain Meaning of the Take-or-Pay Clause in Natural Gas Contracts,* 40 ARK. L. REV. 185 (1987).

One sign of the long term nature of these contracts is the fact that most contracts allowed a five-year period during which a pipeline could "make up" any gas for which it had made a prepayment. Though these contracts may sound like requirements contracts to the unlettered, at least the Texas courts finally have held (as they should) that their specific quantity provisions remove them from that category. Lenape Res. Corp. v. Tennessee Gas Pipeline Co., 925 S.W.2d 565 (Tex. 1996).

28. Pipelines could not have made a worse *economic* miscalculation. Because pipelines operate in a regulatory environment, whether one thinks they truly miscalculated depends upon just how predictable, and fair, one finds the line of FERC orders discussed in this section. The pipelines' gas purchasing decisions look more rational if one expected the administrative cocoon to remain in place and takes into account the severe attacks on pipelines for running out of gas in the Seventies, as well as their expectation that the FERC would protect them from sharp market changes. *Cf.* Richard Pierce, *supra* note 18, at 352-57 (rejecting claims that take-or-pay contracts necessarily resulted from pipeline market power and describing them as rational allocations of risk). I think it is fair to read Pierce as arguing that the high-priced high-take contracts were rational responses to an irrational regulatory structure. *See id.* at 357-70.

Where the blame falls is an important issue not only because it affects who one thinks should bear the stranded costs of too-expensive gas, but also because it alters one's view of whether pipelines were acting efficiently and, accordingly, how much new blood and competition (and deregulation) the industry really needed.

warm weather depressed prices.[29] Pipelines no longer needed their fixed contracts. Take-or-pay prices soared above the price of new natural gas.[30]

29. A number of the factors in Tenneco's standard contract defenses are listed in Hanover Petroleum Corp. v. Tenneco, 521 So.2d 1234, 1237 (La. Ct. App. 1988). They include the "economic recession," the "pricing scheme" in the NGPA (which was passed several years before the contract in dispute was entered and so was fully known to Tenneco), the price of competitive fuels, the "mild 1982-1983 winter," and the "increase in deliverability of fields committed to Tenneco under gas purchase agreements." *Id.* In other words, either factors known to Tenneco or factors that anyone with the slightest experience in the natural gas industry knew were ordinary risks for gas buyers when they signed a take-or-pay promise.

A short discussion of El Paso's laundry list of defenses, all predicated on the drop in demand for its gas and regulatory changes, is located in Hartman v. El Paso Natural Gas Company, 763 P.2d 1144, 1145 (N.M. 1988). The New Mexico Supreme Court cited one of the El Paso documents about its multi-phase "contract cure" program. The document showed that El Paso chose to proceed by buying the "least-cost" gas, in what it called its "least-cost" program, as if it had no contract prices at all and in spite of its sure knowledge that producers would know it was not being "fair and evenhanded" and would sue. *See id.* at 1147.

30. The extent of the problem can be seen from a figure the FERC compiled in the late Eighties, that by 1989 pipelines had settled $44 billion in take-or-pay liabilities. The best information available shows that gas producers bore the bulk of the loss. Most interstate pipelines refused to perform their take-or-pay contracts. Producers had to sue to earn performance. Whether because of market power, bargaining leverage, confusion, risk-aversion, or producers who put a very high value on long-term relationships, producers ended up excusing most of the pipelines' liability. In Order 500-H, the FERC calculated that over $44 billion in take-or-pay liabilities settled for just 14.6 cents on the dollar. Order 500-H, *Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol,* 53 Fed.Reg. 52,344, 52,356 (1989)(Table 5).

This is an extraordinary record. Cases of largely undisputed (in real terms) liability settled for pennies on the dollar. Many producers went bankrupt. Pierce, *supra* note 2, at 343 ("thousands" of producers); Santa & Beneke, *supra* note 25, at 8 ("many" producers).

One can induce that power remained a problem in this market from the fact that producers settled their claims so cheaply even though high courts in major oil and gas jurisdictions established early on that the standard take-or-pay contract would be enforced. By the end of the Eighties, courts in four of the five major producing states had rejected the market-based defenses so favored by the pipelines. The first major published opinion was the Fifth Circuit's affirmance of a summary judgment for the producer in Universal Resources Corp. v. Panhandle E. Pipe Line Co., 813 F.2d 77 (5th Cir. 1987). In the year following Universal Resources, three more courts in forums experienced in oil and gas law enforced these contracts. In Hanover Petroleum Corp. v Tenneco, 521 So.2d 1234 (La. Ct. App. 1988), the intermediate appellate court affirmed a trial court's summary judgment for the producer. In Golsen v ONG Western, Inc. 756 P.2d 1209 (Okla. 1988), the Oklahoma Supreme Court reversed a trial court's judgment, after a trial to the court, for the pipeline, and remanded the case for a determination of the producer's damages. Finally, in Hartman v. El Paso Natural Gas Co., 763 P.2d 1144 (N.M. 1988), the New Mexico Supreme Court affirmed a judgment for the producer in a jury trial.

The likely enforceability was underlined by a series of large judgments. The judgments included one of at least $600 million in Kimball v. Tenneco, Inc., No. 27,880-S (Tex. Dist. Ct. Dec. 1, 1988); over $600 million, remitted to roughly $480 million in El Paso Natural Gas Co. v. TransAmerican Natural Gas Corp., No. 85-09329 (Tex. Dist. Ct. May 24, 1988); $412 million in Colorado Interstate Gas v. Natural Gas Pipeline Co., 661 F. Supp. 1448 (D. Wyo. 1987), *aff'd in part and rev'd in part,* 885 F.2d 683 (10th Cir. 1989)(reduced to $16 million); $108 million in Texas Crude Inc. v. Delhi Gas Pipeline Corp., No. 85-7-450 (Tex. Dist. Ct. Aug. 14, 1986); $65 million in Challenger Minerals v. Sonat, No. 84-C-3537-E (N.D. Okla. Sept. 9, 1986), and $50 million in Forest Oil Corp. v. Oneok, Inc., No. C-84-197 (Tex. Dist. Ct. May 30, 1984).

There was one major winner among the pipelines, ANR Pipeline, but it was the exception that proved the rule. ANR's form contract included an unusual defense if any of *ANR's* own customers failed to take its gas in substantial quantities. ARCO v. ANR Pipeline Co., 768 S.W.2d 777, 780 (Tex. Ct. App. Houston 1989)(no writ). In addition, the volume clause in ANR's deliverability provisions said

Take-or-pay contracts prevented pipelines from buying cheaper gas after deregulation because they were stuck performing these expensive contracts. The contracts thus blocked the competitive wellhead market that Congress sought with the NGPA. This blockage led the FERC to issue the first in a body of rules that, taken together, constitute an integrated effort to inject competition throughout the natural gas business. Each reform returned an aspect of gas delivery to market determination.

C. Good-by to All That: The Deregulation Orders

First came Order 380. One reason for wellhead price rigidity was that pipelines had "minimum bills" with many of their customers. Customers had to pay for gas even if they could not use it, in a seeming parallel to pipeline take-or-pay obligations.[31] Competition was blocked at the city gate. In Order 380, issued in 1984, the FERC voided minimum bills. The Commission found that minimum bills existed because of pipeline monopoly power[32] and it voided them as "unjust and unreasonable" barriers to competition.[33] Order 380 did not end pipeline domination. Utilities, indus-

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that on any day when takes were "affected" by force majeure, the contract quantity would be deemed to be the "actual volume delivered and purchased," *id.*, a clause that ANR interpreted to reduce its obligation to whatever it took, with the wonderful position that it could never have any liability. Though the meaning of both clauses is open to dispute (ANR's reading makes the take-or-pay clause worthless or, in the law's words, renders it a nullity, a violation of rules of contract interpretation), whatever they really mean, they put ANR in a different category than every other pipeline.

31. The parallel was not perfect for several critical reasons that offer part of the explanation why the FERC did not void take-or-pay contracts as well (the more fundamental reason probably lies in the jurisdictional concern that the Commission did not have the power to do so). Minimum bills may look like take-or-pay promises because they are structured the same way, but they are not the same. As the FERC noted, there was "no clear nexus between a pipeline's annual take-or-pay obligations and its minimum commodity bills to its customers." Order 380, *Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions,* 49 Fed. Reg. 22,778, 22,788 (1984) [hereinafter Order 380]. Pipelines might sell enough gas to satisfy their take-or-pay commitments even though their customers did not pay minimum bills. *Id.* at 22,787-88. Customers who had minimum bills might not be the same customers whose demand required pipelines to secure expensive new gas supplies. FERC also was concerned that minimum bills contained no provision to make sure that take-or-pay costs were allocated to the customers who had necessitated the take-or-pay promise in the first place. *Id.*

32. *Id.* at 22,781-83. The actual market position could be more complex. At least at one end of the pipeline, it often was the case of one monopoly dealing with another. For instance, for many years El Paso Natural Gas Company was the only major supplier of natural gas into California, and for some years after that El Paso and Transwestern Pipeline Company were the only suppliers. (Today PG&E owns the "PGT" pipeline that brings Canadian gas into California, and the Kern River pipeline that brings gas into California) El Paso and later Transwestern dealt in turn with two major utilities, SoCal and Pacific Gas and Electric, and the smaller San Diego utility. Neither SoCal nor PG&E could survive without El Paso's gas but, conversely, El Paso would have been out of business if it lost the two utilities.

While Order 380 often is viewed by pipelines as an unfair burden visited solely on them, the final result of Order 380 and following orders is that pipelines and their customers bore some of the burden of voiding minimum bills, but producers paid most of the price. *See supra* note 30.

33. Order 380, 49 Fed.Reg. at 22,781-83. Among the Commission's findings was the following:

> [A] minimum commodity bill can serve as a barrier to competition. A customer is not likely to purchase gas from an alternative supplier if it is required to pay for gas it does not take from the original supplier. As such, a minimum commodity bill may inhibit the natural gas price decreases that could otherwise result from competitive forces.

trial consumers, and producers still lacked a way to get gas to market because the Order had not reduced pipeline power over gas transmission. In 1985, the FERC concluded that pipelines were not opening their lines to allow other buyers into their systems. Instead, pipelines were refusing to transport other companies' gas on a nondiscriminatory basis.[34]

The FERC responded with Order 436. Order 436 brought open access, which in antitrust terminology can be envisioned as forcing open an essential facility, to natural gas. The Commission stated that *if* pipelines wanted to sell spare capacity to anyone, they had to offer their capacity on an "open access," first-come first-served and equal-terms basis.[35] Pipelines needed to sell excess capacity in order to maximize profits.[36] Every major pipeline has become an open access carrier. Open access is a major part of the broader deregulation movement: it is at the heart of the more recent move toward deregulating interstate, and in many states intrastate, electric distribution lines.[37]

Id. at 22,779. The Commission agreed with commentators who argued that the minimum bill problem "creates serious market distortions, insulates pipelines and producers from price signals, hinders competition, and prevents pipelines and distributors from pursuing a least-cost purchasing strategy." *Id.* at 22,782. As such, these barriers were "fundamentally inconsistent with the increasingly competitive wellhead market mandated by Congress in 1978. Congress intended that there be an opportunity for gas prices to increase or decrease—whichever the market demands." *Id.* at 22,783. The FERC summed up that "[t]he record in this docket establishes without question the anti-competitive effects of collecting variable costs in minimum commodity bills." *Id.*

34. Order 436, *Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol,* 50 Fed. Reg. 42,408, 42,420-21 (1985)(subsequent history omitted)[hereinafter Order 436]. The reviewing court accepted the Commission's finding that "a prevailing pipeline practice, particularly their general refusal to transport gas for third parties where to do so would displace their own sales, has caused serious market distortions" and violated the Natural Gas Act. Assoc. Gas Distrib. v. FERC, 824 F.2d 981, 993 (D.C. Cir. 1987). It agreed that the FERC had the power to impose remedies designed to inject competition into the industry. *Id.* at 1017. And it did not challenge the finding that pipeline contract terms were the product of pipeline monopoly power. *Id.*

The Court of Appeals did remand Order 436 for the FERC to reconsider its refusal to act on take-or-pay contracts. The result was Order 500, in which the Commission seems to have quieted the courts by providing some crediting for take-or-pay payments, but stuck to its refusal to void those contracts.

35. The FERC linked open access on these still-regulated activities to a perceived congressional goal to further competition as much as possible. As if distancing itself from its own rule, it claimed that "[t]o the extent the Commission exercises its remaining NGA jurisdiction so as to thwart the competitive commodity market for gas contemplated by the NGPA, the Commission may be negating one of the primary Congressional mandates of the NGPA." *Id.* at 42,420. Thus in this matter it "has no choice." *Id.* In this way the Commission could claim to be forced to impose open access once it found that "pipelines have generally expressed a reluctance to provide these transportation services on a non-discriminatory basis to their existing sales customers or to customers without immediate fuel-switching capability, ... " *Id.* at 42,421.

36. There are two views over just how voluntary a choice the FERC left the pipelines. A very hostile reviewing court likened the choice to the one a condemned man faces between "the noose and the firing squad" and attacked the FERC's reasoning on why it did not alter take-or-pay contracts as 'utterly Panglossian.'" Associated Gas Distrib. v. FERC, 824 F.2d at 1024.

37. Open access is an old administrative mechanism. Congress used it to break oil pipelines loose from the Standard Oil monopoly, *see supra* note 16, and it was the mechanism through which the Federal Communications Commission began the long march to deregulate the telephone industry, some would say inadvertently. *See* Peter Temin, *Down the Primrose Path,* in DONALD MCCLOSKEY, SECOND THOUGHTS 151 (1993).

Order 436 contained a second section cutting into pipeline power. To make sure that customers did not get stuck holding gas they could not use, Order 436 let customers who had contracted for fixed volumes of gas *sales* convert those rights to firm gas *transportation.* Thus pipeline customers now had an assurance that they could ship cheaper gas.[38]

After Order 500.[39] which established a procedure for treating pipelines' stranded take-or-pay costs, came the next restructuring order, Order 636.[40] In another injection of competition, the Commission broke the tying of major pipeline services. Pipelines traditionally combined their services

38. Order 436, *supra* note 34.

39. Order 636, Order 500, *Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol,* 52 Fed.Reg. 30,344, 30,341-46 (1987)(subsequent history omitted)[hereinafter cited as Order 500], did not restructure gas distribution directly, but it dealt with the stranded cost problem that has assumed a dominant role in many deregulation debates. The FERC had not decided how it would treat the growing liability pipelines faced on their take-or-pay contracts. If cheaper gas became available, how would the high costs of old contracts be distributed among pipelines, and their shareholders, customers, and producers?

Order 500 created a crediting mechanism. Pipelines would be guaranteed a gas cost surcharge to pass through the same percentage of their take-or-pay costs, up to 50%, that they absorbed themselves. Order 500 Customers still could challenge a pipeline's gas costs, but if they lost their challenge, they would have to pay all of the pipeline's take-or-pay costs (without the pipeline absorbing any of those costs), so there was a tremendous disincentive against challenging the pipeline's gas cost basis.

Pipelines could try to recover any remaining take-or-pay payments by adding them to their gas price but only with the risk that their customers would not buy this more expensive gas.

The crediting mechanism is easier to illustrate than to describe. If a pipeline agreed that its shareholders would absorb 50% of the accrued take-or-pay liability, it would have a right to pass through the other 50% in a separate charge that would be spread over all its customers and that they would have to pay even if they bought no gas. If the pipeline decided to absorb less than half of its liability, for instance 25%, it would have a right to pass through an equal 25% in its gas charge. The remaining 50% of the contract costs could be added to the pipeline's rates; the pipeline would be at risk that it might not recover all of these costs if the higher rate reduced sales.

Finally, if a pipeline did not absorb any of its take-or-pay costs, it still would be free to add them to its rates. The higher cost might lower sales, in which case the pipeline would not recover its full costs. And the decision to try to pass all costs through to consumers would be certain to make some customers challenge the costs in the next rate proceeding. The pipeline would take the added risk that the FERC might disallow some or all of these costs.

Order 500 contained a second measure designed to balance the burden of Orders 436 and 500. A producer would be free to sell its gas to someone else during periods when its pipeline was not buying, but if it used the pipeline's system to transport the gas, it had to give the pipeline volume-for-volume credit against the pipeline's take-or-pay liability. *Id.* at 30,337-38.

This history leaves out Order 451, which is a counterpart of Order 436. Order 451, *Ceiling Prices, Old Gas Pricing Structure,* 51 Fed.Reg. 22,168 (1986). Many pipelines had contracts concerning old gas at high prices and wanted to renegotiate the worst of those contracts. Pipeline supply contracts had been so important for pipeline service that they could not be abandoned once entered without Commission approval.

Order 451 allowed pipelines to renegotiate existing contracts, but at a price. If a pipeline tried to renegotiate one contract, all contracts with that producer came up for negotiation. In other words, pipelines could not cherry-pick, in this case selecting only the rotten fruit. The hope was that Order 451 would force blocks of contracts into play and free more gas for deregulated gas pricing. For a discussion, see Pierce, *supra* note 3, at 28-29.

40. Order 636, Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations: and Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol, 57 Fed. Reg. 13,267 (Apr. 16, 1992)(subsequent history omitted)[hereinafter Order 636].

into the single product of delivered gas. To get this gas to market, a pipeline had to produce or buy the gas, collect it in a gathering system of fairly small pipes, treat and process the gas to remove impurities (some of which can damage the pipe, some of which are liquids that can be sold for a profit), store the gas if necessary, and transport the gas on its mainline. Until Order 436 separated the pipelines' merchant role from their transportation role, pipelines had to maintain marketing staffs to coordinate sales. Pipelines performed these many services for a single rate when they supplied "delivered" gas.

In Order 636, the FERC made two big changes. First, it imposed a "straight fixed-variable" rate design that put all fixed costs into a "firm" charge that would not vary with volume.[41] This meant that the only added cost shippers faced when deciding how much gas to transport would be the variable cost of moving the gas.[42] Second, the Commission separated the transportation service itself from the services necessary to get gas to the mainline. These services had to be offered separately at their own price.

The FERC intended this "unbundling" to stimulate competition. It expected separate pricing to supply more accurate signals than combined pricing, which invariably includes cross-subsidies.[43] The Commission rested Order 636's reforms on what it called Congress' directive that it improve the competitive structure of the industry.[44] It found that bundled services gave pipelines an "undue" advantage over other sellers and prevented customers from switching from firm sales to firm transportation.[45]

The next-to-last step in gas deregulation occurred in adjudications over field services, particularly gas gathering. This change is more difficult to describe because the Commission did not draw its decisions together in a rule. Order 636's unbundling of services highlighted the difference between

41. The District of Columbia Circuit's recent opinion affirming Order 636 in large part may be the best summary of what is at stake in this rate change. United Distribution Co. v. FERC, Cause No. 92-1485, slip op. § IV (July 16, 1996).

42. Straight fixed-variable rates assume, as do most economists, that companies do not consider sunk costs in their marginal decisions. The justification for shifting to SFV rates was to enhance competition by having shippers face the full marginal costs of moving gas, but nothing else, as they decided how much gas to ship. *Id.* at 89.

43. The details of sophisticated regulatory cross-subsidization are perhaps nowhere better illustrated than in telephone rates. For the story of this subsidy and its place in the larger battle over monopoly power, see PETER TEMIN & LOUIS GALAMBOS, THE FALL OF THE BELL SYSTEM: A STUDY IN PRICES AND POLITICS (1987).

44. Order 636, *supra* note 40, *citing* House Report No. 29 on Wellhead Decontrol Act.

45. *Id.* at 30,393-94, 30,402-04:

> In brief, this rule requires pipelines to unbundle (i.e., separate) their sales services from their transportation services at an upstream point near the production area and to provide all transportation services on a basis that is equal in quality for all gas supplies whether purchased from the pipeline or from any other gas supplier.

For obvious reasons, some in the industry call Order 636 and the FERC's supporting measures the "Restructuring Rules," *see* El Paso Natural Gas Company, 1995 Annual Report, 1996, at 2. Given the impact of Order 436's separation of the merchant role from the transportation function, this article treats all Orders from Order 436 on, rather than just those starting with Order 636, as restructuring rules. Most pipelines probably would trace restructuring to Order 380, which also did violence to their settled markets.

pipeline field service companies and their unregulated competitors. Pipelines understandably complained that they were being undercut by unregulated gatherers.[46] They asked the Commission to deregulate gathering so that they could compete free of regulatory approvals and second-guessing.[47] Pipelines generally sought to justify gathering deregulation by claiming it was needed to let them respond flexibly to competitors and to customers,[48] however, three other motives seem more fundamental: (1) deregulated field service companies could set rates, including variations by customer, without the FERC's input or scrutiny; (2) the companies could keep all profits without a ceiling on their rate of return, so those with market power could exploit it fully; and (3) they could hide discrimination because they no longer would have to file rate and financial information on field services. If the companies abused their power, their victims would have a hard time finding out.

There have been several strands to gathering deregulation. Some deregulated gathering systems came into existence when pipelines began building separate, stand-alone gathering systems. These lines hooked into interstate pipelines but were owned by separate affiliates. A number of pipelines assumed the FERC would not regulate new, affiliate-built systems (a decision with some risk at the time, but one that has proved correct).[49] A second route to deregulation has been by abandoning formerly regulated systems to an affiliate. The Commission initially maintained what it called "light-handed" jurisdiction, a status that seemed indistinguishable from no regulation. For example, some of the Williams companies' systems fell into this regulatory limbo. The FERC allowed Williams to assign these gathering and processing facilities to an unregulated affiliate run by Wil-

46. In essence, pipelines could use their monopoly power over transportation to "tie" their gathering service, just as phone companies used their dominance over local phone exchanges to dominate the long distance business. Companies who wanted to ship their gas in interstate commerce still had to pay the pipeline's full, integrated transportation price, even if they gathered their own gas.

47. The first major application to result in a FERC decision which allowed abandonment to a deregulated entity but retained the authority to reregulate was Northwest Pipeline Corp, 59 F.E.R.C. § 61,115 (1992), *reh'g denied,* 60 F.E.R.C. § 61,213 (1992), *petitions dismissed,* Williams Gas Processing v. FERC, 17 F.3d 1320 (10th Cir. 1994).

48. *See infra* note 59.

49. For instance, the same Northwest Pipeline that moved to "abandon" its existing gathering and processing systems to an unregulated affiliate of the Williams companies had already assisted in building one of the country's biggest new gathering systems, the Manzanares system in New Mexico, but via yet another affiliate. Lloyd Hightower Trial Transcript 2011. Williams initially took all the steps to file an application asking the FERC to declare the system non-jurisdictional, but then it decided to tell the FERC nothing. *Id.* at 2046-50. It rolled the dice that the FERC would not have the stomach to try to assert jurisdiction; in retrospect, this assumption turns out to have been an extremely smart business judgment. This information was developed in a case in which the author is one of the counsel of record for Sunrise Energy Company and its parent corporation in their litigation against Northwest Pipeline Company and Williams Field Services. Sunrise Energy Servises, Inc. v. Northwest Piepline Corp., Docket No. 394-36780, in the United Bankruptcy Court for the Northern District of Texas (Dallas Division). Throughout the article, citations to the court record of this case will be by exhibit number; to the trial transcript, by witness name and transcript page.

liams Field Services, another unregulated affiliate.[50] The FERC called this new form of regulation "light-handed regulation" because it claimed continuing power to reset rates if abuses occur, but it did nothing to supervise actively.[51]

Light-handed status had a short life. While the FERC's decision seemed to indicate that pipeline-affiliated gatherers were jurisdictional facilities, in 1993 decision the FERC decided that gathering facilities transferred to a new pipeline affiliate are exempt, but it required the pipeline to provide two-year "default" contracts to give states time to build their regulatory systems.[52] These interim contracts helped the FERC sustain massive deregulation while postponing opposition because there was no rule on which to focus criticism. Moreover, any injury was delayed by the palliative of default contracts.

This massive transfer of facilities to unregulated sectors has just received a big boost from the District of Columbia Court of Appeals. The intermediate protection of default contracts may have ended when that court decided that the FERC has not yet shown a jurisdictional basis for imposing default contracts on independently run affiliates.[53]

The third strand in gathering deregulation has been expanding the systems the Commission will classify as purely gathering. The Commission used to decide if a facility was just "gathering" under a multi-part "primary function" test in which it classified systems that moved gas over very long distances as "transportation" and within its jurisdiction, while others were "gathering" and exempt.[54] When the Fifth Circuit reversed one of the classifications on narrow grounds,[55] the Commission read the decision expan-

50. The reasons for Williams Gas Processing's existence are regulatory or, more accurately, deregulatory. Though the company appears to function merely as a conduit for Williams Field Services, the new entity that owns the unregulated Manzanares system described in footnote 49 *supra*, the Williams companies did not want to house these two systems under the same legal roof. They worried that the FERC might one day reregulate the Northwest facilities and did not want to spread that risk to any Williams Field Services facilities. *Id.* at 1969. Williams Field Services exercises the day to day management of the facilities. *Id.* at 2011. It is hard to believe that the FERC would stop at such porous legal boundaries, if it ever decided to reregulate.

51. *Northwest Pipeline Corporation*, 59 F.E.R.C. at 61,435-36. Not only did the Commission no longer set rates, but it did not impose any filing requirements, so it could not know the rates Williams is charging. There could hardly have been a more telling contrast to the Commission's market-based rates, where it continues to scrutinize pricing by maintaining filing requirements. There was no sign that the Commission was conducting any oversight of these abandoned gathering and processing facilities. In practical terms, the Commission has let market forces supplant rate-of-return regulation.

52. The FERC's development of this two-year window is chronicled in Larry Pain, *Gas Gathering in the Age of Competition*, 46 INST. OIL & GAS L. & TAX'N 3-1, 3-8 to -12 (1995); *see generally* Arkla Gathering Serv. Co., 67 F.E.R.C. § 61,257, *order on reh'g*, 69 F.E.R.C. § 61,280 (1994).

53. Conoco v. FERC, 90 F.3d 536 (D.C. Cir. 1996).

54. For the history of these tests, see Pain, *supra* note 52, § 3.05, at 3-12 to -25.

55. E.P. Operating Co. v. FERC, 876 F.2d 46 (5th Cir. 1989). The field was approximately 80 miles off the Louisiana coast and centered around a Placid Oil drilling rig. The gas was brought over 50 miles to a production platform, where it was processed and delivered to another pipeline. *Id.* at 47-48. The Fifth Circuit reversed because the Commission had not given a "reasonable explanation" of why this system was not exempt, when it had found two quite similar (if shorter) Shell offshore systems exempt. *Id.* at 48-50.

sively. It has been classifying almost every system submitted to it as gathering ever since.[56]

The gathering decisions, both those on light-handed abandonment and on exemptions, show the Commission eagerly discarding its regulatory powers.[57] In contrast, in areas like transportation rates and in its supervision of oil pipelines, the Commission has refused to let companies set their own rates on jurisdictional services unless it finds the specific market is competitive. If it does, it is willing to step aside for competition because it takes competition as evidence that the market will produce reasonable prices.

Ordinarily the FERC would make these gathering policies in a rulemaking proceeding, and it did indeed hold a rulemaking hearing on gathering two and a half years ago. Most participants in this February, 1994, proceeding presumed that the focal point would be whether or not

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Had the FERC wanted to limit *EP Operating,* it could have used common-law logic with its minute classifications to argue that a special rule existed for offshore systems with their different logistics. Or it could have focused on the fact that the *E.P. Operating* gas apparently was not of pipeline quality until it was processed at the end of its 50-plus mile journey. *Id.* at 49.

56. For instance, in Amerada Hess Corp. (I), 52 F.E.R.C. 61,986 (1990), the Commission took a gathering line that it would have defined as jurisdictional transmission because it did not have many wells connected to it, noted that it would *not* have considered this a gathering system before *EP Operating,* but now defined as gathering. *Id.* at 61,989. In the same order, the Commission hinted in ruling on an Amoco application that "some of the criteria of the 'modified primary function' test might suggest that the primary function [of the line] is transportation rather than gathering," but it applied *EP Operating* to define the line as gathering. *Id.* at 61,991. The Commission treated over a dozen systems as just gathering lines, all the way up to a 1,275-mile-long Panhandle Eastern pipeline, with 11 compressors along the way (presumably to adjust compression to mainline levels). *Id.* at 62,007.

Clearly, the FERC now was applying a new rule. In *EP Operating,* before it was reversed, the FERC had found that a 51-mile pipeline that had just a few wells was so large and so much like transmission that it could not be called gathering. By the time of *Amerada Hess II,* 67 F.E.R.C. § 61,254 (1994), a 60.5 mile system that was beyond the processing plant and whose only purpose was to transport gas ended up being defined as gathering because it was just a "small" extension of a gathering system. Amerada Hess Corp., *id.* at 61,848. As the FERC noted, "in the absence of additional countervailing factors," it would have called the system jurisdictional. *Id.* at 61,847. The system wound up as gathering because (1) the FERC became gun-shy of appeals after *EP Operating;* (2) perhaps because the Commission saw that it could implement its increasing faith in the market by jettisoning as much gathering jurisdiction as possible; or (3) because the FERC is so happy to wash its hands of the messy prospect of regulating gathering (whatever the merits) that it will grant even marginally colorable applications to deregulate. The Commission seems to have lost faith in its regulatory mission and to be eager to disgorge large chunks of the regulated companies.

FERC does continue to keep some gathering jurisdiction. *See, e.g., Transco's 'Unprecedented' Spindown Plan Spins Down the FERC Drain,* INSIDE FERC, at 1, (Sept. 30, 1996)(discussing FERC's rejecting Transco's effort to spin-down over the 3,000 mile system).

57. At times the line between cases in which the FERC declares a system gathering and therefore exempt from its jurisdiction, and those in which it grants abandonment, seem blurred. Both are ways to avoid the FERC scrutiny. One observer has summed up these overlapping decisions in this way:

> Against the orders vacating certificates for gathering facilities [as exempt], there are many other orders that simply grant abandonment. These can be reconciled only in that they get to the same end result, and perhaps go the route requested by the applicants in each case.

Pain, *supra* note 52, at 3-24; for another discussion of the various deregulation avenues, see Bruce Connell, *Federal Regulation of Natural Gas Gathering Activities,* in STATE BAR OF TEXAS, ADAVANCED OIL, GAS & MINERALS LAW COURSE, tab N (Sept. 22, 1995).

gathering was competitive.[58] If gathering was found to be competitive, the FERC would let the market set rates. The FERC would keep cost-of-service ratemaking or it might decide to measure competition market by market if gathering was not found to be competitive.

Pipelines, devout converts to neoclassical economics that they are, argued that they face competition everywhere and cannot impose monopoly prices.[59] So regulation is redundant. Their trade association, INGAA,

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58. Pain, *supra* note 52, at 3-5.

59. The gathering conference Docket No. RM 94-4-000, *Natural Gas Gathering Services Performed by Interstate Pipelines and Interstate Pipeline Affiliates — Issues Related to Rates and Terms and Conditions of Service.* Comments in this proceeding will be cited as "1994 Gathering Conference" throughout the article. The comments were filed on or around January 14, 1994 and will be cited without filing date.

Though it may be hard to believe that companies would simply assert that gathering markets are (or, in the case of the producer comments, are not) competitive, that was the common pipeline approach to the FERC's request for comments. *See., e.g.,* Arkla Gathering Comments 21 ("can state that the business of gathering is competitive"); El Paso Gathering Comments 9 ("all gathering systems are alike in their competition to serve consumption markets"); 16-17 (pipelines "effectively [have] no ability . . . to leverage [prices]"); Enron Oil and Gas Marketing 2 ("competition is everywhere"). Even a group preferring to see interstate pipelines remain regulated, but that does not want that burden extended to its members, chimed in that the gathering market is "highly competitive." Independent Gatherers and Producers Supplemental Gathering Comments 2.

Several pipelines submitted charts or lists of the number of systems gathering gas in the same gas field or basin. Thus, for instance, El Paso Natural Gas listed 42 gatherers who serve its San Juan service area as an example of competition. El Paso Gathering Comments at 12. Arkla submitted the names of 400 gatherers who allegedly served fields in Arkansas, Oklahoma, Texas and Louisiana in which it too gathers gas. Arkla Gathering Comments at 16. Even a nonpipeline group, the Independent Gatherers and Processors, submitted this kind of evidence. Indicated Gatherers and Processors Gathering Comments Exhibits A-D.

Pipelines accompanied their blanket assertions of competition with equally unsupported assertions of such market factors as low barriers to entry. *E.g.,* Arkla Gathering Comments 16 (minimal barriers to entry), 22 (listing entrants in its general area); El Paso Gathering Comments 14 (easy to construct, operate a gathering system); Enron Oil and Gas Marketing Gathering Comments 2 ("relatively low barriers to entry"); Enron Interstate Pipeline Company 34 (assumes producers can build gathering systems if pipelines charge too much).

Pipelines predicted that unregulated companies would drive out the regulated unless things changed by the workings of competition. Arkla warned that regulated companies would be forced to sell their assets to unregulated companies. Arkla Gathering Comments 31. Those companies would have an unfair advantage because they could participate by "cream skimming," entering the best markets and ignoring the rest. *Id.* at 52. Enron Interstate Pipeline predicted that regulated gatherers would be at the same disadvantage that interstate gas producers had suffered compared to unregulated intrastate producers in the Seventies, and that the regulated companies would be forced to divest their assets. Enron Interstate Pipeline Gathering Comments 2, 36.

Last but not least, pipelines purported to be at a competitive disadvantage if they had to disclose their prices but other companies did not. El Paso Gathering Comments 10; Enron Oil and Gas Marketing Gathering Comments 8-9; Enron Interstate Pipeline Gathering Comments 33, 43. Some pipelines hedged these comments by claiming inconsistently that while they needed secrecy to compete effectively, their customers know the rates anyway. *See e.g.,* Arkla Gathering Comments 35 (injured parties will have enough information; producers share market area information); El Paso Natural Gas Gathering Comments 36 (gas shippers are in a better position to get price information than pipelines); Enron Interstate Pipeline Gathering Comments 26 (under Order 636, shippers have access to all pertinent transport information). Yet anyone who has litigated against pipelines or negotiated gathering and processing agreements with them in the post-deregulation era knows that they seal their contracts with confidentiality provisions.

commissioned a study to prove its claim of competitiveness.[60] Producers and many state regulators argued just as resolutely that pipelines have power and the FERC could not just assume competition.[61]

The FERC did not issue a rule, but the pipelines prevailed. The Commission began allowing pipelines to transfer almost any system to an affiliate and treat it as unregulated.[62] In the first of these orders, the

60. INGAA commissioned Foster's, a well-known source of statistical data on the energy industry, to study the "gathering market." FOSTER ASSOCIATES, INC., PROFILE OF NATURAL GAS GATHERING IN THE UNITED STATES, 5 (1994)[hereinafter cited as INGAA Report]. Hiring such a respected source was a wise strategy because it gave the Commission a report that could have the appearance of being a somewhat neutral peek at the gathering market.

The problem is that the report was far from neutral. Foster's looked at five major gas producing states (Texas, Oklahoma, Kansas, Colorado, and New Mexico). These states produced 56% of the natural gas in the continental United States and all told were served by 2,157 gas gatherers. The companies drew gas from 300,000 wells. Interstate pipelines gathered 22% of the gas, their affiliates 7% (a percentage now likely to grow to absorb the 22% regulated gas), and major oil companies roughly the same percentage as interstate pipelines. *Id.* at 1. The FERC's approach guaranteed low levels of concentration by treating five states as one market. Gathering systems operate in much smaller fields or basins of gas within each state. Foster's admitted the obvious problem, which is that natural gas markets may not match state boundaries, when it admitted that concentration increased as one looks at a more "local" level. *Id.* at 40 & n.1.

Foster's analysis is not the kind of market analysis that the FERC follows when deciding whether price regulation is needed. While the FERC seems to have abandoned anything like market or competitiveness analysis in ruling on deregulation of certain facilities, it applied the traditional analysis in a recent application by a pipeline to adopt "market-incentive" rates for its pipeline. *See* KN Energy Interstate Gas Transmission Co., 68 F.E.R.C. § 61,401 (1994).

Foster's asserted that gathering economies of scale (the theoretical reason for pipeline monopoly power) are low because "[g]athering systems generally cannot take advantage of larger diameter pipelines and, with relatively low construction cost, barriers to entry are low." INGAA Report, *supra*, at 3. It never proved this assertion. It did not discuss available capacity, contract terms, pressures, production growth and decline, or any other relevant market factors. Nor did Foster's explain its choice of market or how a five-state (or even one-state) gathering area could be considered a market. Its own work established increasing concentration as it narrowed its focus from five states to each state, although this remained a too-great level of analysis. Thus while interstate pipelines owned only 22% of gathering companies based on volumes transported in the five-state area, they had 73.7% of volumes in Kansas, 79.8% if their affiliates are included, and 47.3% in New Mexico, 48.2% with affiliates. *Id.* at 17. If concentration is measured by top-eight firm shares, the shares are quite high even if the state was a proper market: 73.3% in New Mexico, 82.3% in Colorado, and 81.3% in Kansas. *Id.* at 40. Moreover, while Foster's claimed that barriers to entry are low, it accurately but inconsistently noted that "[d]irect competition between gatherers occurs primarily when wells are first connected or when a gatherer's contract with a producer expires." *Id.* at 3.

61. Producers' allegations of no competition often are as abrupt as pipelines' assurances of total competition. *See* Initial Comments of Independent Oil & Gas Associations of Pennsylvania, West Virginia, & New York, 1994 Gathering Conference, *supra* note 59, at 14-17 (arguing that Appalachian gathering systems are not competitive); Initial Comments of Producer-Marketer Transportation Group, *id.*, at 5 (view of gathering as competitive "is inconsistent with the experience of a vast majority of independent producers, especially smaller producers"); Comments of the West Virginia Oil and Natural Gas Assoc., *id.*, at 2-5 (arguing that Appalachian systems are not competitive, with low volume, production decline, and high unit cost of new facilities); *see also* Arkansas Royalty Membership's Initial Comments, *id.*, *passim* (discussing problems for small producers).

62. One of the problems with the Commission's circumvention of its rulemaking duty—in a situation where it clearly is applying a new rule—is that it did not have to articulate the reasons for its decisions as clearly and rationally as it would have had to in a rule. *Compare generally*, Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402 (1971); Greater Boston Television Corp. v. FCC, 444

Commission admitted that it would not require a competitiveness showing for each transfer. It announced to everyone's surprise (and to pipelines' delight) that:

> [T]he Commission concludes that *the existence of competition is not particularly relevant* to a decision to allow a pipeline to abandon its gathering facilities. To the extent competition is relevant, the excessive effort required to assess it would be unwarranted, especially where customers have other recourse to protect themselves in cases of abuse.[63]

The decision to avoid individual determinations reflects the Commission's growing belief in the power of market forces, as well as its constraints in an era of conservative political oversight.

A number of the gathering decisions are on appeal. The Commission ignored its traditional approach of studying each market if it is to hold that the market will provide just and reasonable rates. Moreover, the Natural Gas Act does not suggest the FERC can deregulate a jurisdictional service. If fear of monopoly justified regulation, one would expect deregulation at the very least would require some guarantee of competitiveness. The FERC is familiar with this approach; in the same general time period, it denied an application for market-based rates on KN Energy's clearly jurisdictional transportation because KN had not shown other shippers competed at each point along its 100-mile pipeline.[64] It required the same

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F.2d 841, 851 (D.C. Cir. 1970), *cert. denied*, 403 U.S. . 923 (1971). Some other, almost incidental comments in these gathering orders suggest that the Commission decided that the cost of market-by-market determinations was too high or, inconsistently, that the Commission concluded that the overall market *is* competitive.

For a hint at the transactions cost rationale, see *Mid-Louisiana Gas Co.*, Docket No. 93-79-001, slip op. at 5 (May 27, 1994):

> Those comments [at the February 1994 gathering conference] confirm that the circumstances surrounding gathering in the United States are so diverse that no generic finding can be made as to whether or not the industry is competitive. Moreover, the comments suggest that any attempt to determine on a case-by-case basis whether competition exists would be unreasonably burdensome and time consuming, in part because there is no agreement as to the standard by which competition should be measured.

For the hint at a determination on competitiveness, see *id.*:

> [T]he responses to the Commission's questions in the Public Notice . . .suggest that abuse of market power is not as significant a problem as some current pipeline gathering customers predict. Rather, customers of unregulated gatherers have found ways to assert sufficient leverage over the gatherers to prevent excessive rates, terms and conditions.

The FERC would have been hard pressed to escape with these comments without a detailed record and fully supported reasoning if it had proceeded via administrative rulemaking. As some of its abandonment and exemption decisions still are on appeal, it remains to be seen whether the FERC will succeed in circumventing normal administrative processes, though the D.C. Circuit's approval in the *Conoco* decision means that the Commission is well on its way. Conoco v. FERC, Cause No. 94-1726 et al. (D.C. Cir. Aug. 2, 1996).

63. Mid-Louisiana Gas Co., F.E.R.C. Docket No. 93-79-001, slip op. at 6 (May 27, 1994)(emphasis added).

For proof that the Commission has not forgotten the rigors of ordinarily market analysis, see the description of its holding in the *K.N. Energy* case. *Infra* note 64.

64. KN Energy argued that its 100-mile pipeline was connected to ten different pipelines, as well as other gathering systems and processing plants; that it had only a small part of the market in the area; and that the market was not concentrated. KN Energy Interstate Gas Transmission Co., 68 FERC

market-by-market test in its "incentive" rates and, very recently, in its capacity release exploration. When power is contested, ordinary antitrust analysis requires proof of enough substitutes in geographic and product markets so that no producer can control prices.[65]

Incentive rates for mainline transportation were the next step in deregulation. The Commission issued its Statement of Purpose (SOP) approving "incentive-based" rates for mainline transportation last year.[66] The SOP gave the Commission's answer to the question whether it would let the market determine "just and reasonable" rates even if the activity clearly falls within its jurisdiction (rather than requiring cost-of-service regulation).[67] Their answer is yes. Yes, that is, if the pipeline: (1) can show its

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§ 61,401 (1994), Docket No. 94-328-000, slip op. at 3-4. In response, the Commission looked at concentration, excess capacity, and barriers to entry *at every part of the pipeline.* It put the burden on KN to prove it lacked power "in all segments of their narrowly defined markets" and denied the market rates because some customers "are connected solely to the Buffalo Wallow System" and KN had not shown those customers had alternatives. *Id.* at 4-5.

KN came back with market information, including a showing of many alternatives and low market share, and nearly two years later the FERC granted the application to charge market-based rates. KN Interstate Gas Transmission Company, Docket Nos. 94-328-001 & RP 95-81-000, slip op. (Aug. 1, 1996).

65. A relevant market, geographic and product, is the market "composed of products that have reasonable interchangeability for the purposes for which they are produced—price, use and qualities considered." United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 404 (1956). The product market may be composed of "well-defined submarkets which, in themselves, constitute product markets for antitrust purposes." Brown Shoe Co. v. United States, 370 U.S. 294 , 325 (1962). As the Court stated in *Brown Shoe:*

> The criteria to be used in determining the appropriate geographic market are essentially similar to those used to determine the relevant product market. . . The geographic market selected must, therefore, both correspond to the commercial realities' of the industry and be economically significant. Thus although the geographic market in some instances may encompass the entire Nation, under other circumstances it may be as small as a single metropolitan area.

Id. at 336-37.

Of course, antitrust litigation has different burdens than regulatory work. In private antitrust lawsuits, plaintiffs have the burden of proving their claims. In contrast, when the FERC is attempting to lift formal rate controls in matters put within its authority on an assumption of market power, one would expect the Commission to give itself some burden to establish competitiveness first, either by market or in an industrywide analysis if it believes the industry lends itself to a single determination.

The point is not that the Commission is totally blind. It has its economic staff and other economic studies to draw on. For a recent survey of analysis available to the FERC on mainline trends, including staff work and its 1992 Pipeline Competition Task Force report, *see* Robert Michaels & Arthur De Vany, *Market-Based Rates for Interstate Gas Pipelines: The Relevant Market and the Real Market,* 16 ENERGY L. J. 299, 316-20 (1995). But this is not market data tested in any administrative or legal process and subjected to a burden of proof.

66. *Incentive Rate Order, supra* note 2.

67. The Commission's general answer is little surprise, as it has used the same approach fairly recently. Elizabethtown Gas Co. v. FERC, 10 F.3d 866, 870 (D.C. Cir. 1993)("When there is a competitive market, the FERC may rely upon market-based prices in lieu of cost-of-service regulation to assure a just and reasonable result."); *see also* the 1995 KN Interstate Transmission opinion, permitting market-based transportation rates, KN Interstate Gas Transmission Company, Docket Nos. 94-328-001 & RP 95-81-000, slip op. at 33 n. 66 (Aug. 1, 1996) (listing its prior approval of market-based rates in five storage projects).

market is competitive;[68] and (2) continues to file its rates, in this case market-based rates.[69] In addition, even if the pipeline does not make a competitiveness showing, the Commission may permit alternative rates as long as customers still can get a cost-of-service rate as a "recourse rate."[70] The Commission would not review the rates when filed, but it would entertain complaints about discrimination.[71]

The Commission has just made two proposals that presage even more deregulation of mainline transportation. At a minimum, they will expand the volumes of firm transportation that trade at unregulated prices. In competitive markets, buyers can trade goods and services in secondary markets. One issue for regulators is whether companies owning jurisdictional transportation can sell it to others and, if so, on what terms. If there is a risk of monopoly, it may be created by secondary buyers who corner the market, not just by the pipeline that builds space. The FERC nonetheless has decided to experiment with uncapped negotiated rates for capacity release, interruptible, and even short-term firm capacity.

The FERC tried to develop a program in selected markets over the 1996-1997 winter to allow trading in capacity if companies "demonstrate they do not possess market power" and file detailed reports on their rates.[72] In a companion measure, the Commission has asked for comments on measures to "streamline" capacity release; eliminate competitive bidding requirements; and let pipelines sell interruptible and short-term firm capacity as well as released capacity above the cost-of-service rate.[73] In markets like California where there is a lot of excess capacity, so that large volumes of released space can drive market prices, capacity release will dramatically alter market conditions.

Treating these rules and orders as a single institutional reform, the Commission has imposed a radical restructuring on the gas industry. It is conducting a sophisticated experiment in imposing competition. It has withdrawn from many of its traditional rate-setting duties.[74] With capacity release, it may be starting the process of withdrawing from them all.

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68. The Commission has determined that where a natural gas company can establish it lacks significant market power, market-based rates are a viable option for achieving the flexibility and added efficiency required by the current marketplace. Incentive Rate Order, *supra* note 2, at 8-9.

69. *Id.* at 20.

70. *Id.* at § V.A.

71. *Id.* at 61.

72. Pilot Program, *Secondary Market Transactions on Interstate Natural Gas Pipelines,* Docket No. RM96-14-001, at 2, 6-9 (July 31, 1996). This part of the capacity release experiment, fell apart after all candidates dropped out. *With Pilot Grounded, Capacity-Release Rule Looms on FERC Radar,* INSIDE F.E.R.C., at 1 (Feb. 17, 1996).

73. Notice of Proposed Rulemaking, *Secondary Market Transactions on Interstate Natural Gas Pipelines,* Docket No. RM96-14-001, at 2, 6-9 (July 31, 1996). The Commissions' general power to regulate released capacity was upheld in the recent Order 636 decision, United Distribution Co. v. FERC, 88 F.3d 1105 (D.C. Cir.1996)

74. The question of what has motivated the Commission is of legal importance because some motives are legitimate and some not, matters of some urgency when abandonment orders and gathering definition decisions remain on appeal. The FERC's motives are of scholarly interest, too, as more evidence in the long-standing debate over why agencies act the way they do. Gas deregulation is a

puzzle for the many organizational theorists who believe that organizations are motivated primarily by a drive for power. It appears to be a case of an agency's unilateral withdrawal from areas it used to control.

Deregulation proponents tend to act as if the Commission was just carrying out a congressional mandate, as if deregulation can be explained in simple doctrinal terms. This claim is belied by the radical scope of the changes. As the FERC has noted, the NGPA had a particular balance:

> The rationale for maintaining utility-type market entry, exit, and price regulation over the sales for resale of interstate pipelines while removing that regulation for similar sales by other market entities is only implicit in the NGPA but appears plain enough: While Congress concluded that gas production was sufficiently competitive to remove regulation, the control which interstate pipelines exercised over transportation still conferred on them the same kind of market power over their customers as had existed at the time of enactment.

Order 436, 50 Fed.Reg. at 42,418.

The FERC already had emphasized this balance when it stated that "regulation will allow competitive forces to operate in those areas where Congress has determined they will better protect the public interest than traditional utility-type regulation, while retaining the traditional-type regulation in those areas where competitive forces have been found inadequate by the Congress." *Id.* at 42,413.

These descriptions are misleading to the extent that they portray the NGPA as a product of rational policy analysis, when the Act so embodies political compromise. But regardless of whether the compromise was "unprincipled" in its intellectual coherence, once enacted its terms become the principle that democracy requires courts to honor.

The power to unbundle, to deregulate unbundled services, and to implement market rates cannot be a general NGA-power. If the Commission believed it had a general power to deregulate wherever competition emerged within its jurisdiction, it should have exercised that power to free the most competitive jurisdictional market, the gas wellhead market, long ago. By the early Seventies, this was far and away the most competitive part of the natural gas business. Yet FERC did not act. It took Congress to deregulate wellhead prices.

One might argue that the FERC did not feel it had the power to upset the Supreme Court's 1954 decision that wellhead prices were jurisdictional, but that once Congress passed the NGPA the Commission took the new statute as a mandate for wider demolition of the regulatory apparatus. Yet the NGPA did not create such a new power because as the last paragraph discusses, the NGPA carefully drew the line between regulation and deregulation. It was a political bargain. Congress had to know that it was leaving transportation and all other pipeline-supplied services regulated. It is implausible that Congress agreed in 1978 on the need to break open company-owned pipes and to unbundle integrated transportation/field services, but decided to say nothing about it in this otherwise elaborate, indeed Baroque, statute. Nor, perhaps more importantly, has the FERC made similar findings of competitiveness in *these* markets as it has pushed them into unregulated sectors.

The FERC's behavior does not fit organizational theories that agencies put their own power first, *see* W. RICHARD SCOT, ORGANIZATIONS 52-53 (3d ed. 1992), because the FERC voluntarily abandoned a large share of its power. It seems to have disavowed as much of its decisionmaking authority as possible. It is always possible that the Commission took the longest possible view and decided that only a minimalist agency would survive in a climate of deregulation, but this hypothesis makes the power thesis unverifiable (it would interpret the FERC as pursuing power whether it expanded, entrenched, or downsized).

Capture theories predict that agencies will be captured by the most concentrated, easy-to-organize interests among those they regulate. *See* the discussion of capture theory in note 118 *infra*. Yet the FERC's orders cannot be matched consistently to the interests of any major player in the natural gas business. First, though pipelines generally have supported Orders 500, 636, the gathering deregulation, and certainly the incentive-based Statement of Policy, they were almost unanimously bitter opponents of Orders 380, 436, and the portions of the later orders that rejected take-or-pay relief. The scope of this opposition is hard to reconstruct because the industry has changed. It increasingly is dominated by pipelines that expect to be beneficiaries of Order 636 and incentive rates. Having adapted to their new environment, these companies now have become aggressive supporters of competition. A number of the losers in these changes have been merged into more aggressive companies, thus stilling their chance to dissent.

In a decade, the Commission has removed the minimum bill protection for gas sales. It has treated interstate pipelines as essential facilities by pressuring them to convert to "open access" systems. It has removed virtually all barriers to entry for pipelines willing to build new facilities at their own risk.[75] It has cut formerly tied products by insisting that pipelines offer

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Rick Harper has reminded me that pipelines were coming under increasing pressure from alternative fuels during the early deregulation period. They were victims of the rigidity of the gas pass-through process. Competition from energy substitutes may be another factor that helped persuade pipelines that their long-term welfare required deregulation.

These changes should not obscure the fact that almost all pipelines rejected the FERC's early steps. One suspects that most of these companies would return any benefits they have received gladly, if only they could return to the old bundled world and if the FERC would let them recover their losses on take-or-pay contracts. A surprising number of producers might prefer this more sedate, less risky world as well.

At the same time, deregulation has not consistently favored producers. Most producers opposed the most recent efforts to deregulate unbundled services, opposed Order 500's crediting mechanism, and are wary, at a minimum, of incentive rates.

Gas deregulation shows a common problem in capture theories, which is their tendency to be self-validating. The theory predicts that the densest, most organized interests will prevail. When one side does prevail, there is a tendency to announce that, aha, this group must have the most concrete interests. It is almost impossible to operationalize this prediction in the gas industry because of the overlapping nature of the interests. There are more producers, and wealthier producers, than there are pipelines because many major gas producers are also the country's biggest oil producers. These companies are fabulously wealthy. Yet on issues like gathering, producers had divided interests because many owned private gathering lines, which they did not want regulated at any price. Still, it is too easy to claim that pipelines therefore must have had the more concentrated interests because they "won" the gathering debate. Capture theory offers no key to predict whether the producers' collective interest as producers, or that of the producers who own gathering lines, would predominate, although it correctly predicts that this division will reduce the effectiveness of the producers' lobby.

The "consumer" interest might be a consistent foundation for deregulation, as every order has furthered market intervention. But this interpretation has its own pitfalls. For reasons that are unclear (one suggestion is that consumer groups devote their resources to the bigger electric industry), there are no national consumer groups that regularly appear in the FERC natural gas hearings. State regulators, many of whom did intervene in various orders, can be taken as a proxy for the consumer interest, but the FERC did not follow their recommendations in areas like gathering. And consumers and state utility commissioners should have preferred the FERC to void take-or-pay contracts, a step that would have lowered end-user gas costs, even though they had an incentive to support Orders 380, 436 and 500 otherwise.

The reading of natural gas history most consistent with the facts is that deregulation is the product of a major shift in political values, perhaps even more broadly in cultural values about the way we look at markets and competition. This shift was accelerated by the conjunction of deregulation in various industries, with each step encouraging changes in other industries. The change emerged from a larger political consensus, one typically attributed to Ronald Reagan, but that traces back at least to the Ford and Carter years. Alfred Kahn, *Deregulation: Looking Backward and Looking Forward,* 7 YALE L. J. 325, 325-26 (1990); *accord,* IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION 9-11 (1992)(concluding that Carter Administration, not Reagan, was primary mover in deregulation); *cf.* Fix & Eads, *supra* note 2, at 293 (noting in 1985 that only regulatory agency abolished was Civil Aeronautics Board, abolished during the Carter Administration). An academic and business consensus that markets could do a better job.

For a sophisticated argument that deregulation, including natural gas deregulation, cannot be explained by special interest capture, agency power maximization, or purely by reformers' ideas, but giving a high portion of explanatory power to ideas, see DERTHICK & QUIRK, *supra* note 9.

75. A new openness to entry began with Order 436, in which FERC lured pipelines into open access by offering to let them build new systems without lengthy approval processes, as long as they would assume the risk of loss. *See* Sheila Hollis, *The Changing Framework of Natural Gas Business and*

and price gathering, processing, and storage separately from transportation. It has permitted the deregulation of each of the unbundled services except mainline transmission, shifting the form of antitrust regulation from administrative determinations to market pricing. Now it is even toying with market pricing for the mainlines and allowing an unregulated market in release mainline capacity.

The radical scope of gas deregulation is hard to overstate. Revenues, profits, and employees of many pipelines have dropped rapidly. While in the regulated period pipelines were not to earn a profit on gas sales, sales of gas nonetheless accounted for most of their revenues (to be offset by debits for the gas purchases) and created many of their jobs. Having to process sales of natural gas made pipelines much bigger companies, whether measured by sales, employees, or assets, and more influential within the business community.

Revenue and income have fallen sharply with deregulation. From 1985 to 1994, revenue dropped from $56.3 billion to $16.6 billion, operating income from $5.2 billion to $2.4 billion.[76] Oil pipeline net incomes actually exceeded gas incomes in five of the ten years between 1985 and 1994, in spite of revenues that were somewhere between one-eighth and one-half of gas revenues.[77] An undetermined amount of this business has shifted to other pipeline affiliates, so these numbers may overstate the changes (and these affiliated services will pose a problem for the Commission down the road), but the immediate changes are dramatic indeed.

Law, 35 R. MTN. MIN. LAW. INST., 14-16 to -19 (1989). Hollis also discusses the FERC's effort to reduce barriers to abandonment under Order 490. *Id.* § 14.02[2], at 14-12 to -15.

76. Warren True, *U.S. Interstate Pipelines Ran More Efficiently in 1994,* OIL & GAS J. 39, 45 (Nov. 27, 1995).

77. The low percentage of income to revenue is even more striking. Gas pipeline income was 9.2% of revenue in 1985, 14.5% in 1994. Oil pipelines, in contrast, had far lower revenues that hovered around $7 billion throughout this period, but net income averaged over $2 billion (forming 30% of revenue in 1994). *Id.*

The decline has shrunk employment at many pipelines, although some of the declines are obscured by mergers and shifts of employees to other functions like cogeneration and to new marketing entities. Two authors cite congressional testimony that the oil and gas industry lost 400,000 jobs in recent years, "more jobs than were lost in the automobile, textile, steel and electronics industries." Santa, Jr. & Beneke, *supra* note 25, at 13. Pipelines are among the primary losers.

There would have been a much more sustained outcry over these job losses had the industry been organized into large, unionized plants like those industries. (There probably would have been more outcry if the oil and gas industry did not have such an anti-government ideology, too, an ideology at odds with its dependence upon legislative privileges). The oilfield has been one of the last homes to small businesses. The trade organization of independent producers, the Independent Petroleum Association of America (IPAA), estimates that independent producers drill 85% of all new wells and produce as much as 64% of the natural gas in the United States. Comments of the Independent Petroleum Association of America, *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines,* Docket No. RM95-6-000, before the Federal Energy Regulatory Commission (Apr. 25, 1995). Not only have many of these companies struggled with much more immediate problems, i.e., bankruptcy, but in addition efforts to organize these interests would face the free-rider and other problems of aggregating many small interests. *See generally,* MANCUR OLSON, THE PROBLEM OF COLLECTIVE ACTION (1971).

Problems will arise in deregulated markets, in natural gas and elsewhere, when some companies have continuing power and information flows are not strong enough to alert regulators and private parties to abuses. Though advocates of reform proclaim a world in which information appears magically and at no cost and new entrants parry every monopolist's thrust, no real market operates this seamlessly. Thus it is important for regulators and others trying to assess the deregulation experience to leaven theoretical predictions with facts. The unregulated gathering market is a good example of a market in which power and poor information will continue to be problems in at least some geographic areas. The next section illustrates some problems of deregulation generally by studying one company's market, the Williams companies' gas gathering in Northern New Mexico.

III. The Risky Business of Deregulation: Gas Gathering and Williams Field Services in Northern New Mexico

There are several reasons why this market makes a good study of deregulation and its risks. One is that the Williams companies have been leaders in deregulation. Williams read its regulatory cues better than most companies. It was among the first companies to see the transforming possibilities of the new era. The company filed one of the first applications to abandon a regulated gathering system.[78] In addition, it was one of the first pipelines to build a new gathering system without applying for the FERC's permission—to simply assume that new facilities would be deregulated.

A related attraction of the Williams case is a luxury of data. A big problem facing those trying to understand the economic effects of deregulation is that information is scarce. The formerly regulated are less than eager to disclose their costs, prices, profits, and terms of service. Natural gas is no exception to the paucity of data. Many pipelines, including the Williams companies, keep their market positions and pricing secret. Fortunately, Williams generated a good record with its filings on deregulation. In addition, many of its internal business documents entered the public record in litigation.[79] Thus, the case presents a rare opportunity to test a deregulated company's public arguments for deregulation against its internal statements. A company's business records seem more likely to display its real motivation than its administrative filings.[80]

78. The FERC's establishment of "light-handed jurisdiction" came in a Williams Company case involving the spin-down of regulated Northwest Pipeline Company facilities. Northwest Pipeline Corp, 59 F.E.R.C. § 61,115 (1992), *reh'g denied,* 60 F.E.R.C. § 61,213 (1992), *petitions dismissed,* Williams Gas Processing v. FERC, 17 F.3d 1320 (10th Cir. 1994).

79. This case is the *Sunrise* case discussed just before the first footnote, in which the author is one of the counsel for the plaintiffs.

80. *But see* Geoffrey Hazard, *Discovery Vices and Trans-Substantive Virtues in the Federal Rules of Civil Procedure,* 137 U. Pa. L. Rev. 2237 (1989). Professor Hazard has defined Rule 34's provisions as the most important in the 1938 Rules: "It is simply to say that the broad access to document repositories is the most powerful weapon in the Rules' discovery armory, particularly in cases involving conduct by business or government." *Id.* at 2239. Contemporaneous documents usually provide better evidence of the true reasons a decision or action occurred than after-the-fact reconstruction. As Hazard notes, "the

The Williams example is interesting as well because Williams has substantial market power by traditional measures in northern New Mexico, even using its own calculations. Thus, the example demonstrates the risks of deregulation in a market where abuse would be easy to implement.

Not to be lost in the analysis should be the significance of the San Juan basin. This market is but one of many producing areas, but it is a significant one. It is the largest coal-seam gas region in the United States. In 1994, the Basin produced 94% of all United State coalbed production.[81] It had more wells drilled than any other coalbed area in 1992, 1993, and 1994 and holds over two-thirds of the country's coalbed reserves.[82] This is one of the largest gas producing areas in the United States.[83]

Though gathering is just one of the formerly integrated services of interstate pipelines, it is neither a small nor incidental part. The deregulated affiliates that offer gathering often include the other unbundled services of processing, treating, and storage, and sometimes even marketing, so they tend to represent a large part of the total services of gas pipelines. "Gathering" can be a euphemism for all of the unbundled services.

For many companies, these services have outgrown the mainline business. On the Williams company system, for instance, the 1993 and 1994 operating profit from the pipeline group was not that much more than the

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content of a document is immutable." *Id.* (This comment overlooking a bit that interpretation is not "immutable"). For this reason, production provokes "the most intense resistance and game-playing." *Id.* at 2240.

Hazard seems to feel that after-the-fact production is somehow unfair to defendants: "Documents that speak with a candor unguarded by anticipation of litigation are particularly damaging. These communications are laid bare to the harsh light of second-guessing litigation." *Id.* at 2242-43.

He may envision the litigation process as a world in which a few careless notations, often by people not really involved in decisionmaking, control the outcome of trials. My experience is that it is much more common that witnesses will not recall what happened, will reconstruct the world in ways most favorable to them, or just lie, unless brought back down to earth by documents showing what they really said and wrote. Contemporaneous documents can be the most accurate kind of information. Juries understand this and usually give them great weight.

For concordance with Professor Hazard, see Frank Easterbrook, *Discovery As Abuse,* 69 B.U. L. REV. 635, 637-39 (1989). Judge Easterbrook laments courts' inability to regulate discovery. He fears that judges analyzing a request "cannot know the productivity of the request." *Id.* at 639. "[W]e cannot define 'abusive' discovery except in theory, because in practice we lack essential information." *Id.*

Again in my experience, courts would be lucky if their sanctions motions were confined to cases in which abuse was hard to define. The Seventh Circuit must have a rarefied, outlying standard of practice. In most courts, discovery problems center on wrongful withholding and yield an obvious answer (produce!). A Federal Judical Center study of 3000 federal cases in the late seventies found that rulings on motions to compel "were overwhelmingly favorable to moving parties." PAUL CONNOLLY, ET AL., JUDICIAL CONTROLS AND THE CIVIL LITIGATIVE PROCESS 20 (1978). The courts granted 94.4% of motions concerning interrogatories and 88.2% of those concerning documents. *Id.*

81. *Technology Spurs Growth of U.S. Coalbed Methane,* OIL & GAS J. 56 (Jan. 1, 1996).

82. *Id.* The Basin has 6,992 bcf out of a total United States reserve of 9,717 bcf. It also has 2,514 of the 6,301 producing coalbed wells in the country. *Id.*

83. *See* El Paso 1995 Annual Report, *supra* note 45, at 1 (calling Basin "one of the most prolific supply basins in the nation"). The Basin is also the center of holdings for Meridian Oil, Inc., which says it is the largest independent oil company in the country. Burlington Resources, 1995 Annual Report, at 1 (1996).

field services group[84] (which only came into existence in 1988). Other large pipelines have begun focusing on unregulated field services, too.[85] These services will have great effect on the overall cost of delivered gas.

The Williams companies took an aggressive position in FERC's 1994 gathering hearing. They argued that gathering markets are competitive nationally. Williams' supporting arguments were that the NGPA was based on a congressional finding that the "field," not just the wellhead, was competitive; that gathering is in fact competitive; that gathering is not jurisdictional anyway because of the NGPA's "production and gathering" exemption; and that the FERC has no reason to belabor these issues because the States will police gathering markets if the FERC does not.[86]

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84. In 1993, Williams Field Services had revenues $432.2 million and operating income of $127.7 million, while the pipeline group had revenues of $570.6 million and profit of $139.8 million. The figures for 1994 were, respectively, Williams Field Services, revenues of $375.7 million and operating profit of $129.3 million; the pipeline group, $469.8 million and operating profit of $152.9 million. The figures for 1995 are not comparable because of Williams' acquisition of Transcontinental Gas Pipe Line: pipeline revenues more than tripled and profits jumped as well. The Williams Companies, 1995 Annual Report, at 38 (1996).

Williams understands its incentive to stress field services: "Our unregulated companies provide higher risk/higher reward growth and have the proven ability to leverage additional value from our regulated businesses." *Id.* at 3.

85. El Paso Natural Gas Company is another major gatherer in the San Juan Basin. El Paso recently reorganized itself into three divisions: one for mainline transportation, one for field services and marketing, and one for equity investments in energy projects. In one indication of the kind of problems the FERC will face in figuring out what is occurring in the unregulated markets, El Paso's annual report does not break out financial results for these three divisions. Nonetheless, it is clear that El Paso, like Williams, is treating field services as a major growth area. It is moving El Paso Field Services from El Paso to Houston, the center of the energy industry, where it "plans to aggressively pursue growth opportunities through acquisition and development of assets in and outside of its current service area." El Paso 1995 Annual Report, *supra* note 45, at 7-8. At the New Mexico gas conference, Robert Phillips of El Paso Field Services indicated that the company is trying to shift its focus to the unregulated sector as much as possible.

86. In support of its claim that Congress had found the gathering market (as well as wellhead prices) competitive, Williams cited a casual statement in Order 636 that "there is no doubt, as Congress expressly found and confirmed, that a competitive market exists for gas at the wellhead *and in the field.*" Statement of Williams Field Services Group, 1994 Gathering Conference, *supra* note 59, at 6, *citing* FERC. STATS. & REGS. ¶ 30,440 (emphasis added). Williams repeatedly asserted that Congress had made a specific determination on gathering. *See, e.g., id.* at 11 ("In the marketplace for production-area services within which gatherers conduct their business, Congress has determined that competition should replace regulation.") This position doesn't make much sense as a statutory reading. If Congress found the gathering market so competitive when it passed the NGPA, presumably it would have ordered unbundling as well as wellhead gas price deregulation. It didn't.

Williams tried to bootstrap its argument about a national gathering market by citing the INGAA/Fosters report. *See supra* note 60. Williams claimed that Fosters "found no major barriers to entry to exist." *Id.* at 16. "Indeed, its additional finding of more than 2,000 gathering companies in the 5-state area studied is itself a testimonial to the ease of entry." *Id.* Neglected is the fact that Fosters did nothing to study the elasticity of demand or supply. Most wells are connected to exactly one of these thousands of systems. The report did not suggest how a producer in, say, New Mexico, one of its five test states, could use the hundreds among those 2000 gatherers whose systems were in Kansas, to say nothing of remote systems even in New Mexico. All Fosters did was add up the number of gatherers it could find in these five states. This is an exercise in counting, not market analysis.

On general competitiveness:

Williams belittled a common argument that contracts tying producers to specific gathering systems deter competition. It called this an "unrealistic, narrow view of the manner in which the production/gathering marketplace operates."[87] The company invited the FERC to conclude that in this "national competitive market," "there simply are too many options for buyers and sellers to get together."[88] As for market power, the company claimed that "none of the many individual competitors in the field gathering areas can force any among millions of gas consumers to pay more than a price which is determined to be competitive . . . ."[89]

Williams told the FERC that the San Juan coal-seam market is "a highly competitive environment."[90] As proof, it referred the Commission to Amoco's building its own Florida River gathering system (not mentioning that Amoco is one of Williams' largest customers and has dedicated a substantial part of its reserves to Williams)[91] and to two other systems built by "producer-gatherers."[92]

Another piece of data about the San Juan Basin at the FERC Gathering Conference, albeit very misleading data, was the INGAA-sponsored 5-

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> In addition to competing in the production-area marketplace, gatherers effectively must compete to serve consumption markets. Such competition for gathering services is multifaceted—based on the delivered price, service reliability, fuel requirements, pressure requirements, capacity requirements, processing requirements, disposition of liquids, timing of construction and countless other variables dictated by any given shipper. Under such competitive framework, no gatherer can arbitrarily set the price and terms, either for the gathering service or the delivered price of gas

Id. at 11; *see also id.* at 13 (the "pervasive competition confronted by Williams in its daily operations"); *id.* at 16 (arguing that no major barriers to entry exist in gathering); *id.* at 25 ("Of paramount importance is the fact that none of the many individual competitors in the field gathering areas can force any among millions of gas consumers to pay more than a price which is determined to be competitive by the dynamic, widespread marketplace for delivered gas").

On the details of FERC jurisdiction, Williams argued that the gathering exemption deprives the FERC of power to regulate gathering by a separately organized affiliate. *Id.* at 3-4.

On state jurisdiction, Williams stated that "Williams Field Services would be, absent Federal preemption, subject to state regulation." It cited an Oklahoma statute that prohibits "unjustly or unlawfully discriminatory fees for gathering." *Id.* at 8. The implication was that the states were actively regulating, but Oklahoma generally is cited as the only state that has made a serious effort to address gathering and it has not processed a single complaint to completion under its statute. Thus no State has begun to establish any precedent to guide affected parties.

It is not clear what Williams meant by "absent Federal preemption." Should a state try to regulate if the FERC disavowed jurisdiction, one can predict that the same pipelines will be right back in court arguing that Congress wanted gathering to be left to the market, that deregulation evinced a desire to leave the entire area unregulated by anyone, and that the states are preempted. One suspects Williams welcomed state regulation because it viewed *effective* state regulation as extremely unlikely.

87. *Id.* at 28.

88. *Id.*

89. *Id.* at 16.

90. *Id.* at 12.

91. On the conventional gas side, Williams' affiliate Northwest Pipeline Company (acting through Williams' director of marketing) prepared contracts committing all of producers' current and future conventional production in large areas. *See, e.g.*, Sunrise Exhibit 331, Northwest's proposed conventional contract for Amoco (cover letter dated August 3, 1990). For coal seam gas, it did the same thing through Williams Field Services. Lloyd Hightower Trial Testimony 2000-01.

92. *Id.*

state study of the gathering market.[93] The report, which concluded that the gathering market was not very concentrated, included New Mexico. Its analysis, however, never would pass muster in a judicial or administrative hearing. All it did was take the five major gas producing states and see how many gatherers it could count in them. The "study" proceeded as if someone could measure the grocery market on the West Coast by counting all the supermarkets in California, Oregon, and Washington.[94] Naturally, the San Juan Basin was but a small part of this five-state market. The report did not find any company that could control prices or exclude competitors in its five-state area.

The State of New Mexico tried to refute Williams' rosy picture, often with facts about the San Juan Basin. The State argued that little competition exists among gatherers because most wells are tied to just one pipeline (the number of gatherers in an area thus masking a series of unrelated submarkets). It asserted that capital requirements prevent competition by increasing barriers to entry and that existing gatherers have a big cost advantage. They "retain[ ] the option of dropping [their] rates to the marginal extent necessary to foreclose entry."[95] Competition might exist on wells with multiple connections, but "[g]enerally, once a well is connected to a given gathering system, there are substantial barriers to competition from other gathering systems."[96]

New Mexico pointed out that Williams and Meridian Oil control over 80% of gathering in the San Juan Basin, with coal seam a separate market from conventional gas.[97] The State identified barriers in the area's high development costs, low average deliverabilities, and low wellhead prices.[98] Without regulation, the State expected to see gatherers collect monopoly rents, impose discriminatory terms, and deny access.[99] It illustrated its concerns by appending a redacted Williams contract in which it "understands" that rates had increased 250% after light-handed regulation.[100] The State urged the Commission to decide deregulation on a market-by-market basis, with gatherers having the burden of proving competitiveness.

Though it portrayed the gathering market as competitive, Williams' private documents were closer to New Mexico's view. There, Williams chronicled its success in dominating the San Juan Basin. The company treated coal seam as a separate market because of the gas' special charac-

93. *See supra* note 60.

94. INGAA Report, *supra* note 60. The company also reported these figures by state. Even Foster's admitted that natural gas markets grow more concentrated as one looks at the "local" level, *id.* at 40, but this qualification is meaningless when Foster's did not study gathering markets at the local level.

95. Statement of Department of Energy, Minerals and Natural Resources Department, Oil Conservation Division, 1994 Gathering Conference, *supra* note 59, at 5.

96. *Id.* at 6.

97. *Id.* at 3-4.

98. *Id.* at 7.

99. *Id.* at 11-12.

100. *Id.* at 18.

teristics.[101] A June 1993 report on its Manzanares coal seam pipeline tallied shares of San Juan coal seam gas. It projected its share at 39%, 45% of "future production," with Meridian's at 39% and falling to 38%.[102] These numbers yielded an HHI concentration index of over 3000, rising to almost 3500, far above the 1800 the Justice Department treats as the threshold for heightened scrutiny.[103]

In another document, Williams listed its strategic use of contracts as a key to success. This internal history gave a different picture then its claim to the FERC that contracts do not tie producers to pipelines. An internal plan described the company's goal of "[v]ary[ing] length of agreements such that maximum advantage can be taken of market opportunities and to avoid all agreements terminating at same time."[104] A mid-1992 history of Williams "expertise" listed among the company's achievements "[n]egotiated 30 long-term major or strategic contracts and other contracts *to protect against competition and bypass*."[105] Williams understood that being tied to a given system makes a tremendous difference, particularly when the pipeline structures contract terms and commitments to maximize leverage. In a market it had told the FERC was open to outsiders, Williams lauded its success in having passed "most of the barriers to entry."[106]

Another aspect of Williams' contracts was the anti-competitive effect of its dedication terms. These long-term contracts were with very large producers, entailing commitment of all their reserves at a time of rapidly increasing production as long as Williams accommodated their business.[107]

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101. A Williams Field Services newsletter announcing the Manzanares system indicated that it was building the system to treat coal-seam gas, which "[b]ecause of a high carbon dioxide content, coal-seam typically is gathered and treated separately from conventionally produced natural gas." February 27, 1990 Newsletter, at 1, Sunrise Exhibit 208.

102. Williams Field Services, *Manzanares and Milagro Expansion Project,* Sunrise Exhibit No. 672-A.

103. 1992 Merger Guidelines, Trade Reg. Rpts. § 13,104, at 20,569, 20,573-5 to -6 (1992).

104. Williams Field Services, *Manzanares Marketing Plan Updated 4/12/91,* Sunrise Exhibit 451.

105. Williams Field Services, Gathering, Processing and Production Expertise, Sunrise Exhibit 596, at 13 (June 29, 1992)(emphasis added). This document reiterated the importance of long-term and staggered contract expirations, stating that "Opal, Ignacio [processing plants], and points behind these plants are protected by long-term contracts with staggered expiration dates." *Id.* at 6.

106. *Id.* at 15.

107. Lloyd Hightower Trial Transcript 1998-99. What a difference a forum makes. Here is Williams' President describing the purpose of the staggered expirations of its dedicated terms, an interesting enhancement of long-term contracts:

> [W]e felt we would be better off dealing with producers one-by-one other than through an administrative process having all the contracts come due at the same time, which would put us in a position of dealing with the producers as a group rather than individually .... And then to have the whole system exposed to a complete renegotiation at a point in time just doesn't seem to be good business.

Id. at 2055-57.

In other words, Williams didn't want a negotiation with parties of roughly equal reserves and capacity or risk a big group of its producers having their gas available to a potential entrant or other existing system at the same time.

Even Williams' expert agreed that there could be substantial barriers to competition against already connected wells. Scott Harvey Trial Testimony 2336-37. (It is true that this expert also argued that Williams' long-term contracts were a sign of competition, *id.* at 2320-22, but at least he admitted

These dedications were among the terms shielded by the confidentiality clauses. Fueled by the commitments, Williams expanded its Manzanares system four times in just a few years, from roughly 360 million cubic feet a day (mmcf/d) to 575 mmcf/d, then 750 mmcf/d, and currently to approximately a billion cubic feet a day.[108] New entrants had no chance to bid for this gas as long as Williams expanded.

Finally, at least some of the Williams contracts required the producer to support regulatory treatment sought by Williams.[109] This kind of clause may explain the silence that greets many state regulators in these early years of deregulation. Whether enforceable or not, these clauses are a pointed reminder to producers that some pipelines and their affiliates will look unfavorably on any opposition.

The San Juan Basin is one of the more concentrated gathering areas in the country, but many markets will be more competitive. Williams' position demonstrates that neither market power nor the problems associated with market power vanish just because the FERC calls a market competitive.

The next section begins the discussion of new forms of regulation. Because regulation was a substitute for antitrust scrutiny and antitrust laws will play a key role in policing deregulated markets, this first section on remedies addresses the state of antitrust in an age of market ideology. The section emphasizes the continuing vitality of certain antitrust restraints, which may be enforced by federal or state regulators and by private parties who suffer business injury.

IV. Antitrust Laws Are Predicates of Order in the Deregulated World

Just as regulation provided the basic competitive rules for the natural gas industry for many years, in its wake the core order will be provided by antitrust laws and a number of other laws that may at times substantially affect pipeline activity. For instance, contract litigation over lease and gas

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that he could not explain an internal Williams' memo saying that long-term contracts protected the company *against* competition and bypass, *id.* at 2323-24).

108. A June 23, 1993, "Update" of Williams' Manzanares system traced its expansion from a 360 mmcf/d capacity in 1990 to 380 mmcf/d in late 1991, 575 mmcf/d by year-end 1992, and 750 mmcf/d by year-end 1993. Williams Field Services, *Manzanares and Milagro Expansion Project,* Sunrise Exhibit 672, at 4-5 (June 23, 1993). The report projected 900 mmcf/d volume from existing capacity, *id.* at 14, a prediction that has been surpassed as the Manzanares system has soared to roughly a billion cubic feet a day. Explaining how this growth had been accomplished, the report stated that "[t]hese producers have signed, or will sign, long term contracts committing all of their working interest volumes behind the CDP's [central delivery points in the field]." *Id.* at 15.

109. For instance, the conventional gas contract, that Williams' officers proposed to Amoco in the name of their affiliate Northwest Pipeline Company, proposed to bind Amoco by contract to "participate in support" of Northwest's efforts to make its gathering facilities nonjurisdictional. Proposed Processing Agreement, *supra* note 91, at 4 (Article IX(b)).

At the New Mexico gas market conference in May 1996, Frank Gorham, head of Cinco General Partnership, a small producer based in Albuquerque whose gas flows on four San Juan gathering systems (Meridian, El Paso, Williams, and its affiliate Northwest), told the audience that three of his four gathering agreements limited, or at least tried to limit (courts should not enforce these clauses) his ability to protest contract terms to the FERC and state regulators.

purchase terms can keep pipeline costs down[110] and state tax authorities may challenge prices that reduce severance taxes.[111] Overall, however, major issues of power, pricing structure, and access are most likely to be litigated under the antitrust laws. Indeed, this seems to be what the FERC intends; in one gathering order, it has noted that complaining customers will "have recourse to state and federal antitrust laws in instances where anti-competitive behavior on the part of the gatherer arises."[112] Although the Article discusses federal antitrust precedent, most states have unfair competition statutes with roughly similar terms. (At times the state statute may be more liberal; an example is whether affiliates can conspire with each other.)

Because of the close relationship between the purposes of regulation and antitrust law, the private enforcement of pro-competition rules will be increasingly important as regulators retreat. This section considers whether the pro-market ideology has undercut the rationale for antitrust enforcement, then discusses the antitrust claims most likely to appear in the deregulated world.

A. The Retrenchment of Regulation and of Antitrust

Swayed by the same neoclassical economic theories that have led Congress and agencies to dismantle the apparatus of regulation, the courts have restricted the antitrust laws in the last two decades. To understand the emerging relationship between these competing sources of market control, it is necessary to start with the changes they have shared over the last two decades.

Faith in private competition has been the rationale for every step of deregulation in every affected industry. The court approving the AT&T consent decree, which separated the local Baby Bells from AT&T's long-distance service and its manufacturing arm, did so in an effort to "pry open to competition" markets that AT&T allegedly had restrained.[113] Alfred Kahn, a chief theoretician of airline deregulation, an authority on the eco-

110. *See infra* note 198.

111. In New Mexico, state taxing authorities apparently have investigated and reached settlement on a dispute over aspects of costs deducted before Meridian calculated its severance tax payments. The author has been unable to procure a copy because the audit and its conclusion are confidential.

112. Arkla Gathering Services Co., 69 F.E.R.C. § 61,280, at 62,088 (1994), *order issuing final authorization and on reh'g,* 70 F.E.R.C. § 61,079 (1995).

113. Telephone deregulation should be viewed as a hybrid deregulation. It was the one industry whose path to the market was cleared by the Justice Department, rather than by Congress or an overseeing agency. A federal trial court modified the settlement, so the final dimensions of the change were a joint product of what the Justice Department could extract from AT&T in negotiations and changes added by Judge Greene.

The court's opinion on what was happening, and why, with its own modifications, was published in United States v. AT&T, 552 F. Supp. 131 (1982), *aff'd sub nom.* Maryland v. United States, 460 U.S. 1001 (1983). The court viewed itself as enforcing a market agency to "effectively pry open to competition a market that has been closed by defendants' illegal restraints." *Id.* at 150 (citations omitted). Its remedial action was based upon evidence that AT&T had monopolized the intercity telephone market and related product markets in several ways, using its power over local calling to do so. *Id.* at 160-63.

nomics of regulation, chairman of the Civil Aeronautic Board, and one of the most important figures in the deregulation movement, viewed deregulation as removing costly rigidities and imperfections of government controls and paving the way for the affirmative benefits of markets.[114] The movement has swept through many industries, including railroads, banking, telecommunications, natural gas, and, more recently, electricity.[115] It seems accurate to summarize deregulation as moving from an academic proposal to a "preferred style of policy choice in the nation's capital, espoused more or less automatically, even unthinkingly ".[116]

> Within a very short time, deregulation was transformed from a lonely cause with poor political prospects into a buzzword and bandwagon . . . . [T]he notion of deregulation itself, as prescription turned symbol turned fashion, had an influence on events that was to some degree independent of the resources deployed by particular advocates . . . . And it imposed an exceptionally heavy burden on political actors who might advocate new forms of anti-

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Judge Greene's statement of his role does not explain why deregulation occurred, because the other actors had different views. For instance, one can read a lot of exasperation at the Justice Department into his description of how the case settled after most of the very long trial was over, *id.* at 139-40, an exasperation that may have carried over from his pretty clear view that AT&T improperly pressured the Justice Department by, among other things, enlisting the support of the Department of Defense to secure its 1956 consent decree, *see id.* at 152-53 (describing this as an "unfortunate history" and one of several reasons for careful scrutiny of the 1982 decree).

AT&T took an interesting position in its efforts to exclude competitors. The FCC had made AT&T provide a variety of cross-subsidies, most particularly a subsidy of local service by long distance service. AT&T viewed new entrants like MCI as trying to skim the cream of the lucrative long-distance market without paying the price of the local subsidy. *See* DERTHICK & QUIRK, *supra* note 9, at 175-79 (discussing AT&T's incorporation of an ideology of universal access and duty of public service). Judge Greene rejected this public-service defense to the monopoly charges.

In one way, the AT&T opinion is not representative of the new economic thinking. Judge Greene disagreed with the Chicago School, but agreed with an older line of thinking, that a monopoly should be policed for political as well as economic reasons. *See id.* at 163-65.

114. Here is how Kahn described the impetus to reform, in an article responding to critics a decade after airline deregulation:

> During the 1960s and 1970s there emerged something close to a consensus among disinterested students of the airline industry . . . that regulation had: denied the traveling public the benefits of price competition; sheltered inefficiency; systematically encouraged competition in wasteful, cost-inflating ways; and encouraged the wage-price spiral that, in a broader context, might be conceived of as the microeconomic component of our national stagflation problem.
>
> Deregulation and the competition it unleashed, however messy and imperfect, have bought the traveling public benefits worth billions of dollars a year, curbed and reversed the wage/price spiral, broken up institutional rigidities, and swept away legal and psychological barriers to productivity and innovation.

Alfred Kahn, *Airline Deregulation—A Mixed Bag,* 16 TRANSP. L.J. 229, 250-51 (1988).

115. In his article on the economic theory of deregulation, Peltzman runs through the cases of railroads, trucking, airlines, telecommunications, stock brokerage houses, banking, and oil. Peltzman, *supra* note 1. Derthick and Quirk's *The Politics of Deregulation* provides in-depth case studies of airline, trucking, and telephone deregulation; and, Chapter Six summarizes deregulation of early natural gas, air pollution, milk, the maritime industry, and the Davis-Bacon Act's prevailing wage mandate on federal construction projects. *See* DERTHICK & QUIRK, *supra* note 9.

116. *Id.* at 35.

> competitive regulation or actively oppose pro-competitive reform, contrary to prevailing views.[117]

Natural gas regulation cannot be understood unless one understands the accumulation of academic criticism about gas regulation and the larger deregulation movement.[118] Gas deregulation was *not* a voyage buoyed by

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117. *Id.* at 53, 57.

118. By the early eighties, a wide range of economists and other observers had come to the belief that the regulation of wellhead prices, a result of a quirky Supreme Court reading of the Natural Gas Act, had caused severe distortions in a largely competitive market. Chief among the critics were STEPHEN BREYER & PAUL MACAVOY, ENERGY REGULATION BY THE FEFERAL POWER COMMISSION (1974); ROBERT HELMS, NATURAL GAS REGULATION: AN EVALUATION OF FPC PRICE CONTROLS (1974); PAUL MACAVOY & ROBERT PINDYCR, PRICE CONTROLS AND THE NATURAL GAS SHORTAGE (1975). Breyer's views assumed greater authority after his role as special counsel in the Senate Judiciary subcommittee's hearings on airline deregulation. *See* DERTHICK & QUIRK, *supra* note 9, at 40-45.

See Pierce, *supra* note 18. Pierce's article is the most frequently cited authority in the variety of court opinions on deregulation and continues to turn up in many decisions. It gave a strong endorsement to the process. In fact, though Pierce discussed a variety of remedies including selective regulation of monopolies and common carrier standing, his heart seems to have been committed to total deregulation. He argued that most pipeline markets are competitive and that those that aren't don't pose that much risk:

> Because there are natural barriers to entry and large economies of scale in the pipeline industry, deregulated pipelines might be able to exercise some market power in a few markets. But even if this were the case, such imperfect competition would still likely yield lower rates and higher outputs than those produced by the present ineffective and highly distortional method of regulating pipelines as public utilities.

Id. at 381-82.

These analyses were part of a sustained, general critique of government intervention that had been growing for years. The deepest roots were Ronald Coase's argument that the goals of almost any form of regulation could be accomplished by the market if transactions costs are low enough, Ronald Coase, *The Problem of Social Cost,* 3 J. LAW & ECON. 1 (1960). Coase followed up a number of years later with an article whose significance seems more obvious now, in which he tried to show that even lighthouses, which anyone would think must be public goods, once had been provided privately and can be provided efficiently by the market. Ronald Coase, *The Lighthouse in Economics,* 17 J. LAW & ECON. 357 (1974).

The Sixties saw a revival of concern with the costs of intervention, a tradition linked to F.A. Hayek and his THE ROAD TO SERFDOM (1944) and THE FATAL CONCEIT (1988). Both books have been republished by the University of Chicago Press, THE ROAD TO SERFDOM in a fiftieth anniversary edition with an introduction by Milton Friedman. Friedman probably played the biggest role of any single figure in popularizing the critique of government intervention with the 1962 publication of his very accessible CAPITALISM AND FREEDOM (1962).

The University of Chicago generated an extraordinarily sustained level of scholarship attacking the premises of economic regulation, all of which helped create an atmosphere in which deregulation could achieve its momentum. One cornerstone was Harold Demsetz' article arguing that most monopoly problems could be solved by creating a competitive bidding process for the right to operate a monopoly. Harold Demsetz, *Why Regulate Utilities?,* 11 J. LAW & ECON. 55 (1968). Demsetz dedicated his paper to Coase, "who was unconvinced by the natural monopoly argument long before this paper was written", and to George Stigler and Joel Segall, with one of his first citations being to Milton Friedman. He set out bluntly asserting that the traditional relationship between concentration and competition "is based largely on an incorrect understanding of the concept of competition or rivalry." *Id.*

John McGee wrote a detailed criticism of the premier divestiture case, that epitome of trust busting, the Standard Oil case. McGee questioned whether Standard's rapid conquest of oil distribution might not have been proof of its greater efficiency and a beneficial implementation of common standards for petroleum use. John McGee, *Predatory Price Cutting: The Standard Oil (N.J.) Case,* 1 J. L. & ECON. 137 (1958).

ever greater discoveries of competition. Congress put the old system in play by deregulating wellhead prices after it judged that market "workably competitive."[119] The FERC cited the need to enhance competition as its justification for every later step, but often with little evidence of whether the deregulated component would support competition.[120]

At the same time, the belief that markets function more efficiently than state-run alternatives has produced a sharp restriction of antitrust standards. Here, too, the goal has been to increase the range of purely

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George Stigler and other capture theorists produced a body of literature suggesting that agencies invariably will be captured by their supposed subjects. *See supra* note 21. Stigler took on many other forms of regulation, including the traditional area of electricity and such apparently beneficial interventions as the disclosure standards of the securities laws. *See* George Stigler & Clair Friedland, *What Can Regulators Regulate? The Case of Electricity,* 5 J. LAW & ECON 1 (1962); George Stigler, *Public Regulation of the Securities Market,* 19 BUS. LAW. 721, 721 (1964); George Stigler, *The Economics of Information,* 3 J. OF POL. ECON. 213 (1961).

The work on formal regulation was matched by a sustained assault on the premises of judicial control via the antitrust laws. *See infra* note 122. It seems undeniable that deregulation could not have occurred without these intellectual antecedents. The long-term impact of works like these explains the movement's ability to gain speed quickly. *See* DERTHICK & QUIRK, *supra* note 9, at 34-58 (describing growing consensus about overregulation and three-stage evolution of deregulation, from (1) a policy literature about reducing costs to (2) political advocacy by Presidents Carter and Ford and other political leaders to (3) "a preferred style of policy choice in the nation's capital, espoused more or less automatically, even unthinkingly, by a wide range of officeholders and their critics and used by them as a guide to position taking," *id.* at 34.). The general anti-regulation literature grew rapidly. For samples of the general criticisms, see MURRAY WEIDENBAUM & DEFINA, THE COST OF FEDERAL REGULATION OF ECONOMIC ACTIVITY (1978)(estimating annual cost at $100 billion); ROBERT LITAN & WILLIAM NORDHAUS, REFORMING FEFERAL REGULATION (1983)(urging adopting of national regulatory budget); *see also* EUGENE BARDACH & ROBERT KAGAN, GOING BY THE BOOK: THE PROBLEM OF REGULATORY UNREASONABLENESS (1982)(criticizing regulatory inflexibility); Alfred Kahn, *Regulation and the Imagination,* in INNOVATIVE TECHNIQUES IN THEORY AND PRACTICE 1 (1980).

Though Derthick and Quirk argue that there was widespread academic consensus on deregulation generally by sometime in the seventies, DERTHICK & QUIRK, *supra* note 9, at 54, they claim that expert clarity did not extend to natural gas. Instead there were "sharply differing perceptions" among the participants in the natural gas debate. *Id.* at 209. Of course, Derthick and Quirk were writing in 1985, at what they may have assumed was the end of natural gas deregulation but has turned out to be the beginning.

Thus by the time the FERC began issuing deregulation orders, there was a large literature among economists, policy analysts, and others urging that regulation generally was inefficient and that natural gas regulation had not worked well. For some discussions of the problems of natural gas regulation, *see* Pierce, *supra* note 3, at 8-16; Vietor, *supra* note 13, ch. 3. Stephen Breyer's account is a little more cautious, because he concludes that "[o]ne cannot prove that the effort to regulate was unfounded, for there was a legitimate problem that arguably warranted a governmental solution," but his description of the shortages caused by price regulation and the somewhat comical process of trying to find the right prices leaves little doubt where his loyalties lie. *See* STEPHEN BREYER, REGULATION AND ITS REFORM 244-40 (1982).

119. This is how the Commission summarized Congress' purpose in the NGPA: "These statutory changes reflect a Congressional determination that producers of natural gas do not have 'natural' monopoly power. In other words, the statute reflects the workably competitive nature of the production industry." FERC Order 436, *supra* note 34, at 42,411. "Workably competitive" is not a phrase the Commission pulled out of its hat, but a standard advanced in J.M. Clark, *Toward a Concept of Workable Competition,* 30 A.E.R. 241 (1940).

120. *See supra* section I.C. It is a mistake, however, to put the FERC's decisions on a continuum with the NGPA, as if this was all a rational progression, and to forget the accidental, arbitrary, and chaotic ingredients to the NGPA. *See supra* notes 23-24 & accompanying text.

managerial decisions where firms could adopt any policy without fear of government intervention. One also finds the same skepticism about the possibility of efficient government intervention and the same belief in the long-run benefits of private action. It is a fair description of the sea-change in the antitrust laws that "[a]s time goes by, fewer and fewer things seem appropriate for per se condemnation. We see competitive benefits in practices that once were thought uniformly pernicious."[121] This market ideology has transformed antitrust doctrine in a very few years.[122] The antitrust law of the Nineties is unrecognizable by that of the Sixties and Seventies.

121. Frank Easterbrook, *The Limits of Antitrust,* 63 TEX. L. REV. 1, 10 (1984); *see also* Richard Posner, *The Chicago School of Antitrust Analysis,* 127 U. PA. L. REV. 925, 932 ("traditional industrial organization is becoming discredited in academic circles"), 933-34 ("basic tenet of the Chicago School, that problems of competition and monopoly should be analyzed using the tools of general economic theory rather than those of traditional industrial organization has triumphed").

As protagonists for the new approach, Easterbrook and Posner have every incentive to exaggerate the scope of their victory and the route of opposing forces. This article attempts to show that they *do* exaggerate the extent to which new theories like contestable market theory and what they mean by price theory has removed the intellectual justification for continuing concern. They are discussing a world of theory that does not exist. But even a cursory reading of the cases suggests that Posner and Easterbrook's description of the shift in antitrust doctrine is not exaggerated.

122. It would be wrong to argue that the intellectual process that led to the changes took only a handful of years. Richard Posner traces the elevation of price theory back to Aaron Director, who was shaping scholars at the University of Chicago in the years after World War II. Posner, *supra* note 121, at 928. The changes in antitrust law cannot be understood outside the intellectual influence of the band of scholars gathered at this one school.

The growth of the large body of Chicago School criticisms about cost-of-service regulation discussed in note 118 *supra*, a development resting in part on the belief that central planning of any sort is an inefficient way to run an economy, spurred skepticism about intervention via the antitrust laws as well. For articles critical of particular antitrust areas, *see, e.g.,* Robert Bork, *Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception,* 22 U. CHI. L. REV. 1957 (1954); Ward Bowman, *Tying Arrangements and the Leverage Problem,* 67 YALE L. REV. 19 (1957); John McGee, *Predatory Price Cutting: The Standard Oil (N.J.) Case,* 1 J. L. & ECON. 137 (1958); Richard Posner, *Natural Monopoly and its Regulation,* 21 STAN. L. REV. 548 (1969); Richard Posner, *The Rule of Reason and the Economic Approach: Reflection on the* Sylvania *Decisions,* 45 U. CHI. L. REV. 1 (1977), combined with two fairly accessible texts that painted the new microeconomic picture, Robert Bork's THE ANTITRUST PARADOX (1978) and Richard Posner's ANTITRUST LAW (1976). Many courts were comforted that they had the authority to restrict antitrust doctrine sharply after Bork's argument that consumer welfare was the only manageable purpose of the antitrust laws. *See infra* note 322.

The judicial retrenchment came in the Eighties, years after the intellectual shift. The court changes would not have proceeded as quickly without the new intellectual climate, Ronald Reagan's election, and a general disaffection with government. Growing concern about the country's international competitiveness made politicians (and the electorate) vulnerable to ideologies which suggest that wealth can be increased simply by rearranging economic structures, better yet, by doing so through dissolution of costly bureaucracies. Deregulation in many ways seemed to offer the same kind of magic that Keynes offered in the Thirties: a production of wealth from underutilized resources without any necessary sacrifice. It promised a free snack, maybe even a free lunch.

The rapid judicial embrace of Chicago School doctrines is eerily akin to the agenda model of politics that John Kingdon has suggested. JOHN KINGDON, AGENDAS, ALTERNATIVE, AND PUBLIC POLICIES (2d ed. 1995) (applying Michael Cohen, James March, & Johan Olsen, *A Garbage Can Model of Organizational Choice,* 17 ADMIN. SCI. Q. 1 (1972)). In this model, scholars work out generalized policy solutions and remedies, but these intellectual assets rotate ineffectively in the policy universe as unrealized possibilities. For a lucky few, just the right constellation of forces thrusts a pertinent issue onto the public agenda and gives these intellectual tools a chance to be endorsed by elective majorities. Though the courts are not supposed to be policy bodies, the rapidity of antitrust revisionism looks much

In 1984, for instance, in one of its opening shots, the Supreme Court held that affiliates would not be liable for antitrust conspiracies. The Court announced that it would immunize affiliate decisions because they are "as likely to result from an effort to compete as from an effort to stifle competition."[123] The Court wanted a firm to "be free to structure itself in ways that serve efficiency of control, economy of operations, and other factors dictated by business judgment without increasing its exposure to antitrust liability."[124]

Two years later, the Court displayed similar deference to business judgment in affirming the dismissal of the predatory pricing case against Japanese color television manufacturers. It affirmed in spite of evidence that these firms had sharply increased their market share over two decades while pricing below their costs.[125] The Court ignored this prototypical evidence of predation. Instead it emphasized that "cutting prices in order to increase business often is the very essence of competition."[126] This holding would legitimate any predatory pricing scheme. The Court's new faith in market processes appeared in its conclusion that below-cost schemes often

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more like a political reflection of a cultural shift than a reasoned judicial elaboration within a system of precedent.

The scope of change may look a little less pronounced if one views all of the antitrust changes as the adoption of just two or three new theories about the way markets operate, particularly the contestable market theory that monopolists face a losing battle in trying to maintain their power and a transactions-cost laden view of regulatory operation. It may be that the courts made one large paradigm shift and that the resulting opinions are all repercussions of that change. This kind of broad-view thinking is not, however, the way we ordinarily think about common law reasoning.

There is an irony in the intellectual role of transaction cost theory . . . One would expect an increasing interest in transaction costs would lead to greater realism, not less. This is particularly true when Ronald Coase and many other major Chicago School figures like Gary Becker and Milton Friedman have had such a healthy interest in empirical work. One factor that seems to have limited the realist impulses of transactions cost has been the continuing assumption, one strongly held by Coase's popularizer Oliver Williamson, that markets naturally select efficient organizations for survival. If that is so, then variety shows not cost inefficiencies but variations in the market conditions to which organizations are responding. This tension in economic theory is best shown by the continuing confusion over whether the most important point of Coase's article on social cost is: (1) the efficiency properties of a world with no transactions costs, or the opposite, that (2) costs in fact distort economic activity in the real world.

123. Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 769 (1984).

124. *Id.* at 773. The Court continued that the costs of affiliate liability were too great because "[s]ubjecting a single firm's every action to judicial scrutiny for reasonableness would threaten to discourage the competitive enthusiasm that the antitrust laws seek to promote." *Id.* at 775.

125. In Matsushita Electric. Industr. Co., Ltd. v. Zenith, 475 U.S. 574 (1986), the Supreme Court reinstated the trial court's summary judgment for the defendants in spite of evidence that they had sold their televisions at prices that incurred losses of as much as 25% and had pursued this below-cost conspiracy for twenty years, increasing their market share from under 20% to nearly 50%. *See id.* at 581 n. 5, 591 n. 15.

126. *Id.* at 592-95. The Court endorsed the Chicago School argument that the duration of the alleged conspiracy, evidence that suggests a conspiracy did indeed occur, made it unlikely that the conspirators ever would recoup their losses. *Id.*

are "self-deterring" because it can be so hard to recoup losses in a functioning market and in its citation to a variety of Chicago School theorists.[127]

In a handful of years, the Supreme Court made similar promarket changes in the traditionally per se violations of tying,[128] resale price maintenance,[129] group boycotts and refusals to deal,[130] and even horizontal

127. In arguing that predatory pricing schemes are speculative and "rarely successful," the Court's "proof" included citations to work by Robert Bork, John McGee, Frank Easterbrook, as well as the more centrist Areeda & Turner treatise. *See id.* at 588-590.

128. In Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2 (1984), the Supreme Court rejected the argument that an arrangement to tie hospital operating rooms to the hospital's chosen firm of anesthesiologists was a *per se* tying violation. It held that the plaintiff had to show that the hospital had enough power to force customers to use unwanted anesthesiologist services. Reversing the Fifth Circuit, the Court concluded that the hospital did not have enough power to force this purchase, *id.* at 26-29, and remanded the case for decision under the rule of reason.

The plaintiff had to know it was in trouble, under the principle of meaningless concessions, when early in the opinion the Court misstated that "[i]t is far too late in the history of our antitrust jurisprudence to question the proposition that *certain* tying arrangements pose an unacceptable risk of stifling competition and therefore are unreasonable '*per se*'." Id. at 9 (emphasis added). Of course, what was at stake was whether *all* tying arrangements were *per se* illegal. It was just this rule that the Court was changing, late in tying history though it might be. Frank Easterbrook correctly describes *Hyde* as having "removed tying arrangements in all but name" from the roster of *per se* violations. Frank Easterbrook, *supra* note 121, at 10.

129. In 1988, the Court reversed a jury verdict in a resale price maintenance case because the jury had found the plaintiff was terminated "because of its price cutting," but not for failing to maintain prices at a particular level. Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717 (1988).

Like *Matsushita, Business Electronics* turned on the Court's sense of the beneficence of competition. The Court went out of its way to speculate on the many legitimate reasons a firm might terminate a price cutter, even though "evidence" of these appeared nowhere in the record. Thus in a case in which the evidence was focused on Sharp's resale price lists and complaints from a competing distributor about the plaintiff's price cutting, complaints followed by termination, the Court repeatedly speculated about other, legitimate motives for terminating Business Electronics. *Id.* at 728 ("[without restraints] Manufacturers would be likely to forgo legitimate and competitively useful conduct . . ."), 729 (restraint was not "naked" restraint unless "it is not a quite plausible purpose of the restriction to enable Hartwell to provide better service under the sales franchise agreement"), 731 ("manufacturers are often motivated by a legitimate desire to have dealers provide services, combined with the reality that price cutting is frequently made possible by 'free riding' on the services provided by other dealers").

The more general if unstated message was that the Court would assume businesses have many legitimate reasons for behavior that might sound predatory. The Court was cutting back on the extent to which it would intervene in market judgments.

Business Electronics drew its sustenance from Monsanto Co. v. Spray-Right Service Corp., 465 U.S. 751 (1984), a funny case in which the Supreme Court affirmed a jury verdict for the plaintiff, but took the opportunity to announce the new rule that a manufacturer's termination of a distributor after receiving complaints about its prices was not enough, alone, to support a price fixing claim. This dictum would have much more effect than the holding. The Court invited almost infinite fact-meddling by the lower courts in announcing a new standard that there must be "evidence that tends to exclude the possibility" of independent action, "something more than evidence of complaints." *Id.* at 764. This rule followed two and a half pages of the reasons manufacturers might have to exchange price information. *Id.* at 762-64. *Monsanto* was an open invitation to the lower courts, supposedly limited to deciding issues of law, to make decisions of fact as well.

Firms would receive a wider deference; government intervention, less.

The Justice Department bought the legitimacy of new approaches home to many judges and lawyers by the new liberalized standards in the Merger Guidelines. *See infra* note 202 and accompanying text.

price fixing, the archetypal per se violation.[131] Every one of these retreats from prior case law rested on skepticism about whether courts are equipped to understand markets and a corresponding belief that markets do quite well when left alone. This is the same belief that has fueled deregulation.

B. Deregulation Withdraws Shields against Antitrust Liability

Though deregulation and the revision of antitrust doctrine flow from the same anti-interventionist faith in market processes, deregulation will reinvigorate the antitrust laws. This transformation is an unintended consequence of reform. The resurgence of antitrust will occur in spite of the fifteen years of antitrust opinions reducing intervention, even via private litigation, in business decision-making.

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130. In Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284 (1985), the Court modified the previous rule that group boycotts were *per se* illegal to hold that some group boycotts might be *per se* illegal, but then again, others might not. The Court put cooperative buying agencies that expel a member into the not-necessarily camp. Reversing the Ninth Circuit, and with Justice Brennan stealing his rhetorical principle from Justice Stevens in *Hyde,* the Supreme Court narrowed its prior rule to the principle that "[t]his Court has long held that *certain* concerted refusals to deal or group boycotts are so likely to restrict competition without any offsetting efficiency gains that they should be condemned as *per se* violations of § 1 of the Sherman Act," *id.* at 290 (emphasis added), and that "'[g]roup boycotts' are often listed among the classes of economic activity that merit *per se* invalidation under § 1," *id.* at 284.

Readers of those earlier opinions should be forgiven for thinking that *all* concerted refusals to deal and boycotts had been *per se* illegal. The Court was removing the point of *per se* classifications by undertaking a rule-of-reason analysis. It speculated that "[w]holesale purchasing cooperatives such as Northwest are not a form of concerted activity characteristically likely to result in predominantly anticompetitive effects." *Id.* at 284. The advantages of this kind of arrangement might include economies of scale, quick access to supplies, and cost savings. *Id.*

Northwest Stationers ended with a somewhat bizarre paragraph reaffirming the *per se* rule, just not in this backyard. The Court cited another prior opinion that "[t]he *per se* rule is a valid and useful tool of antitrust policy and enforcement." *Id.* at 298 (citation omitted). But, it "does not denigrate the *per se* approach to suggest care in application." *Id.* For example, apply a rule-of-reason screen to every case that does not fit directly into prior *per se* cases or, as in the vertical price fixing decision in *Business Electronics,* even if it does.

131. In Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., 441 U.S. 1 (1979), and NCAA v. Board of Regents, 468 U.S. 85 (1984), the court applied rule-of-reason tests to selling combines in, respectively, sheet music and college sports, although coming to opposite conclusions under those tests. Both cases treated arguments that a challenged restraint on output was necessary to give value to a special product, but then, most holders of unusual market positions have some explanation for their need to violate ordinary market standards. The more room to decide whether a practice that clearly invokes a *per se* category, like price fixing, might not be *per se* illegal, the less *per se* the *per se* rule becomes.

A cynic might argue that the rule is that price fixing is *per se* illegal in most activities that aren't likely to interest judges or Justices, like, say, floor products and oil, but you get more protection if you happen to manufacture upper-class quality-of-life goods like college sports and music. Another plausible reading is that there is a better rule for professionals, who after all would hardly be professionals if no one deferred to their judgment, than for ordinary blokes. *See* United States v. Brown University, 5 F.3d 658, 670-72 (3d Cir. 1993)(discussing rule of deference to professional organizations in applying "quick look" rule of reason to Ivy League practice (the "Ivy Overlap") of fixing amount of financial aid to students admitted at more than one school).

Of course, all these restrictions on the antitrust laws mitigate somewhat the restraints that pipelines will experience as they move from an agency-regulated world to an antitrust-regulated one.

Antitrust litigation will increase because regulation was a substitute for private antitrust enforcement. As deregulation strips away the direct government mechanism for market protection, it increases the need for traditional private remedies.[132]

It is not surprising that deregulation will be linked to more antitrust lawsuits because both bodies of law correct market abuse. The NGA incorporates competitive standards, for instance, in its duty to proscribe "unjust and unreasonable" rates and the Act's prohibition against discrimination.[133] It stands to reason that as these measures recede, some form of protection will take their place. Moreover, an inverse relationship between deregulation and antitrust is mechanically inevitable under existing doctrine. Regulation included a series of legal shields that will disappear along with the agency price-setting and entry apparatus. Because the state established permitted conduct company by company, the law protected much of the same behavior from private antitrust challenge. (As long as administrators were designing competitive standards, it didn't make sense to let juries or judges second-guess whether the agency, the supposed expert, really got it right). There were several types of antitrust immunities. The preemption doctrine protected acts closely tied to the regulatory scheme from attack.[134] In the many industries whose regulation included rate setting, the filed rate doctrine precluded suits for damages that directly or indirectly would

132. *Accord* Paul Larue, *Antitrust and the Natural Gas Industry*, 11 ENERGY L. J. 37 (1990)(citing wave of antitrust litigation that coincided with open access and predicting that, "[i]f there is a second wave of cases, it will result from further steps which have been taken to deregulate the industry. These steps have broadened the pipelines' antitrust exposure by subjecting more of their activities to business judgment rather than regulatory edict.").

133. The courts have concluded that the FERC has a duty to consider antitrust considerations, but that it does not have to follow antitrust standards slavishly. *See, e.g.,* Maryland People's Counsel v. FERC, 761 F.2d 780, 784-87 (D.C. Cir. 1985)(reversing Commission for failure to consider anticompetitive effects of special discount pricing program); Northern Natural Gas v. FPC, 399 F.2d 953, 959-73 (D.C. Cir. 1968)(reversing approval of new pipeline to be built under "public convenience and necessity" standard for failure to consider foreclosure of potential competition); Lynchburg Gas Co. v. FPC, 336 F.2d 942, 946 (D.C. Cir. 1964)(noting Commission's duty to scrutinize rates for restraint of trade and discrimination, but not finding those deficiencies in rate under consideration); *see generally* Gulf States Utilities Co. v. FPC, 411 U.S. 747 (1973); California v. FPC, 369 U.S. 482, 485-88 (1962) (holding that Commission should not approve El Paso Natural Gas's acquisition of Northwest Pipeline Company pending results of Department of Justice antitrust litigation over the merger, which ultimately disallowed merger).

134. This shelter exists not only in the "exceptional instance" in which Congress expressly exempts an industry from the antitrust laws, as it has portions of the insurance industry in the McCarran-Ferguson exemption, 15 U.S.C. §§ 1011-15 (1988); Group Life & Health Ins. Co. v. Royal Drug, 440 U.S. 205 (1979); Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119 (1982); *see generally*, II ABA ANTITRUST SECTION, ANTITRUST LAW DEVELOPMENTS 1109-18 (3d. ed. 1992), but more commonly when "a pervasive regulatory scheme would be disrupted by antitrust enforcement," *id.* at 1016-17 (express exemptions), 1018-19 (implied exemptions). Congress did not expressly exempt the natural gas industry from antitrust enforcement, as is illustrated by the number of cases challenging mergers and denials of access that occurred during regulation.

Companies still could get in trouble for certain kinds of manipulations of the regulatory process under the rocky and narrow road spelled out in the *Noerr-Pennington* doctrine, see *id.* at 989-1012, but there have been few successful *Noerr-Pennington* lawsuits. Put another way, the range of exempt activities before the government far exceed the activities that can get you into antitrust trouble.

require refunds of approved rates.[135] That protection, too, is gone and state deregulation is removing the state-action shield that protects behavior following "clearly articulated" and actively supervised state policies.[136] Deregulated companies will now make their decisions on price, services, and expansion privately. Their rates no longer will enjoy immunity under the filed rate doctrine. Private lawsuits will not be preempted by federal regulations. In short, formerly regulated companies will be treated like all regular companies.

For antitrust litigation to increase, of course, it is not enough that defenses fall away and antitrust standards apply. Abuses must exist. Antitrust will find a significant number of applications in many deregulated industries, including natural gas, because deregulation swept across imperfectly competitive markets as well as competitive. This is one result of the fact that the movement was more ideological than economic.[137] Some deregulated industries will be competitive, but some not, and in many, like gas gathering, the degree of competition will vary by geographic area. Even industries that appear competitive today may become concentrated as the removal of administrative barriers to entry allows dominant companies to absorb their neighbors. Over time, economies of scale, contract barriers, information asymmetries, and other causes of market differentiation may stratify seemingly competitive markets into highly restricted ones.

Natural gas is a good example of the incomplete fit between competition and deregulation. Congress set gas deregulation in motion by deregulating wellhead prices, prices that it may never have intended to regulate in the first place.[138] It found the production market competitive. The FERC's subsequent moves to force open access, to unbundle services, and to deregulate field services generally have not been based on detailed market studies. Much of the pressure has come from a political climate in which deregulation is deemed a cure for all ills.[139] Yet, gas transportation remains a monopoly in many markets. Recently deregulated field services like gathering, processing, and storage also will be monopolized by interstate pipelines in some, though by no means all, areas. Some submarkets will be competitive, some not. Because deregulation and antitrust restraints flow from the same market-based theories, some Congressmen and regulators

135. The lead filed-rate case is Keogh v. Chicago & Northwest Railway, 260 U.S. 156 (1922), a railroad case. For an example of the filed rate doctrine in the natural gas context, see Arkla v. Hall, 453 U.S. 571 (1981)(rejecting producer's attempt to claim higher price under favored nations clause, when higher price exceeded filed rate).

136. *See, e.g.,* California Retail Liquors Dealers Assoc. v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980); Cantor v. Detroit Edison Co., 428 U.S. 579 (1976). The clearly articulated prong requires that there be a real conflict, not an incidental one. It should ensure that "the state has authorized regulatory departures from reliance upon market rivalry." ABA ANTITRUST SECTION, *supra* note 134, at 970. The active supervision test functions to separate policies that are true state policies from those foisted on the state by a trade group or other interested party and to protect only the former. *See id.* at 973-74.

137. This may only be fair. After all, in a number of industries the reasons for regulation seem to have been no more economically-based, *see supra* note 8, although the core natural gas concern with monopoly power did have a basis in reality, *accord,* Pierce, *supra* note 18, at 346.

138. *See supra* note 15.

139. For a discussion of the theory of natural gas deregulation, *see supra* note 118.

are sure to try to free deregulated markets from all restraints, antitrust and otherwise. The next section shows why the new market theories have not made an intellectual case that justifies reducing antitrust protection.

C. *The New Antitrust Theories Do Not Justify Removing All Intervention*

The major intellectual figures in antitrust retrenchment probably believe in their hearts that no regulation is the best regulation, though they publicly condemn the most obvious "horizontal" restraints of trade.[140] Yet, the logic they apply has not undercut the microeconomic arguments that big cost advantages tend to produce monopoly and that monopolists will try to set prices in a way that reduces social welfare. Instead, the critics tend to make theoretical assertions that depend upon nearly full information, minimal barriers to entry, and other approximations to perfect competition. These are assertions about the empirical world that regulators should test, not accept on faith.[141]

There are three main strands to current criticisms of antitrust regulation. Although these criticisms developed over time in analyses of separate antitrust torts, so that there is one literature about price discrimination, another on predatory pricing, and so on, they all share a common base and their common factor is the motor force for deregulation as well. All assume that market forces overcome virtually all barriers to entry in a meaningfully short time.[142] It is for this reason that Chicago School econo-

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140. Just as it is an interesting litmus test to ask pipelines to describe when they ever would regulate and producers when they would cotton to deregulation, so it is an interesting test of boundary definition to try and figure out when mainstream Chicago School advocates *really* would endorse regulation or apply antitrust protections. Consider Frank Easterbrook's proposal for screens of antitrust analysis, which would require showings of market power, a benefit to the defendant, and — unless the restraint seemed to have no other purpose except an anticompetitive effect (and every antitrust defendant will spin (or, more accurately, hire lawyers to and experts to weave) some theory to explain its behavior)— whether other firms use different methods, whether the practice has restricted output, and whether a business is suing. Easterbrook, *supra* note 121. It is hard to think of many practices that would survive these screens. This is Easterbrook's point. If they did, then the court would move on to rule of reason analysis. That almost all practices would be legitimated is no problem for Easterbrook because he believes that most practices are beneficial, that "the market" corrects monopoly, and that the costs of monopoly are small but those of erroneous judicial intervention large. *Id.* at 15-16; *see also id.* at 2 ("Monopoly is self-destructive. Monopoly prices eventually attract entry.").

The same lesson is drawn from Posner's summing of the great Chicago principle: "Firms cannot in general obtain or enhance monopoly power by unilateral action—unless, of course, they are irrationally willing to trade profits for position." Posner, *supra* note 121, at 928. If they do trade profits for position, in Chicago, where firms expand and contract effortlessly and expire or are killed without cost or regret, competitors will be happy to reenter after some self-induced blood-letting. This disbelief in unilateral power just leaves cartels and large horizontal mergers as objects of concern, *see id.*, but it is unclear how much this will mean in practice because of the Chicago belief that cartels are unstable and "in the long run futile" without "substantial" barriers to entry, *id.* at 932.

141. One can say that the ratio of rhetoric to content is particularly high in these statements. *See generally* Donald McCloskey, *The Rhetoric of Economics*, 21 J.L. ECON. 481 (1983).

142. This is what Richard Posner means when he argues that "price theory" has overcome the industrial structure theories identified with an earlier generation of Harvard economists. Posner, *supra* note 121, at 933-34. Posner's claim is exaggerated, though, because both schools use the tools of microeconomics to explore the ways markets operate. The Harvard school, however, had a fairly static

mists believe that predatory prices are self-defeating, that discrimination will fail in almost all circumstances, that cartels will self-destruct, and that

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picture that portrayed markets as behaving in fundamentally different ways depending upon cost structures and whether these produced a competitive, monopolistic, or oligopolistic market. The most doctrinaire members of the Chicago School seem to think that these structures make no material difference and that all markets have the same basic competitive tendencies, if we only let them unfold.

Where these critics differ most sharply from representatives of older traditions is in their assessment of whether markets fail in important ways. Doctrinaire price-theory advocates claim that they don't. *See, e.g.,* Easterbrook, *supra* note 121, at 15 (arguing against *per se* categories because most forms of cooperation are beneficial; the economy "corrects monopoly more readily than it corrects judicial errors"; and the costs of wrongly outlawing a competitive practice outweigh the risk of wrongly sustaining a monopolistic practice.). In contrast, some economists and virtually all regulators treat market failure as a serious problem. *See, e.g.*, Kahn, *supra* note 74 (arguing that deregulation and competition require significant government intervention, perhaps more than regulatory regime); SCHERER & ROSS, *supra* note 8, at 8 ("Free and unfettered markets fail; on that there is little disagreement. [Actually, many Chicago School protagonists disagree with this point strongly.] How seriously they fail is a matter of dispute.").

It certainly is true that the Chicago School influence and the law and economics movement it spawned have greatly changed the way lawyers and courts think about markets. But just how great a difference, a very important question because in its resides the answer to whether there should be *any* government intervention, is much more debatable. If one takes at face value the comments of some of the movement's major figures at a 1981 conference, the world is wholly changed. Regulators and lawyers who still talk about discrimination and market power as common occurrences are vestiges of a worldview that has been scientifically disproven and superseded.

> They were studies that did not seem to have any driving hypothesis that was being tested and that were geared to going out and sort of feeling the elephant and seeing what could be deduced from merely feeling the elephant, and there wasn't much that was deduced from it.
>
> That approach [using price theory] was contrary to what was then the general approach in the literature, which was, every time you saw something that was peculiar in terms of the framework of the prefect competition model, to mystically conjure up the word monopoly and stop the analysis right there.

The Fire of Truth: A Remembrance of Law and Economics at Chicago 1932-1970, 26 J.L. & ECON 163, 170, 204-05 (Edmund Kitch, ed. 1983)(comments of Harold Demsetz).

> For four days Ed [Levi] would do this [teach antitrust law], and for one day each week Aaron Director would tell us that everything that Levi had told us the preceding four days was nonsense. He used economic analysis to show us that the legal analysis simply would not stand up.
>
> . . . What had we learned when this process had been completed? We learned that there was a system of analysis that (1) was quite relevant to the stuff we talked about in law school and (2) was much more powerful than anything the law professors, than anything that Ed Levi had to tell us.

Id. at 183-84 (comments of Weseley Liebeler).

> But I felt at the time that what I got out of there was the feeling that business practices shouldn't be explained away as irrational. They have a purpose.
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> . . .
>
> So, whether there was competition or monopoly, the answers didn't immediately spring forth, you had to interpret that consistent with rational behavior on the part of the participants. . . . it stimulated a whole line of development which did not accept simple statements such as: Businessmen are irrational, they don't know what they are doing. They know what they are doing. We don't know sometimes why they're doing it.

Id. at 185, 204-05 (comments of Gary Becker).

> Ronald Coase taught a course that was jointly listed in the law school, the economics department, and the business school, on antitrust. . . . Most of the time we reached the conclusion that we had no idea what was really going on in the business practices described. I got the feeling that something was deficient in economic theory.

Id. at 192 (comments of Benjamin Klein).

resale pricing schemes that are not balanced and justified by increased service cannot survive.

The argument that even monopolies cannot maintain power for long comes from the theory of contestable markets. This theory posits that even monopolists can be restrained effectively by companies that could enter their markets, not just those that are in it.[143] In their strong form, contesta-

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> Ronald [Coase] said he had gotten tired of antitrust because when the prices went up the judges said it was monopoly, when the prices went down, they said it was predatory pricing, and when they stayed the same, they said it was tacit collusion.

Id. at 192 (comments of William Landes).

> [I] arrived on the scene confident that there was ever so much monopoly—malevolent—and that it could do almost anything you could imagine. The absolute dominant influence was that profit maximization, wealth maximization, became a constraint, and I had never looked at it that way at all.
>
> So economics was a constraint on a whole bag of imagined activities which when subjected to that constraint started evaporating, or, as [Aron Director] used to say, crumbling in your hands.

Id. at 205 (comments of John McGee).

As Robert Bork noted, these new scholars were janissaries. *Id.* at 183. Reading the notes of this conference gives a good sense of the concentrated power of Chicago thinking. The movement supports a view that, at least in intellectual circles, there is much to capture theory: the tightly organized interests permitted by gathering all this intellectual firepower at one school permitted it to dominate wide areas of thought in ways that isolated scholars probably would not. But what the speakers treated as the highly accidental gathering of economic thinking in a law school probably also contributed to a more black-and-white picture of the economic world than was necessary. The result has been to replace a view of imperfect markets that had too little room for competition with a view of competition that has virtually no flaws, in short, one unrealistic picture with another.

The Chicago School has "won" in its attacks on treating intervention without worrying about its costs, assuming that all aspects of an integrated service like gas delivery are noneconomic, and ignoring the possibilities of bidding and other competitive injections. It has prevailed on the view that policymakers must consider the pressures of competition, actual and potential, even in monopoly markets. In so doing, it has showed that the simple market-share way of looking at the world is unrealistic, costly, and not a sufficient policy guide.

But one has to question how many regulators really had such a simple world view (even if it appears in early court opinions). It is quite another thing to leap from the deficiencies of regulation to an assumption of perfect competition and assume that abuses of power are not a problem. Do we really believe that a monopolist will not act differently than a competitive firm, just because other companies *might* enter its market? Is it realistic to discuss markets without treating transaction costs and other barriers, including simple inertia, as material factors? Do we believe that firms will not respond to their incentive to wield market power and implement schemes that damage consumer welfare? The new economics does not have realistic answers to these questions. It has to fall back on its general claim that not enough is known about competition to intervene anywhere. Yet these are the questions that regulators face and must decide.

There is no denying that it is a very big change to begin with competitiveness and ask in every case why a market fails, rather than to lock markets away into the categories of "competition," "monopoly," and "oligopoly." But once one begins adding barriers to entry, information problems, and other imperfections back into the picture, the differences will not be as great as Chicago theorists suggest. The glass may seem to be emptying if one looks to the past, but it is resolutely half full when planning for the future, and it is the future in which regulators will have to make decisions.

143. The potential-entrant or contested-market theory is that if entry and exit are easy, and either do not require large capital investments or do not require large irreversible (sunk) capital investments (for instance, if capital can be acquired cheaply in second hand markets or resold upon exit), then even a firm that dominates its market will be unable to set its price too high. If it starts to make unusual profits, it will attract other companies.

ble market theorists argue that it is irrational for anyone to set prices much above competitive levels because outside companies will be attracted by *any* continuing excess profits. While entrants face barriers to entry, proponents have emphasized that the true costs of entry often are lower than they appear because facilities can be leased or resold if entry fails.[144]

If the first argument is that markets are more virile than expected—a faith shared by the deregulation movement—a second critique is shared too. This is the argument that the costs of regulation are greater than anticipated. The critics have fingered a number of regulatory shortcomings. An early attack runs back to Ronald Coase and simply points out that some proponents of market intervention assume perfect intervention with no cost.[145] Another argument with deep roots is that judges and juries (and lawmakers) know so little about how markets operate that they cannot get enough information to intervene effectively.[146] In its strongest form this argument is that even successful businessmen will be hard-pressed to

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> [N]either large size nor newness of firms necessarily means that markets need function unsatisfactorily. Impediments to entry and exit, not concentration or scale of operations, may be the primary source of interference with the workings of the invisible hand.

Elizabeth Bailey & William Baumol, *Deregulation and the Theory of Contestable Markets,* 1 YALE J.ON REG. 111 (1984); WILLIAM BAUMOL, JOHN PANZAR, & ROBERT WILLIG, CONTESABLE MARKETS AND THE THEORY OF INDUSTRY STRUCUTURE (1982); William Baumol, *Contestable Markets: An Uprising in the Theory of Industrial Structure,* 72 AM. ECON. REV. 1 (1982).

Bailey and Baumol claim that their theory "has provided a conceptual basis for the view that many markets that are subject to economies of scale should not be regulated by the conventional methods." Elizabeth Bailey and William Baumol, *supra,* at 111. Indeed, in this view, the greater a monopolist's excess profits, ceteris paribus, the more vigorous the competitive response it calls forth. Profits are magnetic, with larger profits holding a greater charge.

144. Bailey & Baumol, *supra* note 143, at 113-15 (arguing that it is not amount of capital, but how much is sunk capital, that determines a market's penetrability).

145. It is also the basis for Coase's mocking critique of neoclassic welfare analysis:

> Pigou seems to have had no doubt that these Commissions would work in the way he describes. So, starting with a statement about the imperfections of government, Pigou discovers the perfect form of governmental organization and is therefore able to avoid inquiring into the circumstances in which the defects of public intervention would mean that such intervention would tend to make matters worse.

COASE, *supra* note 4, at 22.

146. Frank Easterbrook in particular exudes skepticism that courts or juries can understand the true reasons for business decisions. *See* Easterbrook, *The Limits of Antitrust, supra* note 121, *passim*; Frank Easterbrook, *Ignorance and Antitrust,* in THOMAS JORDE & DAVID TEECE, ANTITRUST, INNOVATION, AND COMPETITIVENESS, 119-36, *passim* (1992). Easterbrook seems to share with F.A. Hayek the conclusion that "The Market" is a mysterious instrument for the satisfaction of our needs, one whose power is so great that the individual mind cannot comprehend its operation. At least, this seems a justified reading of his assertion that "[t]he defendant is unlikely to have a good explanation for its success," that "many times there are no satisfactory explanations," and that "[t]he welfare implications of most forms of business conduct are beyond our ken." Easterbrook, *The Limits of Antitrust, supra* note 121, at 6,8, 11.

It is the old conservative saw. Society is greater than its members. Take it on faith that social organization is a product of accumulated wisdom and not chaos. Beware tinkering because you will unleash forces you cannot possibly comprehend (and isn't the present really pretty good, after all, just like Ronald Reagan's springtime in America, or at least better than the unknown?).

The argument that regulation has many more costs than once believed has gained wide support. Consider, for instance, the remarks of Alfred Kahn, who in spite of his history as an aggressive deregulator remains among the more liberal economists in his belief that markets do fail, discrimination

understand the reason for their success—that is the magic of the market's integrative process—so it is unfair to make them justify their conduct.[147] Another regulatory inefficiency argument that has had wide acceptance is the assertion that regulators tend to be captured by the regulated.[148] In the antitrust context, the modified version of this argument is that antitrust lawsuits tend to be brought by competitors who are trying to impose higher costs on rivals.[149]

A third criticism looks at change over time. This is a newer emphasis that pays more attention to innovation. Joseph Schumpeter argued a lifetime ago that the rate of innovation is more important in determining long-term economic welfare than current market decisions.[150] These critics

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and other abuses are real problems, and government needs an effective regulatory structure even for deregulated markets:

> The case for deregulation has been that direct regulation typically suppressed competition, or at least severely distorted it, and that competition, freed of such direct restraints, is a far preferable system of economic control. I read the recent experience as having essentially vindicated that proposition, making substantial reversal of the deregulatory trend unlikely.

Kahn, *supra* note 74, at 329; *see also* Kahn, *supra* note 74, at 341 (listing as "deficiencies of regulation—deficiencies of information, wisdom, and incentives, along with a strong inherent tendency to suppress competition"). Kahn at least implies the interesting argument that belief in regulation may have been exaggerated by the critical experience of the Depression (as one could argue that the country responded to a temporary emergency with unnecessary permanent relief). *Id.* at 330.

147. This is what Hayek means when he defends markets as enabling people to exploit to the fullest their knowledge of particulars, a knowledge so varied that no center can apply it, even though they cannot comprehend the workings of the whole. If you accept Hayek's premise and view regulation as an attempt to impose a plan for the whole, you do not have to travel far to reach the Chicago redoubt in which regulation is not only futile, but also a costly disruption of an otherwise healthy system.

148. *See supra* note 21 and accompanying text.

149. For this reason, Judge Easterbrook would make the identity of the plaintiff a factor in antitrust analysis. "When a business brings suit, it is often [?] safe to infer that the arrangement is beneficial to consumers." Easterbrook, *supra* note 121, at 18. He believes that antitrust litigation "is attractive as a method of raising rival's costs" because of an "asymmetrical structure of incentives," by which he means that the plaintiff's costs "will" be less than the defendant's. Easterbrook, *supra* note 121, at 34.

This is an odd view. It is true that an imbalance in cost can occur because corporate defendants tend on average to be larger and have more files and employees than antitrust plaintiffs. But the defendants often try to bury plaintiffs by filing detailed, burdensome and irrelevant discovery requests in return. Antitrust defendants, for instance, tend to have far more resources than plaintiffs and can afford to spend much more in an effort to wear the plaintiffs out. *Cf.* Stephen Susman & John McArthur, *If It Ain't Broke, Don't Fix It,* 55 ANTITRUST L.J. 59, 68 (1986)(*citing* "Georgetown" study of 1900 antitrust cases in 1973-1983 period, which found that sales of defendants were on average *one hundred times* those of plaintiffs).

Like many conservative critics, Easterbrook disregards many reasons why defendants might choose to use expenditure as a litigation weapon, rather than being forced to overspend because of a plaintiff's devious discovery requests. Cost and delay often are defense weapons. It is far-fetched to cite the defendants' often self-induced cost of litigation as an argument for thwarting what can be meritorious claims against them.

150. *See, e.g.,* Phillip Areeda, *Antitrust Law as Industrial Policy: Should Judges and Juries Make it?,* in JORDE & TEECE, *supra* note 146, at 31 ("At least since Schumpeter wrote nearly fifty years ago, innovation has been thought to contribute far more to our well-being than keeping prices closer to costs through competition."); Easterbrook, *Ignorance and Antitrust, supra* note 146, at 122 ("An antitrust policy that reduced prices by five percent today at the expense of reducing by one percent the annual rate at which innovation lowers the costs of production would be a calamity."); Thomas Jorde & David Teece, *Introduction,* at 4, in JORDE & TEECE, *supra* note 146 ("We take it as axiomatic that innovation

argue that antitrust rules that stifle innovation, including constraints on joint ventures in research and development, cost more than they might gain in short-term avoidance of market power.[151] Like the first set of critics, proponents of this view tend to have a very optimistic view of the benefits of markets. Many assume that market incentives are most conducive to technological change.[152]

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and its rapid and profitable commercialization are the key factors driving productivity improvement and economic welfare.").

Phillip Areeda advances three reasons why efficiency may have been slighted by some courts: the high level of domestic production for many years (which made foreign competition seem less important), an affluence that made product costs less important, and a fear of monopoly. Areeda, *supra*, at 34. He also points to the problem of applying an innovation standard. "Both the facet of future benefit and its magnitude relative to society's losses from monopoly are entirely uncertain." Areeda, *supra,* at 40.

Schumpeter commonly is cited for the joined propositions that the rate of innovation is more important than static efficiency considerations *and* that monopoly is more conducive to innovation than competition; *but see* Robert Merges & Richard Nelson, *Market Structure and Technical Advance: The Role of Patent Scope Decisions,* in JORDE & TEECE, *supra* note 146, at 185 (1992)(claiming that Schumpeter never said that concentrated industry is more conducive to innovation).

151. *See, e.g.,* the recommendations by Thomas Jorde and David Teece in their proposed National Cooperative Research and Commercialization Act, and their discussion of looser market power analyses. *Infra* note 158.

152. This is a bold theory. The argument for unregulated monopolists as technological innovators is that their very size and resources will enable them to conduct research on a scale unavailable to lesser companies (often with a cite to Bell Laboratories as the example). Moreover, the comfort that market power will protect excess profits certainly helps make a monopolist's long-term, expensive capital gambles look a little less risky. But the model assumes once again perfect information, a perfect assessment of risk and no unusual risk aversion, and requires a seamless operation of economic forces that leaves no room for the cultural inertia of successful companies. So little is known about the true conditions for innovation that both "proofs" and counterexamples tend to be anecdotal. For every AT&T (and a good case can be made that AT&T, for all its efficiency at delivering basic phone service through black dial phones and its general research capability at Bell Labs, retarded the profusion of alternative communications that have flourished with deregulation), there is an IBM and its failure to exploit the personal computer and the advanced software it was developing. (For the IBM story, *see* PAUL CARROLL, *BIG BLUES: THE UNMAKING OF IBM* (1993)).

One can at least posit some other conditions that would worry a monopolist in a stable market as it contemplated innovation. It would have pretty good information about its position with existing technologies. It would have to consider whether the new technology, whose details presumably are unknown during research, would lend itself to copying and produce an industry with lower barriers to entry. This seems to be just what happened with personal computers. The monopolist would need to make assumptions about the shape of demand for the new services, as well as its new cost curves, to guess whether its total profit would grow. These questions would split into hundreds of other questions. For instance, IBM had to consider whether personal computers would lend themselves to the leasing programs it had exploited with mainframes. And whether by leasing or purchasing, would customers be as interested in replacing the machines? Would IBM's vaunted repair force mean as much, particularly if the machines were a lot more reliable? And on and on.

The advantage of a competitive market is that every firm has to worry about another company's beating it to the new technology. Each has an incentive to capture the excess profits that will come from being the leader with a new product. They cannot afford to assume that the market will not change unless they introduce new products. A monopolist who feels secure with its customers does not have the same driving incentive. New products may look like Pandora's box.

There are three antitrust criticisms, beyond those in text, that may be less relevant to natural gas but that can justify in restricting antitrust and many other forms of regulation. First, a related basis for undermining antitrust intervention arose in the eighties. Courts and theorists began to worry that size might be an advantage in competing with foreign companies and that rules against monopolies may

These new economic theories are sharply at odds with traditional regulatory doctrine. For instance, regulation assumed that monopolies were durable and, in natural-monopoly industries, desirable. Regulators limited entry to let the monopolist lower its costs and used price caps to transfer the benefits to consumers. Statutes like the Natural Gas Act outlawed discrimination in prices and terms because Congress assumed that pipeline power prevented competitors from undercutting discriminatory pricing structures. They assumed that barriers would protect discriminators from the entry of other firms.

Bans on price discrimination are a central part of traditional regulatory structures and of regulatory activity. Another frequent concern are affiliates; regulators spend much more time on affiliate abuses than antitrust authorities, who since the *Copperweld* case generally ignore transactions between affiliated companies. On other antitrust fronts, the FERC has attacked tied products through its unbundling rules. Like other agencies, it has vigorously policed price levels in the belief that utilities will be able to maintain high prices without losing market share to new entrants.

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have hurt America's balance of trade. This criticism has been mitigated to some extent by legislation passed in the Eighties to facilitate cooperative ventures. In the National Cooperative Research Act of 1984, 15 U.S.C. § 4300 et seq., Congress brought joint research and development ventures under the rule of reason. In addition, the Act set up a registration process in which registered ventures could only be sued for actual damages. Although natural gas responds to prices of alternative fuels and of Canadian gas, most of the business has been sufficiently geographically grounded that American companies have not faced technologically superior foreign competitors.

Second, an argument that doesn't often appear in antitrust literature, that is related to the innovation argument, is that agreement on standards is necessary in certain industries to create the conditions for spreading a technology. Part of a standard technology's efficiency effects may occur because everybody is using the same form. (Lawyers gain a similar benefit in legal research from the standardization of the Shephard's citation system and the West key system.) Transaction costs can fall sharply when everyone relies on the standard operating procedure. Companies can orient their services to the accepted standard. Certain issues no longer need be debated. Thus there is a social value to having most or all parties using the same forms and channeling their needs into the same practices. In this sense, the first technology or contract form to arrive on the scene may become the chosen technology simply because it generates increasing returns to scale as it is adopted by increasingly large groups. *See* Brian Arthur, *Competing Technologies, Increasing Returns, and Lock-In by Historical Events,* 99 ECON. J. 116 (1989); Brian Arthur, *Positive Feedbacks in the Economy,* SCIENTIFIC AMERICAN 92 (Feb. 1990). Thus, using a common form often reduces transactions costs, sometimes sharply, but the savings do not mean that the parties chose the form that would *most* reduce costs. "[O]nce random economic events select a particular path, the choice may become locked-in regardless of the advantages of the alternatives." *Id.* at 92.

Computer software is a good example. If all computers ran on the same software, national training time would be greatly reduced. People changing jobs and computers would not need to learn a new set of skills. Software creators could write one program for all machines. Personal computers and networked machines could operate on the same principles. Because the natural gas industry seems to operate on enough of a common standard so that pipelines can interconnect, this theory has not played a significant role in the natural gas debates.

One can make another social welfare argument for monopoly, which is that the stability of large companies produces a more friendly world for employees and customers. For instance, large unionized corporations tend to pay higher wages. RICHARD FREEMAN & JAMES MEDOFF, WHAT DO UNIONS DO? 96-97 (1984). The employees of bundled, regulated interstate pipelines lived in a more relaxed, secure world than their successors. Deregulation has brought very painful personal costs that never get figured into the calculus of its returns.

While antitrust doctrine states that it is competition (not competitors) that deserves protection, the FERC and other regulators have paid close attention to the health of competitors as a route to competition.

Some of this contrast between the practice of regulation and the new economic thinking arises because the critics are talking about a theory that has very restrictive assumptions like effective information, stable preferences, and a single profit-maximizing goal, while regulators have to navigate the messy, imperfect, cost-laden real world. Regulators face disputes in which information is imperfect and often limited by contract, bids and auctions are costly, change has costs and increases risk, market entry can be deterred strategically—in short, a real world that does not necessarily operate as economic theory dictates. Moreover, regulators often find that economies of scale do keep other companies out. For gas pipelines, comparative advantages can include not only cost advantages from scale and integration, but also spun-off facilities that cost new affiliates only their depreciated cost, contract commitments and staggered terms that block entrants, and the lack of reliable information.

Theories like the contestable market theory are like a theoretical physics with no friction. A ball placed on a slight incline would roll forever. The theory can be useful, but it must be used carefully.[153] The existence of imperfections means that regulators and courts should not jettison the lessons of years of experience, just because economic theory predicts certain optimal results in frictionless markets. The unanswered question about deregulated markets, the hard question, will have to be answered separately for each market: how closely does this market behave like a competitive market, and how far do imperfections and pockets of power produce abusive pricing? The purists of the Chicago School deny the need for fact-based determinations when they claim that price theory is a meaningful guide without regard to market structure, but they are discussing a model that exists only on blackboards.[154]

Courts and regulators will need to remember that the neoclassical economic critics have *not* disproven the microeconomic argument about abuse.[155] The traditional industrial-structure argument about natural

153. McCloskey, *supra* note 141, at 500-01(use of model world, even toy economies, "no vice if done reasonably").

154. The derisive charge of blackboard economics is Ronald Coase's, hurled in a different setting as he argued that economists must learn to consider internal firm structure as an independent variable in economic performance. Ronald Coase, *The Firm, The Market, and the Law,* in COASE, *supra* note 4, at 1, 28-30.

155. Richard Posner tries to contrast microeconomic thinking qua price theory with the older, industrial relations school that was associated with Harvard University. *See supra* notes 121, 142. His assertion of a dichotomous world lets him present the Chicago view that competition is broader than suspected as a fundamental change from the institutional approach of classifying market behavior by looking at market structure.

What is missing in Posner's analysis is acknowledgment of how much both schools are wedded to a profit-maximizing, rational (and material) choice model. Both use the same motivational assumptions, theories of price setting, and view of the ways firms compete. What is different is the degree to which they predict that barriers can last, in the short run because of contestable market theory and a disagreement over the effectiveness of barriers, in the long-run with different views on the role of

monopolies has the same microeconomic base as the new critics. It just argues that costs, limited information, risk, and other barriers to entry matter—an empirical assertion. Both groups rely on a theory of the firm that predicts companies with monopoly power will try to set prices too high, produce too little, and take consumer surplus for themselves. The critics have not found a persuasive reason why companies with power will not seek monopoly prices and discriminate.

Moreover, there is a telling inconsistency in the critics' treatment of market imperfections. When it comes to administrators, the critics are quite happy to stress that regulators behave in a very imperfect manner. They can't get enough information, their agencies cost a lot, they don't understand markets, they are subject to capture, etc. Thus dealing with agencies, the critics pay a lot of attention to transactions costs. On the other hand, when talking about firms, they brush off market imperfections and other impediments to competition. They pretend that whatever transactions costs exist do not impede the long-run healthy operation of the market.

This inconsistency can be described at a more abstract level. Both firms and political units like agencies are organizations in constant interaction with their social environment. Both seek resources from their environment, both issue requests and commands (although the firm acts with money, while agencies wield political power), and both have members trying to advance the organization's interest. Yet in capture theory, the new critics assume that regulators are vulnerable to subversion and that their will can be bent or bought to aid the most compact, powerfully regulated group. The assumption that human nature is not perfect and power corrupts is, at an even larger scale, the reason for the separation of powers and other checks and balances in federal and state governments. In dealing with firms, on the other hand, the critics ignore the overwhelming evidence that, here too, power can corrupt; that money can buy passions; and that many succumb to the market's tremendous pressure to cheat on the rules of the game. There is *no* theoretical basis for the assumption that businessmen always will pursue legitimate ends—indeed, it flies in the face of economic history—but there it is.

Another partiality crops up in contestable market theory. This game theory models the way a company with power is expected to respond to perceived threats of entry. It argues that under most circumstances—all those in which entrants would not be crippled by a failed assault—the company with power will act competitively to avoid entrants. Yet the very similar approach of strategic deterrence takes the same world of expectations and shows how a dominant company can signal potential entrants that it can punish them for any attacks.[156] Monopolists can contest back. Here too, what really happens is an empirical question, not one of theory alone.

The longer-term argument over innovation is also primarily an affirmation of faith rather than empirically supported proof. Even many of its

innovation. The old school says the barriers are so fundamental that you can assume different structures; the new one assumes competition will dissolve barriers over any reasonable period of time.

156. Salop, *supra* note 11.

proponents admit that they have no evidence that unregulated markets produce more innovation than regulated.[157] In any event, this argument is limited as a policy guide because cooperative research already gets special protection under the antitrust laws.[158]

Faced with these theoretical arguments, courts and natural gas regulators need neither return to earlier command intervention nor close up shop. They need to remain sensitive to market imperfections and the possession of market power. They should look at profit levels and market shares to determine whether companies are successfully discriminating, tying products, and charging monopoly prices. As they often will no longer be setting rates, regulators need a framework that enables them to determine whether abuses are occurring, a point returned to in the last section of this article.

Because antitrust rules will be a central focus in the wake of deregulation, the next section discusses the antitrust issues most likely to arise in the deregulated natural gas industry.

D. The Continuing Focus of Antitrust Regulation

1. Price Discrimination

The first major area where pricing may violate the antitrust laws is a form of pricing also prohibited under the Natural Gas Act—discriminatory pricing.[159] Prohibitions against "unreasonable" differences in prices and other terms are part of the traditional regulatory fabric. It probably is correct that "[m]ost of the history of economic regulation can be written around the phenomenon of price discrimination."[160] It certainly is correct that this must be one of the most frustrating areas for opponents of regulation (and antitrust): they believe that competition prevents successful price discrimination, yet regulators still talk as if it is an everyday occurrence. This underlying disagreement over the meaning of price variations was muted by regulation because pipelines tended to charge a single price for each category of service, but deregulation will bring a profusion of pricing strategies.

Discrimination enables a monopolist to appropriate the consumer surplus above a single market price.[161] Discrimination is prohibited under the

157. JORDE & TEECE, *Introduction, supra* note 146, at 6 (no evidence that either competition or monopoly is "ideal for promoting innovation"); *see also* Merges & Nelson, *supra* note 150, at 185 (no evidence that monopoly "is a necessary or optimal setting for technical advance).

158. For a proposal to expand protection under the National Cooperative Research Act, see JORDE & TEECE, *supra* note 146, at 71-81 (printing proposed "National Cooperative Research and Commercialization Act).

159. In addition to requiring that rates be "just and reasonable," the Natural Gas Act prohibited any natural gas company from "mak[ing] or grant[ing] any undue preference . . . [or] maintain[ing] any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service." Section 4(b), 15 U.S.C. § 717(c)(b)(1976).

160. Kahn, *supra* note 74, at 346.

161. F.M. Scherer defines discrimination as "the sale (or purchase) of different units of a good or service at price differentials not directly corresponding to differences in supply cost." SCHERER & ROSS, *supra* note 8, at 489. It requires the seller to (1) have some control over price; (2) an ability to segregate

Robinson-Patman Act, an antitrust statute that does seem most directed at protecting competitors (in this case, small companies). The Act prohibits "discriminat[ion] in price between different purchasers of commodities of like grade and quality," if the effect of the discrimination "may be substantially to lessen competition or tend to create a monopoly," subject to an allowance for cost-differentials and such changing market conditions as the need to sell perishable goods.[162]

In some circumstances, though, discrimination can extend goods and services to people who otherwise could not afford them. For goods with economies of scale, increased output may lower costs for everyone. Thus, price discrimination has come under attack by Chicago School and other economists, who argue that unless a company enjoys market power it is irrational to discriminate because another competitor will take away the high-priced business.[163] They think firms will only attempt pricing variations with the benevolent goal of serving new customers who could not buy at the old price. As in all of the revisionist microeconomic arguments, the effectiveness of competition to thwart improper discrimination depends upon full information, no cost advantages, and few, if any, transactions costs.

The seriousness with which administrators treat discrimination is one of the striking ways in which traditional regulation differs from Chicago School theories. This is due in part to statutory mandates prohibiting "undue preferences," but in part to the fact that administrators deal with real parties in real markets with actual transactions costs. They see companies favor their own affiliates and big customers and try to price the same services at different levels all the time.

Neoclassical theory teaches that companies with power have every incentive—and as profit-maximizing firms, they should follow their incen-

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customers into groups; and (3) some way to avoid arbitrage (trading) between customers with different prices. SCHERER & ROSS, *supra* note 8, at 489; *see generally* SCHERER & ROSS, ch. 3.

162. 15 U.S.C. § 13 (1973).

163. *See, e.g.*, Posner, *supra* note 121, at 926, 934-35 (arguing that discrimination expands monopolist's output toward competitive level and reduces misallocation of monopoly). One sign that trouble looms in this area is the euphemism that some economists have applied to discrimination, "nonlinear" pricing. The shift in phrasing removes the presumption that there is something wrong with price differences. It also is unwarranted, because contained within the body of discrimination precedent is permission to vary prices as long as there is a cost-based justification. In that sense, legitimately different prices are not really different because there is a linear relationship between the company's underlying costs and the price it charges, even though both may vary among customers.

Even F.M. Scherer, no particular friend of Chicago thinking, notes the dual possibilities of discriminating:

> In sum, systematic price discrimination can preserve and strengthen monopoly positions by permitting large firms to buy inputs at lower prices than their smaller rivals, by getting buyers together with sellers giving discounts for concentrated purchase, and by making entry into narrow segments of a market more difficult. On the other hand, systematic discrimination can improve the efficiency pricing in situations where monopoly is inevitable, while unsystematic discrimination can invigorate competition by undermining oligopolistic pricing discipline.

SCHERER & ROSS, *supra* note 8, at 502. He concludes that the Robinson-Patman Act is a "complex and imperfect instrument" and that "legislative reform merits support." SCHERER & ROSS, *supra* note 8, at 515, 516.

tives—to establish prices that will take the maximum profit from customers. The fact that pipelines are likely, given their cost-structure, to have market power in many areas, suggests that many price differences will be discriminatory—without an underlying cost basis. This makes the existence of discrimination a reasonable proxy for identifying at least some of the markets in which pipelines have market power. Alfred Kahn has listed the surprising frequency of discrimination as one of the early lessons of deregulation.[164]

One can see the incentive to discriminate in a basin where there are only two or three major pipeline systems. Assume that in some places one major gathering system lies next to the other major gatherer; in other places, it is the only available gatherer. In some areas, wells lie close to interstate pipelines. In others, they are far away. The pipeline may adopt an "avoided cost pricing." This means that the producer will be billed for the cost it avoids paying someone else. As one of Williams' marketing plans described this kind of pricing:

> Pricing focus will be on getting as high a rate as is reasonable given the circumstances. Attention will be *primarily on avoided cost alternative* while recognizing IRR constraints and future business opportunities.[165]

In other words, if another company has facilities nearby, the customer gets a low price, but if no one else has facilities nearby, customers pay a lot more. When pipelines seek the right to use "flexible" rates, the obvious risk is that the pricing variations will cloak such a discriminatory scale.[166] One

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164. Kahn has been quite blunt about the fact that deregulation creates an opportunity for a "fuller exploitation of monopoly power" by whatever companies do have market control. Kahn, *supra* note 74, at 338. Though he believes that "[e]ven ardent deregulators have understood that unregulated price competition in the public utility industries would probably be highly selective and localized, with its benefit available only to some well-situated customers," [if so, Kahn must mix with a quite candid group of intellectuals], Kahn, *supra* note 74, at 347, he nonetheless claims that "[m]any of us have been surprised, however, to find discrimination increasing also with the deregulation of industries that we thought were potentially structurally competitive." Kahn, *supra* note 74, at 347.

165. Williams Field Services, *Manzanares Marketing Plan Updated 4/12/91, supra* note 104, § III.5, page 4(emphasis added).

166. In the Incentive Rate Order hearing, the Commission endorsed a combination of negotiated/recourse rates. It claims that "negotiating different rates and service terms for individual shippers could result in wide flexibility . . . ." Though the Commission had not allowed "narrow classification of customer groups," it would "entertain, on a shipper-by-shipper basis," requests for negotiated rates as long as customers kept the ability to choose a cost-of-service recourse base. The Commission also reminded pipelines that their rates are not to be "unduly" discriminatory. Incentive Rate Order, *supra* note 2, at 53, 55, 56, 59. One can predict that the avoided cost controversy will raise its head under the battle cries of Flexibility! (for the pipelines) and Discrimination! (for the disfavored shippers).

Alfred Kahn has described the double-edged nature of individual contracting in the deregulated market:

> The importance and promise of individually negotiated long-term contracts can hardly be exaggerated, . . .
>
> The ability, newly available under deregulation, to enter into such arrangements, adapted to the particular needs of the individual shipper and providing for rewards and penalties based on performance of the transportation function, is said to have been an essential factor in the rapid spread of just-in time inventory and logistical control systems, which have produced cost savings estimated in the scores of billions of dollars a year.

can be confident that pipelines will try to submerge fundamental discrimination beneath many small differences of service, gas quality, and other factors that would not affect prices in competitive markets.[167]

Regulators will have to decide the burden to apply in discrimination complaints. If they assume that markets like gathering are almost always competitive, they may put an initial burden of showing unreasonable differences on complainants. If they expect pipelines to have power in many markets, they should fix the burden on pipelines. They may also want to set the burden after a quick market power determination. Commissioner Williamson of the Texas Railroad Commission has proposed funneling complaints about field services through a barebones administrative process in order to minimize costs on both sides.[168]

Whatever standard regulators adopt, the relatively criticized (among microeconomists) tort of discrimination will become more common in newly deregulated markets that, like gas gathering, contain pockets of market concentration. One battle looms over cost-based rates. The cost of a gathering line increases, on average, with distance. Wells that are far from a pipeline cost more to hook up. Fixed rates made nearby customers subsidize distant customers. Not only will pipelines now bill each unbundled service separately, but they are likely to use zone or other distance-based rates. As deregulation intends to make consumers face the real cost of things they buy, major geographic cost differences should work their way into prices. Producers facing distance rates will find their prices changing, increasing for some and (if their pipeline is serious about cost-based rates)

> Of course, such arrangements openly invite companies—and, insofar as the adoption of rate caps is coupled with the opportunity for a wider range of achieved rates of return, encourage them—to introduce a finer discrimination in the prices they charge for their several services. This is only a more polite way of saying that deregulation permits a fuller exploitation of monopoly power.

Kahn, *supra* note 74, at 335-36, 338.

167. In describing how competitive it finds the gathering market, Williams asserted that it faced competition in price, reliability, fuel requirements, pressures, capacity, processing, liquids, timing, "and countless other variables dictated by any given shipper." *See* Statement of Williams Field Services Group, 1994 Gathering Conference, *supra* note 86. By constructing a scale that makes it appear that producers have dozens or even hundreds of *material* variations in what they want, Williams is trying to redefine the world as a place in which there always will be some difference that it can claim justifies a price difference. Many of these differences will not change Williams' costs, or the difference will be less than the cost of measuring it and figuring it into a price structure. A competitive market would over time isolate the materially different services for which consumers would be willing to pay more; the challenge of noncompetitive markets is that administrators have to make this judgment.

168. Barry Williamson, *What's Next for the Natural Gas Industry?*, Speech Presented at New Mexico Natural Gas Conference, Santa Fe, New Mexico, at 6 (May 12, 1996)(proposing a "Low cost, streamlined, easy-to-use COMPLAINT SYSTEM to address allegations of illegal pricing of rates and services")(emphasis in original). Williamson's goal is a procedure "that doesn't cost producers thousands of dollars to pursue a complaint." *Id.* at 20. Upon receiving a complaint, the Railroad Commission staff will investigate. As Williamson reiterated, "However, let me underscore right here: I WANT THIS ACHIEVED WITH MINIMAL REGULATORY BURDENS." *Id.* at 22 (emphasis in original).

Texas may be getting more aggressive. It has formally asserted jurisdiction over gathering, including gathering spun-off or spun-down facilities, and it "may require gatherers to file new tariffs for gathering or transportation services." *Texas Regulators to Assert Jurisdiction over Gathering Facilities*, INSIDE FERC 3, (Nov. 4, 1996).

falling for others. But distinguishing legitimate price increases from exercises of market power will be very difficult.

The same issues will occur in mainline transportation as the FERC allows incentive rates. The Commission's decision to allow pipelines to negotiate market-based rates will open difficult new questions.[169] One can predict that certain large customers and customers with multiple connections will get lower prices than others. Those who cannot credibly threaten to shift their business will not. Prices to residential customers already diverge from prices for other customers.[170] Customers may be captive because of the location of their wells, their low volumes, contract terms, gas quality and pressures, or an existing pipeline's effective deterrence of competitors. Price differences may have no cost justification. It is precisely because of differential benefits that the District of Columbia Circuit remanded the FERC's early approval of special marketing programs over a decade ago.[171] The same issues will arise in the liberation of the secondary release market.

The Commission thus far has not articulated any standard adequate to this address this problem. Pipelines will use terms like "customized standards" and "flexible service" to describe what often are favors to large customers. Rules that permit discounting to keep business can be manipulated by large companies that will threaten to leave even when they have no intention of doing so and their exit costs would be excessive.[172]

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169. Incentive Rate Order, *supra* note 2.

170. Paul Bautista, *Rise in Gas-Fired Power Generation Tracks Gains in Turbine Efficiency*, OIL & GAS J., Aug. 12, 1996, at 44 (citing *Journal* data showing only 5% drop in average residential prices from 1984 to 1991, but 12% drop for commercial, 40% for industrial, and 41% for electric utilities). This period probably begins and ends too soon to capture the full effects of deregulation.

171. The seemingly technical but actually quite pressing issue before the District of Columbia court was whether pipelines could offer special marketing programs only to certain customers (allegedly customers whom the pipelines feared might switch to other fuels, a category that predictably benefited large industrial users). There are three sequential decisions in which the special marketing programs were dissected by the courts, with remands because of the FERC's failure to justify the selective application of the programs: Maryland People's Counsel v. FERC, 761 F.2d 768 (D.C. Cir. 1985); Maryland People's Counsel v. FERC, 761 F.2d 780 (D.C. Cir. 1985); and Maryland's People's Counsel v. FERC, 768 F.2d 450 (D.C. Cir. 1985).

172. For more on the complexity of this area, consider Jeffrey Leitzinger's comments on this section of the article:

> This discussion reads to me as if you are suggesting that the FERC has not decided how to deal with discrimination. My understanding is that they have. Generally speaking, discounts driven by competitive offers are not only allowed but encouraged, even where customers receiving exactly the same service but not the same competitive alternatives continue to pay full rates. That, of course, makes some economic efficiency sense given large fixed costs and marginal costs near zero. Charge people who value it most —which is often those who have the fewest alternatives—high prices needed to recover the investment; charge lower value customers (e.g., those with good alternatives) rates approaching marginal costs to maximize the net social benefit.
>
> It is an interesting issue whether there is a tension here with Clayton Act standards regarding price discrimination. From that perspective, discounting is supposed to be cost driven not competition based. However, well documented efforts to meet competitive offers does provide a defense to otherwise illegal price discrimination. Is that different in substance from what the FERC does?

The law against price discrimination can play an important role in partially competitive markets. A duty not to discriminate forces a pipeline to choose between offering all customers the market-driven prices of its most competitive market and risking the loss of those markets. A partial monopolist would jeopardize its share of competitive markets if it uniformly charged the too-high price it drew in other areas. It should elect to bill the competitive price as long as the profits it gains are greater than the profits it foregoes by not using the monopoly price. While the deregulated world will not guarantee that the pipeline always will choose the lower, competitive price, prohibitions on price discrimination can ensure that companies who do decide to meet competition are forced to pass the benefits along to all customers.

Pricing information will be critical to policing discrimination. Over time, pricing to the limits of market power in partly competitive but partly monopolized markets is likely to produce a pattern of pricing unrelated to cost, but directly related to the presence or absence of competitors. Though this kind of pricing forms a basis for liability, the victims face a tremendous, often insurmountable challenge of uncovering their sources of injury. They need easy access to pipeline pricing structures.

2. Monopoly Prices.

A second difficult area in antitrust law involves monopoly and the problem of high prices. Monopoly cases present a big difference between regulation and the new world. Antitrust law forbids companies from acquiring or maintaining monopoly power using "bad acts," but not from charging even very high prices if they acquire their power by competing. The antitrust laws generally leave monopolists free to charge any price they want, including prices that reduce output and extract "excess" (above competitive) profits. This is the result of the Sherman Act interpretation that it is not monopoly per se, but only "bad acts" committed by a monopolist, that the antitrust laws forbid.[173] The classic phrasing of this test is Judge Learned Hand's famous, flawed *Alcoa* standard:

> It does not follow because "Alcoa" had such a monopoly, that it "monopolized" the ingot market: it may not have achieved monopoly; monopoly may have been thrust upon it . . . [S]ize does not determine guilt; that there must be some "exclusion" of competitors; that the growth must be something else than "natural" or "normal"; that there must be a "wrongful intent," or some other specific intent; or that some "unduly" coercive means must be used . . . . A single producer may be the survivor out of a group of active competitors, merely by virtue of his superior skill, foresight and industry . . . . The success-

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Jeffrey Leitzinger, *Memorandum to John McArthur*, at 2 (Aug. 22, 1996).

Allowing discrimination by alternatives, which means demand factors, as well as by supply (cost) factors, means that the market will start charging more for customers who generate exactly the same costs as others with more options. The FERC will be inundated with work if it has to distinguish illegitimate discrimination from "discounts driven by competitive offers."

173. This distinction is central to antitrust analysis, although it is also its uneasy foundation. Robert Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J. L. & ECON. 7, 12 (1966)(citing as one argument that Congress did not intend to protect competitors, only competition, that Congress "agree[d] that monopoly itself was lawful if it was gained and maintained only by superior efficiency."

> ful competitor, having been urged to compete, must not be turned upon when he wins.[174]

This is one area where deregulation is likely to immunize decisions that would not have satisfied "just and reasonable" standards. The main thrust of traditional regulation, in contrast to the antitrust laws, is to prevent monopolists from collecting too-high prices. It is willing to sustain the monopolist in return for pricing restraint. Accordingly, rate setting in a cost-of-service regime tries to keep prices down to competitive levels.

A few oil and gas cases remind us that a firm's unilateral price decisions generally do not implicate antitrust concerns, even if the firm is forcing its terms on business partners. For instance, producers tried to find monopoly remedies for pipelines' seemingly clear use of market power to dodge take-or-pay liabilities. Their complaint was that pipelines were paying too little. The courts generally responded by finding market power or at least enough evidence of it to get to a jury, but that trying to get a better price was not a "bad act." Further, they found that paying producers too little was not "injury to competition," no matter how severe the injury to a competitor.[175]

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174. United States v. Aluminum Co. of America, 148 F.2d 416, 429-30 (2d Cir. 1945).

The beauty and failure of Learned Hand's language is that, like many conflicting passions, it embraces hopelessly contradictory standards. Competitors are supposed to want to seize market share: it is the drive for more profits and, better yet, excess profits on current and future sales that pushes them so hard. Competitive firms should specifically intend to beat all their rivals. We just hope they do so by legitimate means, which the courts have to define. Good competitors want to seize monopoly, not have it thrust upon them (although they would be delighted with that, too, but most know not to waste their time on fanciful dreams). Just how unrealistic Hand's picture is, or, put another way, how unreconciled are his visions, is apparent in a less-often cited passage:

> [P]ersons may unwittingly find themselves in possession of a monopoly, automatically so to say: that is, without having intended either to put an end of existing competition, or to prevent competition from arising when none had existed; they may become monopolists by force of accident.

Id. at 429-30.

One can understand why authors like Robert Bork sense easy pickings in attacking *Alcoa* for failure to articulate an enforceable rule. It is true that some big companies may not believe their success and be astonished at how quickly they reap market share, i.e., they may not have understood that they would find the key to a market when they did, but putting competitors out of business is the stuff of most competitive dreams.

Some of the hardest issues in interpreting *Alcoa* come up in essential facilities cases, when a defendant has built up an asset from its own effort but allegedly done such a good job of it that its potential competitors need its help to for them to survive. (Buddy, can you spare some capacity?) For recent cases on this issue, *see infra* note 187.

175. Take-or-pay cases generated a fair amount of antitrust fallout, but not many successful cases. In Garshman v. Universal Resources Holding, Inc., 625 F. Supp. 737, 745-46 (D.N.J. 1986), *aff'd,* 824 F.2d 223 (3d Cir. 1987), *dismissing rest of case,* 641 F. Supp. 1359 (D.N.J. 1986), the trial court rejected claims brought by investors in a drilling project who alleged that they suffered injury in their business because of predatorily lower prices. In the initial opinion, the trial court rejected allegations of antitrust conspiracy and price fixing, but accepted under motion to dismiss standards a relevant market limited to the producer's field and the possibility that the facts might support a claim of monopolization. *Id.* at 741-44. It found that the general partners who sued did not have standing to sue, but noted that the producers might. *Id.* at 745-47. In its second opinion, the court found that conduct designed to lower a pipeline's prices would support neither monopolization nor price fixing. 641 F. Supp. at 1367-71.

In State of Illinois ex rel. Hartigan v. Panhandle Eastern Pipeline Co., 730 F. Supp. 826 (C.D. Ill. 1990), *aff'd,* 935 F.2d 1469 (7th Cir. 1991), the State of Illinois sued Panhandle on behalf of residential and industrial consumers. Faced with very high take-or-pay costs, Panhandle refused to move cheaper gas purchased by local distribution companies through its pipes. After a bench trial, the court found for Panhandle and rejected claims of monopolization, attempted monopolization, monopoly leveraging, failure to open essential facilities, and tying. The court did find Panhandle had power in a relevant market, but not bad acts. At the heart of the opinion was the court's refusal to find that a pipeline's refusal to let its contract gas go to waste by shipping undercutting fuel, on behalf of the very customers for whom it had entered the onerous contracts in the first place, was an antitrust violation. It felt that the customers "wanted to have [their] cake and eat it too." 730 F. Supp. at 886. Or, in the words of the Seventh Circuit when it affirmed,

> Panhandle incurred an obligation to use its best efforts to meet it customers' supply requirements . . . many LDCs . . . balked at paying above market rates for their gas and sought to escape their contractual obligations . . . by demanding that Panhandle transport gas they wanted to purchase from other sources. At the same time, these customers wanted to hold Panhandle to its obligation to supply their contract demand quantities, should they desire to purchase them.

935 F.2d at 1480.

The circuit court agreed that Panhandle had not committed bad acts by trying to maintain what it considered a regulatory allocation of risks and to fund its estimated $4 billion take-or-pay liability. *Id.* at 1483-84. It added that Panhandle had little other reason (i.e., little except survival) to want to charge customers high prices because it did not earn a profit on its gas sales under the regulatory structure. *Id.* at 1486.

In Cayman Exploration Corp. v. United Gas Pipe Line Co., 873 F.2d 1357 (10th Cir. 1989), a producer filed antitrust and racketeering claims arguing that United's take-or-pay strategy of allegedly coercing producers to accept below-contract prices constituted vertical and horizontal price fixing. *See id.* at 1360-61. Not only did the court reject each claim on certain technical grounds, but it pointed out in addition that Cayman had not shown that United's action had any anti-competitive effect. *Id.* at 1361. I.e., presumably gas consumers benefit from lower prices, even though the prices hurt producers. Competition, not competitors, is protected.

One producer's take-or-pay monopoly lawsuit that should be classified as successful is Hartman v. Burlington Northern, Cause No. 87-CA-313, in the United States District Court for the Western District of Texas. The federal action followed Doyle Hartmann's victory over El Paso in New Mexico state court. *See supra* note 281. Its antitrust charges of monopolization and attempted monopolization, charges Hartman leveled at a variety of El Paso companies, Enron Corporation, and one of affiliates, included using monopoly power to shut in Hartman's production; manipulating the New Mexico allowable process to limit Hartman's production and favor affiliates, and refusing to deal with Hartman. Plaintiff's Original Complaint at 25-27, Hartman (Cause No. 87-CA-313). Hartman already had secured an injunction against El Paso in New Mexico state court, based in part on a finding that El Paso had "manipulated the nomination and proration system of the State of New Mexico." *See id.* at 22, § 63. In addition, Hartman alleged a conspiracy by Burlington Northern and Enron based on their practices in New Mexico and their activities surrounding the Mojave Pipeline. The case settled before trial. Telephone interview with Gene Gallegos, author and Hartman attorney (Aug. 18, 1995).

In another monopoly case, Consolidated Gas Co. v. City Gas Co., 880 F.2d 297 (11th Cir. 1989), *aff'd en banc,* 912 F.2d 1262 (11th Cir. 1990), *dismissed as moot after settlement,* 111 S. Ct. 1300 (1991), the trial court found after a bench trial that a supplier of natural gas in southern Dade County, Florida violated section two of the Sherman Act by dividing the county in half with a competing supplier and by refusing to deal with the plaintiff, at least, refusing to sell gas to the plaintiff except at an "unreasonably high price." *Id.* at 299-300. It awarded a nearly five million dollar judgment to the plaintiff. The case then settled.

In Venture Technol., Inc. v. Natural Fuel Gas Co., 685 F.2d 41 (2d Cir. 1982), *motion to consolidate with other cases and for rehearing denied,* 459 U.S. 1138 (1983). A company trying to enter the drilling business in western New York State claimed that the local distribution company and a competitor had conspired to destroy his company. He sued for monopolization and section one conspiracy. The jury found no liability on the monopoly claims, but it awarded $1,500,000 in damages for conspiracy. The

In cases over gathering and related services the charge will be that pipelines are using their power to charge too much, not pay too little. The courts still are likely to reject these claims, however, citing the principle that collecting monopoly profits is not alone an antitrust violation.

Plaintiffs will be able to get to a jury if the courts decide that regulated companies fall into an intermediate category between legitimately acquired power and artificial market positions. Much of the market share of deregulated companies is due to state protection. The FERC protected pipelines from entrants, supported their recovery of capital, and allowed them to use eminent domain to build their systems.[176] Power acquired and nurtured during regulation does not sound like power acquired by "business acumen" or "superior skill, foresight and industry." This argument would distinguish *Alcoa* and offer a legitimate economic basis for challenging high prices if consumer welfare is to be the courts' polestar. The odds are low, however, that courts will adopt this reading. The judicial atmosphere is too imbued with hostility to antitrust intervention. The ideology of the beneficial market is too strong. This is part of the irrationality of decision-making by ideology rather than by precisely honed, empirically grounded principles.

The State of New Mexico may have been correct to complain about Williams' raising its gathering prices after light-handed deregulation, as was Oklahoma to complain about El Paso's increases, because they were before the FERC.[177] But these were *regulatory* arguments. If rapid price increases persist because of market power, they may bring the wisdom of deregulation into question. If they persist too long, the solution will be some form of reregulation.

Second Circuit reversed the judgment, holding that the evidence of concerted action was too insubstantial to support the verdict. *Id.* at 45-48.

In Woods Expl. & Prod. Co. v. Alcoa, 438 F.2d 1286 (5th Cir. 1971), *cert. denied,* 404 U.S. 1047 (1972), the Fifth Circuit reversed a very long running antitrust case with instructions to enter the jury's verdict. Woods owned a very small part of the Appling Field in Texas. It alleged that the other interest owners monopolized, attempted to monopolize, and conspired to monopolize production by filing false allowable data with the Texas Railroad Commission, *id.* at 1292-95, as well as refusing to transport Woods' gas and conspiring to prevent it from operating its own pipeline. *Id.* at 1300-02. The Fifth Circuit agreed with Woods that the field was the relevant market. *Id.* at 1304-06.

Finally, in a category all its own is CIG v. NGPL, 885 F.2d 683 (10th Cir. 1989), *cert. denied,* 111 S. Ct. 441 (1991). Although CIG is a major interstate pipeline and had fought many cases trying to invalidate its own take-or-pay contracts, CIG alleged that NGPL stopped buying CIG's gas to pressure CIG to drop its supply contracts. This conduct allegedly centered on a scheme for NGPL to pick up CIG's market share. NGPL's practices supposedly would shift business to the Trailblazer System, a pipeline that CIG and NGPL owned jointly. CIG initially recovered almost three-quarters of a billion dollars, remitted to something over $400 million. *Id.* at 685. The Tenth Circuit reversed the antitrust findings because of the peculiar co-ownership that CIG shared with NGPL, *see id.* at 691-97, but it upheld the tortious interference judgment.

176. Each of these powers is codified in 15 U.S.C. § 717f (Supp. 1996). Not only does the FERC have the duty to police entry and exit, but the NGA empowers holders of certificates of public convenience to use eminent domain to get properties they cannot acquire in private negotiations. *Id.* at § 717f(h).

177. *See supra* note 100. *See also infra* note 306 and accompanying text.

A number of natural gas monopoly cases find a relevant market in dictum, when they dismiss on other grounds. Complainants should not be comfortable that courts will be this easily persuaded of market power, however, if the plaintiff can prove the other elements of monopoly. The impact of the theory of contestable markets suggests that courts will give more weight to potential entrants and less to market share alone. The Justice Department Merger Guidelines reflect this looser approach.[178] Market definition already requires expensive expert testimony in most cases. While many fields and producing areas are single markets, it will take more of a battle to prove this than in the past.

Rising prices will tempt a lot of plaintiffs to investigate antitrust actions because deregulation almost certainly will change the pattern of prices. Lacking the "whip" of competition, regulated utilities had little reason to experiment with narrower and more efficient offerings. Rising prices are inevitable, given the cross-subsidies of the regulated period. In some instances, though, pipelines will just use their power to jack up prices. One can predict that the industry will need some shake-down cruises (i.e., lawsuits) to learn to separate the two.

3. Essential Facilities

One monopoly theory that will see greater use is the essential facilities doctrine. Open-access rules show how durable this concern has been in the regulated natural gas world. The antitrust laws prohibit the owner of an "essential" facility from barring access to others, either directly or via price manipulations."[179]

> The gist of the 'essential facility' concept as applied in the antitrust law is that one competitor has control of the facility and is able to foreclose effective competition in one or more other relevant markets by denying a competitor's access to the facility.[180]

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178. The more expansive view of markets appears primarily in the specific consideration of potential entrants, but also in separate analyses of anti-competitive effects and of "net efficiencies" concerns. *See infra* note 202.

Some advocates of wider sway for innovation want to define markets more broadly, too. Thomas Jorde and David Teece argue that innovating firms may capture market power for a while, but that technological controls tend to be unstable. They worry that power captured in a one-to-two year period will overstate a company's likelihood of having enduring control and suggest a four-year default period. Jorde & Teece, *Introduction, supra* note 146, at 7, 11-12. In addition, Jorde and Teece complain that market share measurements too often ignore or discount performance variations. They want market share rules modified to "include variations in performance attributes of existing and potentially new technologies." *Id.* at 9.

179. For a detailed review of the essential facilities doctrine in the natural gas context, *see* William Tye, *Competitive Access: A Comparative Industry Approach to the Essential Facility Doctrine,* 8 ENERGY L.J. 337 (1987); *see also* Stephen Mahinka & Janet Johnson, *New Antitrust Issues in a Deregulated Environment: Access to Pipelines,* 4 ENERGY L.J. 211 (1983)(arguing that courts should expand business justifications and narrow doctrine).

For some of the modern cases, see Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985); Olympia Equip. Leasing Co. v. Western Union Tel. Co., 797 F.2d 370 (7th Cir. 1986), *cert. denied,* 480 U.S. 934 (1986); MCI Communications Corp. v. AT&T, 708 F.2d 1081 (7th Cir. 1982), *cert. denied,* 464 U.S. 891 (1983).

180. Tye, *supra* note 179, at 344.

It is illegal to bar access by exclusionary prices, not just by an outright refusal to deal.[181]

Essential facility issues were not that common during full-fledged regulation because the system was premised upon single companies dominating their own markets. But the doctrine is very important to regulators. The Commission has treated the still-regulated parts of the pipeline network as essential facilities by designing the open access framework, forcing pipelines to offer all customers space on equal terms and a first-come (or, more accurately, first-to-commit), first-served basis.[182]

Litigation over access to utilities has been fairly common. One of the major refusal to deal cases, *Otter Tail Power Co. v. United States*,[183] arose after the electric utility serving a 465-town area in Minnesota and the two Dakotas refused to sell power to four towns whose contracts had expired. The towns wanted to start municipal utilities. Otter Tail not only refused to sell them wholesale power, but it refused to "wheel" power from other sources and filed suits that the court found were intended to prevent the towns from establishing their own business.[184]

Justice Douglas took little time to declare this conduct illegal. He read the record as "abundantly clear that Otter Tail used its monopoly power in the towns in its service area to foreclose competition or gain a competitive advantage, or to destroy a competitor, all in violation of the antitrust laws."[185] He treated access to Otter Tail as essential; for instance, he claimed that municipalities desiring to run their own systems had to buy wholesale power and "[t]o do so they must purchase the electric power at wholesale."[186]

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181. "Sheer physical impossibility of the alternative is not necessary; there is often some cost high enough for which the essential facility (or its service) could be duplicated. It is clear therefore that the test must be economic." *Id.* at 348.

182. The Commission will not have similar power over fully deregulated services. (When the FERC retains jurisdiction but does not regulate, as in light-handed regulation, presumably it has the power to insist on open access; if it defines a system as nonjurisdictional, it does not.)

183. 410 U.S. 366 (1973). William Tye observes that the *Otter Tail* Court did not explicitly refer to the essential facilities doctrine in its relatively brief opinion. The concepts of essential facilities and refusals to deal are intimately connected, however, and portions of the opinion, like the discussion of what it would cost for the towns to build their own utility, make it clear that the Court was talking in terms that reflect — indeed, helped generate—the doctrine. *See* 410 U.S. at 378 ("Interconnection with other utilities is frequently the only solution [for isolated community utilities].").

184. *Id.* at 366-72.

185. *Id.* at 377.

186. *Id.* at 370. The district court found that Otter Tail had "'strategic dominance'" over electricity transmission in most of its service area. *Id.* at 377. Justice Douglas also discussed the "difficulties and problems of those isolated electric power system," for whom "[i]nterconnection with other utilities is frequently the only solution." *Id.* at 378.

Otter Tail apparently had another remedy for towns that did have access to other systems: it sued them, trying to prevent them from getting their plans off the ground. *Id.* at 371-72.

Otter Tail ends with one of those wonderfully vague and suggestive dictum, in which the Court insisted that it did "not suggest, however," that the district court "should be impervious to Otter Tail's assertion that compulsory interconnection or wheeling will erode its integrated system and threaten its capacity to serve adequately the public." *Id.* at 381. I.e., running room in any direction.

The presumption that entry is easier than once believed, and retaining power correspondingly harder, will hurt essential facilities claims. The more likely it is that an outsider can penetrate a market, the less essential the facilities of existing companies. Recent essential-facility plaintiffs in general have not fared as well as the *Otter Tail* plaintiffs.[187]

4. Tying

A related violation is tying, a form of monopoly leveraging. A company ties a service when it has one product or service consumers very much want and makes them buy one they don't want to get it. It squeezes out competitors this way. Tying requires proof of two services or products, a tie between them, and market power in the "tying" market that explains why the defendant can impose the tie.[188] Although tying used to be a per se violation, the intricate analysis into whether separate products exist, market power, and business justification makes it function like a rule of reason offense. The tying doctrine mitigates the rule that a lawful monopolist can charge whatever price it wants and that its internal firm decisions (like affiliate structuring) are its own business. Monopolists cannot tie two products if in so doing they force customers to buy a product they don't want.

Tying has come under severe attack by Chicago School critics who argue that it is irrational because if the monopolist has power over one product, it can extract all of its excess gain in that market. As Posner has stated:

> [A] tie-in . . . is not a rational method of obtaining a second source of monopoly profits, because an increase in the price charged for the tied product will,

187. One well-known access case involved local gas distribution. City of Chanute, Kansas v. Williams Natural Gas Co., 31 F.2d 1041 (10th Cir. 1994). Pipelines often do have monopoly power in relation to their LDC customers, but this relationship is regulated at the state level and most claims traditionally have been resolved in administrative, not judicial, disputes. (This too may change as local gas deregulation comes of age.)

The cities argued that Williams Natural Gas had to offer open access transportation. The parties reached a settlement that provided for phased-in open access, but Williams largely prevailed on its defenses to antitrust claims for damages allegedly arising during the period when Williams temporarily canceled its open access policy. For a general background, see City of Chanute v. Williams Natural Gas Co., 955 F.2d 641 (10th Cir. 1992), *cert. denied,* 113 S. Ct. 96 (1992), *later opinion on attorney's fees,* 31 F.3d 1041 (10th Cir. 1994). The Tenth Circuit rated Williams the substantially prevailing party in denying the cities' request for attorneys' fees. 31 F.3d at 1047-49.

In the *Hartigan supra* note 175, the trial and circuit courts found the essential facility claim lacking on two grounds. First, they did not believe that access to Panhandle Eastern's pipeline network was essential. The lower court found that "it would have been economically feasible for competitors to duplicate much of Panhandle's system within central Illinois by means of interconnections between competing pipelines and the construction of new pipelines." 730 F. Supp. at 928. Second, both courts agreed that access was not "feasible" because opening the portals to cheaper gas would have left Panhandle with no way to fund its perhaps $4 billion take-or-pay liability. *Id.* at 862.

188. *See* Jefferson Parish Hospital Dist. No. 2 v. Hyde, 466 U.S. 2, 12-13 (1984)(elaborating standard of illegal tie as the conditioning of sale of one good upon the purchase of another, by a seller with market power in the first market). Section 3 of the Clayton Act forbids tying of "goods" and other tangible products, 15 U.S.C. § 14 (1988), with section one of the Sherman Act (as well as section five of the Federal Trade Commission Act) extending these principles to services. *See, e.g.,* Northern Pac. Ry. v. United States, 356 U.S. 1 (1958)(tie of railroad services).

> as a first approximation, reduce the price that the purchaser is willing to pay for the tying product.[189]

The rules against affiliate favoritism and Order 636's unbundling requirement may prevent pipelines from tying field services or field services and transportation. They do nothing, however, about the larger number of unregulated gatherers. These rules will not apply to deregulated affiliates or to the many companies that always have fallen outside the FERC's jurisdiction. These companies may be tempted to offer one price for a package of services, but only high prices if, say, a customer that wants to buy storage but not gathering. Moreover, pipelines may effectively tie unbundled services to transportation by offering a package price that is more attractive than the separate services.

The elements of a tying claim include two separate products. These products are defined by looking at the shape of demand: Do consumers want goods or services in combinations not offered in the marketplace?[190] Regulated markets often tie goods or services and include many long-term cross-subsidies. (The most famous tie is a regulated one, the link between local and long-distance phone service in the AT&T monopoly.) In natural gas, the traditional model tied services of producing, gathering, processing, storing, and marketing into the transportation service. Thus one can predict that the escape of natural gas back into the market will generate disputes that will focus on product definition and arguments over whether the joint service is desired or, instead, imposed.

5. Joint Violations

Then there are section one's joint violations of the Sherman Act: price fixing, refusals to deal, boycotts, and market division.[191] Courts have

189. Posner, *supra* note 121, at 926. Writing in 1979, Posner believed that "the conclusion that tie-ins should not be forbidden seems both correct and increasingly influential on academic opinion." *Id.* at 935-36.

190. "[T]he answer to the question whether one or two products are involved turns not on the functional relation between them, but rather on the character of the demand for the two items." *Hyde,* 466 U.S. at 19. Demand often follows function, however, which is why product definitions end up in dispute less than one might expect.

191. Resale price maintenance is another *per se* category that has earned Chicago School condemnation, but that still formally falls under the *per se* rule in spite of *Business Electronics v. Sharp.* The criticism is that if markets are competitive (and Chicago School proponents think they virtually always are), then a company that imposes price terms on its distributors without using them to require some desired customer service is giving business away to its competitors. In this view: "No manufacturer wants to have less competition among its dealers for the sake of less competition. The reduction in dealer's rivalry in the price dimension is just the tool the manufacturer uses to induce greater competition in the service dimension." Easterbrook, *supra* note 121, at 13.

This fits with Easterbrook's view that "[m]ost vertical arrangements appear to have increased output." *Id.* at 32. Easterbrook does not discuss manufacturers pressured into price systems by their distributors, those who gamble that they can appropriate excess profits, those who decide they would rather convey a premium product image (even if consumers would prefer more at less cost), or why companies would police service indirectly and imperfectly by price supports rather than simply requiring certain service level.

Resale price maintenance cases generally involve manufacturers who hire different distributors. A terminated distributor sues, claiming he is being punished for price cutting by the manufacturer and

restricted these traditionally per se violations by defining many categories of exceptions that get only rule of reason treatment.[192] Both the likely level of proof (per se or rule of reason) and likelihood of success most often will depend on whether the evidence of conspiracy is direct.

The fact that pipelines had to justify their rates in separate proceedings meant that price collusion didn't make much sense during regulation. Administrative control over entry and exit made market division difficult and the separation of markets made refusals to deal largely moot as well. The traditional pattern of different pipelines in different markets tended to preclude joint violations.

The opportunity and incentive for collusion will expand in the deregulated world. Pipelines will enter each other's markets when those markets can support competition. The likely return to conspiracy will rise. If two or three substantial gatherers shared a single market, for instance, they could raise their profits if they divided it by exchanging facilities until each dominated its own segment. Then each could increase rates. As long as the companies agreed on prices or on a strict market division, they could prevent producers from playing one off against the other.

There already are striking commonalities among some oil and gas company practices. The most touchy practice at present is the posted price used by many oil companies and now under attack in Texas and other states. A series of antitrust lawsuits allege that the posted price was a front to enable large oil companies to fix a low price for oil that they purchased. The companies allegedly earned a higher price when they resold the production.[193] Litigation will determine whether these companies went

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other distributors. This kind of case does not arise when a single affiliate sets the price for a single service whose production it controls. Any conflict over price levels stays in the family.

192. *See supra* notes 128-31.

193. The Texas Land Commissioner, three private trusts, a guardian, and a class recently sued the eight major oil producers in Texas— Amoco, Chevron, Exxon, Marathon, Mobil, Phillips, Shell, and Texaco. The plaintiffs argue that these companies have underpaid royalties due the Permanent University Fund and other class members by basing their payments on an industry posted price. Original Petition, Texas General Land Office on behalf of the Permanent School Fund of the State of Texas, Cause No. 95-08680, in the 345th District Court of Travis County, Texas (July 14, 1995). The plaintiffs also sued on behalf of a class of "those persons to whom the defendants have made royalty or overriding royalty payments, calculated by the defendants on the basis of 'posted prices' for crude oil." *Id.* § 24. A study performed for state land offices in Texas, Colorado and New Mexico found that the posted price was 3 to 6% below market prices in the several years before the lawsuit. Laura Johannes, *Suit May Mean Wide Increases in Oil Fees,* W. ST. J., July 19, 1995, at T3.

The plaintiffs allege that each defendant assumed the duty "to pay royalties based upon at least a fair market price for crude oil production." *Id.* § 18. Instead they allegedly have calculated and made payments on the basis of so-called 'posted prices.' They have done so as a matter of continuing business practice. As they know, the level of 'posted prices' has been consistently below the fair market value of crude oil. *Id.* § 19.

Major oil companies have long bought oil at published posted prices. When the posted price lawsuit was first reported in the press, a representative of the Mid-Continent Oil and Gas Association, an industry group, responded that "the posted price typically is higher than the market price." *State Claims 8 Companies Underpaid Oil Royalties,* AUSTIN AMERICAN STATESMAN, July 15, 1995, at A14.

The Land Commissioner's case is only a breach of contract case involving royalty terms, not an antitrust case. For other cases, see Petition, Kershaw v. Amoco Prod. Co., Cause No. CJ-95-184, in the

beyond independently imitating each other's practices to joint pricing and other shared efforts to reduce competition.

A good natural gas example of standardized practices are take-or-pay contracts. These form gas purchase agreements had very similar take, maximum lawful price, price floor, and force majeure clauses. Moreover, the many refusals to perform often imitated each other in timing and substance. But discovery in these cases did not turn up direct evidence of conspiracy (i.e., in defense strategy), and obviously each pipeline had its own interest in avoiding its contracts.

Section one cases will thrive or flounder depending upon the directness of the proof of conspiracy. A good example of the kind of case that will be lucky to get to a jury is *Buffalo Royalty Corp. v. Enron.*[194] The plaintiffs, working interest owners in Texas, alleged that El Paso and Enron

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District Court of Seminole County, Oklahoma (Sept. 13, 1995)(suit against 13 oil companies with class of "those persons to whom the defendants have made royalty or overriding royalty payments" using posted prices; suit for breach of express and implied covenants, UCC violation, and accounting). Other plaintiffs have filed parallel lawsuits on antitrust conspiracy theories. Plaintiffs' First Amended Original Petition, Lee County v. Amerada Hess, Cause No. 10,652, in the District Court of Lee Country, Texas (Oct. 23, 1995)(suit against over 50 companies, with class of royalty and working interest owners whom defendants have paid for Texas oil at posted or discriminatory prices, and claims under various state statutes including common purchaser and competition statutes, plus requests for an audit and accounting); Lee County v. Union Pacific Resources Co., Cause No. 10,651, in the District Court of Lee Country, Texas (Oct. 23, 1995)(adding more than 20 more companies). *See also* Engwall v. Amerada Hess, Cause No. 95-322, in the Fifth Judicial District Court of Chavez County, New Mexico, *cited* in John Lowe, *Current Issues in Royalty Clause Construction*, at 29 n. 29, Presentation at 22nd Annual Oil, Gas & Mineral Law Inst. (Mar. 22, 1996).

In a federal case filed in Houston, the plaintiffs sued 35 major oil producers for price fixing via posted prices. The proposed class is

> All owners of Direct Payee Royalty Interests and Working Interests who were paid or credited by virtue of Lease Production Oil produced and first sold to one or more Defendants or Affiliate Traders from a mineral lease at or by reference to posted price at any time since September 30, 1986.

Class Action Complaint for Violation of the Federal Antitrust Laws § 48, The McMahon Foundation v. Amerada Hess, Cause No. H-96-1155, in the United States District Court for the Southern District of Texas (Apr. 10, 1996).

The price fixing allegations include using the posted price "rather than a competitive market price" and conducting "reciprocal trades or exchanges" that shift production back and forth, but then ultimately selling the production or its traded equivalent at a higher market price. *Id.* §§ 60-61.

A Department of the Interior investigation has claimed that major California producers underpaid about $856 million in royalties on oil produced from federal land in California. The Interior Department study, which covers just the ten largest producers of federal crude oil in California, is discussed in *Study Reviews Royalty Issue on California Crude,* OIL & GAS J., at 26, col. 3 (May 27, 1996). For the possibility that at least Chevron and Exxon may be protected by prior settlements, see Kenneth Howe, *Chevron May Not Owe Oil Royalties As Claimed,* S.F. CHRON., June 19, 1996, at B.

194. Cause No. 2-91-0085 (N. D. Tex. 1991). This case was a class action against El Paso Natural Gas and Enron Corporation filed in Amarillo Texas. The plaintiffs initially sued in federal court, with statutory claims for antitrust and racketeering violations and claims for breach of contract, fraud, accounting, breach of fiduciary duty, conversion, unjust enrichment, and deceptive trade practices. Plaintiffs' First Amended Complaint §§ 59-61, 71-78, 79-81, 82, 87, 92-97 (paragraph 97 is a twenty-page racketeering statement required by the Amarillo district federal court). *Id.*

The amended federal complaint was dismissed when the court dismissed the only federal claims, the antitrust and racketeering claims. The court found the allegations of conspiracy too conclusory. In addition, it thought that the class had failed to allege a business injury distinct from the conspiracy. *Id.*

conspired to fix low prices that breached their gas purchase agreements. Yet they had no direct proof (such as names, dates, or documents) of agreement among the two companies. Their circumstantial assertions faced the

(Order Granting Defendants' Motions to Dismiss Antitrust Claim and Order Denying Plaintiffs' Motion for Leave to Amend at 9-19).

The plaintiffs refiled their common law and deceptive trade charges in state court. Plaintiffs' Original Petition, Buffalo Royalty Corp. v. Enron Corp., Cause No. 28,234, in the District Court of Gray Country, Texas (May 8, 1992). The Texas court denied certification without explaining its decision. (Phone conversation with attorney Jon Wallis, November 27, 1995).

The *Buffalo* litigation focuses on a variety of accounting issues, as did the federal pleadings. El Paso was for a long time the country's largest and longest pipeline company. Enron more recently operated the country's largest natural gas system. The lawsuit sought certification for the class of working interest owners "who contracted directly, with one or more of Defendants and/or their co-conspirators, for the sale of natural gas, during the period from 1979 to present, and who have sustained damages as a result of the wrongful acts and the conspiracy herein alleged subsequent to 1979." *Id.* § 14.

Some of the allegations concern what sound like standard take-or-pay claims, including underpayment for volumes taken and failure to take appropriate contract volumes. *Id.* Others address affiliate problems of the newly deregulated gas market. Thus at least part of the underpayment claim revolves around allegations that both Enron and El Paso Natural Gas Company "[u]tiliz[e] complicated accounting procedures based on fictional alternative fuel pricing clauses in order to conceal from Plaintiffs the intentional underpayments." *Id.* § 48(d). Many of the Enron contracts, for instance, use a "Minneapolis Fuel Clause" that is in essence the Northern average rolled-in netback or delivered price at Minneapolis, Minnesota. The plaintiffs allege that Enron calculated this price after deducting transportation costs on its system, but without reducing those costs for discounts that it grants to other sellers of gas on its pipeline. *Id.* § 49.

The deduction of gas handling and shipping costs from the gas price, without credit for discounts that the pipeline received, or put another way, charging the royalty interest with costs never incurred by the pipeline, is a new twist on the old oilfield practice of not passing back discounts.

In the *Venture Technology* case *supra* note 175, the drilling-company plaintiff had no direct evidence to back up its allegations of a conspiracy between the ldc and a competing driller. A jury found section one liability. The Second Circuit, after a brief review of evidence showing that the only contacts between the alleged conspirators looked like ordinary business contacts, reversed this award because "[n]othing but sheer speculation would support the conclusion that this occurred." *Id.* at 47. Although the law of circumstantial conspiracy remains on the books, this kind of holding reflects the higher value courts place upon business decisionmaking these days and their unwillingness to let juries weigh the motives for management decisions in section one cases unless there is direct evidence of conspiracy.

In contrast, a section-one class action that succeeded is the *New Mexico Antitrust Litigation.* A class of 350,000 past and present residential consumers of natural gas in New Mexico sued over the joint pricing practices of major gas producers in the State. New Mexico's domestic gas prices had been rising rapidly. The case arose in an interesting way. Teachers in the public school system noticed that their school budgets were being depleted by rising energy bills. They decided to investigate. In re New Mexico Antitrust Litig., 607 F. Supp. 1491, 1494 (D. Colo. 1984). The class alleged that the increases resulted from a conspiracy of Southern Union and a "significant number of the over 100 natural gas producers" in the San Juan Basin. *Id.* The plaintiffs tried the case and won a jury verdict on liability, but the judge then recused himself. *Id.* at 1496.

The case was on its way back to trial when it settled. Initial settlements by Conoco, Consolidated Oil & Gas, Inc., Supron, and Southland Royalty produced $42,205,000 for the class. *Id.* The final settlement included plaintiff Public Service Company of New Mexico's purchase of gas assets owned by Southern Union for $51,500,000 less than book value, a staggered payment of $32,600,000 to the class, and $2,300,000 to the State of New Mexico. *Id.* at 1498. The court approved the class settlement in its opinion awarding attorneys' fees In re New Mexico Antitrust Litig., 607 F. Supp. 1491 (D. Colo. 1984); its opinion awarding attorneys' fees is at 607 F. Supp. 1511 (D. Colo. 1984).

problem that both El Paso and Enron had a unilateral interest in avoiding high take-or-pay costs. These problems were fatal to the plaintiffs:

> Plaintiffs do not allege that Defendants knowingly participated in a common scheme or design, nor do their allegations of conscious parallel conduct permit an inference of conspiracy. They do not even identify the alleged conspirators, when or how they functioned, or the nature and the extent of El Paso and Enron['s] participation in the alleged conspiracy. Rather, Plaintiffs simply use the word "conspiracy" and "co-conspirators" a couple of times, and allege that the Defendants used "their gas production, gas marketing, and gas purchasing capabilities in concert."
>
> . . . they have also not alleged any facts which would support an inference that Defendants and other pipelines engaged in conscious parallel conduct which was contrary to the economic self-interest of the co-conspirators absent an agreement.[195]

While the standard applied by this court is at the conservative end of the spectrum,[196] the skeptical environment that exists for antitrust claims generally is likely to make courts apply this kind of screen.

Affiliate favoritism drew more attention in regulatory regimes than in antitrust. One aspect of affiliate favoritism, intra-corporate conspiracy, is not a basis for federal antitrust complaint under the Supreme Court's 1984 *Copperweld* decision that affiliates cannot be liable for antitrust conspiracy.[197] Many practices involving affiliates, like imposing new layers of profits on formerly integrated services by providing them through separate companies, may violate common law or other statutory duties,[198] but generally will not support antitrust violations (at least not under federal law). Pipelines do have to be careful not to favor affiliates in access to still-regulated services, not for antitrust reasons but because this kind of favoritism remains squarely forbidden by Order 497.[199] Such practices may create antitrust liability if the pipeline has market power and the affiliate relationship forms part of a "bad act."[200] But in general, affiliate problems are most likely to be litigated in breach of contract lawsuits over the terms of

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195. Order Granting Defendants' Motions to Dismiss, *supra* note 194, at 14.

196. *Id.* at 8, n.4 (contrasting standards of more liberal jurisdictions).

197. *See supra* notes 123-24 & accompanying text.

198. Deregulation already has spawned a variety of common law suits. For instance, Meridian Oil's handling of gas pricing and processing is at the heart of a major natural gas class action, Plaintiffs' Second Amended Original Petition, Altheide v. Meridian Oil Inc., Cause No. 92-026182 District Court of Harris County, Texas(Sept., 23, 1994). The class alleges that Meridian uses a network of affiliates to extract extra profits when reselling both gas and liquids. *Id.* §§ 18, 28-29. It also allegedly deducts a transportation fee under "netback" contracts that it does not actually pay to its former affiliate, El Paso Natural Gas Company. *Id.* § 31. A very similar individual case, Bank One, Trustee for San Juan Basin Royalty Trust v. Meridian Oil Inc. & Southland Royalty Co., Cause No. SF94-1982(c), in the first judicial district of Santa Fe, has settled, on terms that are confidential. The claims were for breach of the royalty agreement, breach of fiduciary duty, and breach of duty of good faith under New Mexico law.

199. Order 497, *Inquiry into Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines,* 53 Fed.Reg. 22,139 (1988). *See also* Sheila Hollis, *supra* note 73, § 14.02[4](discussing Order 497).

200. *See* Larue, *supra* note 132, at 48 ("antitrust suits challenging pipeline-marketing affiliate relationships most likely will have to be brought under the monopoly provisions of section 2").

gas sale and royalty agreements and in government audits and litigation under taxing statutes and regulations.[201]

6. Mergers

A last area is mergers. Mergers invoke concerns about the long-term structure of a market. In recent years, the Justice Department has moved away from rules that rely solely on market share and toward a more varied analysis that adds the role that potential entrants can play in deterring abuse.[202] Both it and the courts have been swayed by the argument that markets will function competitively, even if they have very few members, as long as it would be easy for outsiders to enter and appropriate excess profits.[203] Moreover, one of the core deregulation arguments, that markets are more competitive and market power harder to control than had been suspected, dictates a more relaxed attitude to mergers.

Although natural gas has been too regulated for too long for anyone to have much idea about this market's natural tendencies, concentration has increased after deregulation.[204] The industry seems to be witnessing the emergence of dominant companies that will have the power and knowl-

201. Private contract litigation can be a potent mechanism to attack some of these practices, as the Meridian Oil litigation shows. *See supra* note 198.

Private contract remedies are not substitutes for antitrust relief, though, because antitrust so often remedies abuses of market power that occur through a contract mechanism. Some antitrust claims, like refusals to deal or group boycotts, can injure parties who may not have a contract with the defendant. But more common violations, including price fixing (vertical or horizontal), tying, discrimination, and many forms of monopoly, often hurt parties who have contracted with the wrongdoer. Frequently it is not the defendants' refusal to have a relationship, but its use of power to distort it, that is in issue.

202. 1992 Merger Guidelines, *supra* note 103, at 20, 572-9 to -11 (discussing role of entry analysis). The Department of Justice and Federal Trade Commission, joint authors of the Guidelines, also consider (beyond traditional market definition and share analysis) the "potential adverse competitive effects" of a challenged merger, *id.* at 20,573-6 to -9; whether the merger is needed to achieve "net efficiencies," *id.* at 20,573—574; and whether at least one of the firms or its divisions was in "imminent" danger of failing. *Id.* at 20,574. For one argument for liberalized market-share analysis in natural gas, see Michaels & De Vany, *supra* note 65, at 332-45.

203. The potential-entrant or contested-market theory is that if entry and exit are easy and do not require large capital investments, or at least do not require large irreversible (sunk) capital investments (for instance, if any necessary capital can be acquired cheaply in second hand markets or resold upon exit), then even a monopolist will be unable to set its price too high. If it starts to make unusual profits, it will attract other companies. *See supra* note 143.

Though the theory of contestable markets most often functions to make markets appear more competitive than traditional market-share analysis might suggest (thus suggesting reduced scrutiny), the need to preserve powerful potential entrants can increase scrutiny. One of the leading Supreme Court merger cases overturned El Paso Natural Gas' acquisition of Northwest Pipeline Company, in order to preserve Northwest's role as a likely entrant into the then-monopolized California market. United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964). It needs no emphasis that concentration has been a long-running concern in the oil and gas industry, given that the lead divestiture case (at least until AT&T, and the AT&T case is of less significance as precedent because it ended in a settlement) is the divestiture sanctioned in Standard Oil Co. v. United States, 221 U.S. 1 (1911). Standard had acquired much of its power by acquisition.

204. The list of acquisitions since the mid-to-late Eighties is impressive:

1. Enron, with 37,000 miles of pipe the longest pipeline system until recently, was formed by the merger of two major pipeline systems, Houston Natural Gas Corporation and InterNorth, Inc., effective June 1985.

edge to compete nationally and internationally, like Enron and The Williams Companies. As renewed market pressure generates better performance measures, we will be able to tell whether these companies are more competitive or simply better at amassing power.[205]

The peculiar role of contestable markets suggests caution, however, in mergers. The theory relies upon predictions about the response of some companies to the acts of others. If competition can be stimulated because of the threatened entry of outside companies, then large, aggressive pipelines with the ability to enter markets far from their existing systems may exercise a positive influence on those markets. Given economies of scale, the rise of larger companies may be the form that the competition sought by Congress and the FERC will take. It becomes more important to preserve these large companies as threats.[206] The relaxation that the potential entrant theory brings to analysis within a market should be tempered by the social cost of reduced threats in outside markets, if a merger combines two potential entrants into one.

This section discussed areas where antitrust problems may be likeliest to occur. Private parties enforcing the antitrust laws are implementing Congress and FERC's market-enforcing goals. Developing new principles of

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2. Coastal Corporation acquired ANR Pipeline and its Michigan based system on March 31, 1985.

3. Arkla Pipeline Group added the 5,585-mile Mississippi River Transmission Company to its 6,515-mile system on June 30, 1986.

4. Panhandle Eastern, founded in 1929 and with a core pipeline from Texas into the Midwest that had grown into a 12,500 miles system by the Eighties, acquired the 9,000 mile Texas Eastern system that runs from Louisiana to the mid-Atlantic in a $3.22 billion merger on February 1, 1989.

5. Transcontinental Energy Company with its 10,500 mile Transcontinental Gas Pipeline acquired the 6,100-mile Texas Gas Transmission system on April 3, 1989.

6. The Williams Companies, which already owned the Northwest Pipeline Company, Williams Natural Gas Company, Texas Gas Transmission, and half of Kern River Gas Transmission, in 1995 acquired the 10,500-mile Transcontinental Gas Pipe Line, as well as the remaining 50% share of Kern River Gas Transmission. The acquisition made it the largest pipeline company in the United States. Williams 1995 Annual Report, *supra* note 77, at 2.

7. El Paso Natural Gas Company, now known as El Paso Energy Corporation, just bought Tenneco Energy. Deals & Suits, *El Paso Energy Acquisition of Tenneco Energy,* Tex. Law., July 1, 1996, at 11, col. 3.

(Unless otherwise shown, dates and other information taken from the annual reports of the acquiring pipelines).

The consolidation has spread rapidly across industry lines. For a current list of the second wave of mergers, including many natual gas/electricity mergers, *see* Barbara Saunders, *U.S. Gas/Electric Megamergers May Slow as New Policies Tested,* OIL & GAS J., at 19-20 (Feb. 3, 1997).

205. At least a limited role for potential entrants has a long history in antitrust. This was the theory upon which the Department of Justice forced El Paso's divestiture of Northwest Pipeline Company. Northwest was not in El Paso's California market, but its system lay next door, so it was a natural entrant for the California market. United States v. El Paso Natural Gas Co., 376 U.S. 651, 660 (1968). The unbundling of gas services means that many other companies not physically close may be potential entrants in storage, gathering, processing, and even transportation, in the same way that the range of competitors in electric generation is expanding dramatically with regulatory changes.

206. The analysis is complex because it depends on whether one thinks the primary sources of efficiency will be economies of scale and integration, or simulated competition between actual and potential entrants.

application will be part of the organizational adjustment to deregulation. The antitrust laws are not the only rules that apply to deregulated companies. Virtually all deregulated activities occur under contract. A variety of contract remedies can apply to this conduct, as the affiliate-charge litigation reminds us. And so may state statutes like severance tax laws and common purchaser and ratable take statutes. But the antitrust laws are the set of rules that deal directly with market behavior. The next section discusses reforms that could help make sure that effective scrutiny continues in newly freed markets under antitrust and other rules.

V. Building the Lighter-Handed Deregulation Agency

Even if antitrust principles supply many of the standards for protecting competition, enforcement will require new forms of regulation and a free flow of information. This section discusses both needs.

When customers of deregulated pipelines need to turn to the antitrust laws, they will have a hard time getting their hands on the cost and price information they need to protect themselves and competition. Many will not be able to pry the facts from their pipelines. Pipelines will use the imbalance of resources that exists between them and many producers and consumers to avoid disclosure.

These problems suggest that even if direct rate setting has proven too costly or inefficient, administrators need to maintain an organization that makes pipelines reveal their prices, costs, profits, and terms of service. This information will let affected parties spot and combat abuses when they do exist. Information also is needed for continued agency action. In this era of reduced regulatory action, however, its most important function may be to spur private market policing.

A number of steps, separately or jointly, could ensure a proper balance of forces in natural gas. The reforms recommended here are better information flows; state and federal cooperation, most likely through a FERC joint board or state cooperation via the IOGCC; new state complaint procedures rather than standard setting; and long-term study of the effects of deregulation to make sure it is working as intended.

Most of this institutional discussion applies directly only to the unbundled, deregulated services, because mainline transportation has not been fully deregulated and, just as important, still falls into the Commission's core statutory control. But many of the same issues — particularly the problem of long-term concentration and lack of information — are going to begin affecting still-regulated mainline transportation as the FERC expands its experimentation with competition in that market. Moreover, even though longline jurisdictional pipes do not compete quite as obviously with intrastate pipelines as interstate gathering systems compete with the intrastate, the transportation market generally is another market fractured by partial regulation. Interstate pipelines are much more regulated than many intrastate systems. If the FERC really pushes competition into pipelines' core transportation function, the lines with intrastate pipelines will begin to become blurred. Pipelines will argue that they are unfairly ham-

pered by regulation and the most efficient intrastate systems may begin eyeing interstate markets. And if regulators have developed any form of effective joint administration of the unbundled field markets (which should include more than just gathering), they would do well to begin considering whether they can build a single cooperative agency for transportation as well.

A. Direct State Rate Regulation is Not Likely to be Legal or Effective

One possibility is for state regulators to supersede the FERC. Some states sound eager to pull on the Commission's boots. But the gathering market shows that such a transfer of responsibilities is unlikely to occur without a deliberate change of course. Texas, for instance, asked the FERC to give gathering to the states.[207] A Commissioner of the Oklahoma Corporation Commission recently suggested that unbundling has so changed the natural gas market that states can regulate it in spite of contrary precedent. He urged Congress to give the states this jurisdiction (or the FERC to delegate it) if a formal delegation is needed.[208]

1. The Inefficiency of State-by-State Controls

State regulation may not be available for gathering problems under existing law, but it would not be efficient were it allowed. The inefficiency lies in the cost of regulating. While some agencies in major producing states, like Texas with its long-established Railroad Commission, want jurisdiction, others have urged the FERC to retain its oversight. Agencies in the second camp did not think they were capable as constituted of monitoring pipelines. Several states have no administrative gathering structure in place. Understandably, they are not eager to build a new regula-

207. Written Comments of the Railroad Commission of Texas, FERC 1994 Gathering Conference, *supra* note 59, at 14 (arguing that Railroad Commission is better equipped than FERC to regulate gathering). The Commission urged that, "to the extent federal law permits, regulatory responsibility over all types of natural gas gathering in Texas is best handled at the state rather than the federal level." *Id.* at 17.

208. The Commissioner, Cody Graves, thinks that states have had jurisdiction over gathering under the NGA all along. He necessarily relies on caselaw about the state's continuing power to control production as necessary to prevent waste. Cody Graves & Maria Seidler, *The Regulation of Gathering in a Federal System,* 15 ENERGY L.J. 405, 408 (1994)(restructuring has "obscured" line between production/gathering and transportation), 417 (concerns underlying prior opinions "are no longer relevant" after unbundling), 419 (gas sales market, allegedly the "market price to which the Commission's interest has been limited in carrying out its NGA responsibility to protect the ultimate consumer from excessive rates," is not competitive), 419-21 (citing Northwest Cent. Pipeline Corp. v. State Corp. Comm'n, 489 U.S. 493 (1989), in discussion that does not weigh contrary Supreme Court cases in footnote 240-41 *infra*).

If changed circumstances really have altered the basis for the line of Supreme Court cases that brought gathering under NGA jurisdiction, state regulators could just begin issuing orders and watch as pipelines appeal on jurisdictional grounds. Section VI.A.2 explains why this presumption of authority may misread the older cases and why the states would need more power to act, a fact Graves implicitly recognizes when he proceeds to discuss the desirability of the FERC's delegating its authority or Congress' formally recognizing state jurisdiction over gathering, see Graves & Seidler, *supra*, at 424-25.

tory body or department.[209] Oklahoma, one of the richer producers, told the FERC in 1994 that it did not have the resources to regulate.[210]

The inactivity of the four largest states in the Foster's sample, Texas, New Mexico, Oklahoma, and Kansas, shows just how difficult it has been for states to replace the FERC. In 1995, these states produced over half of the natural gas in the mainland United States.[211] None of the states sets rates. None makes gatherers file rate information. Only Oklahoma has a statute that addresses any part of gathering and only it seems to have an active gathering complaint procedure.

Texas was the most aggressive advocate of deregulation before the Commission. The Railroad Commission claimed it should regulate because of its greater familiarity with local factors.[212] It urged the FERC not to switch to "light-handed" regulation because this would apply only to some gatherers. Texas reassured the Commission that if gathering were not FERC-jurisdictional, "these facilities in Texas would generally be regulated by the Railroad Commission as jurisdictional facilities."[213]

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209. The Arkansas and Louisiana Public Service Commissions noted in their joint filing that gathering was not actively regulated in their states; that Wyoming had a statute in place but not one person had been sued under it; and that Oklahoma had only recently amended its laws to prohibit discrimination in gathering. Arkansas and Louisiana Public Service Commission, FERC 1994 Gathering Conference, *supra* note 59, at 13. These commissions concluded that there was "little active regulation." *Id.* at 21.

New Mexico, the second largest gas producing state in 1994, does not regulate or even have a well developed data base. New Mexico Depart of Energy, Minerals, and Natural Resources Gathering Comments, *id.* at 2, 24. One pipeline, El Paso, candidly admitted that there was no "significant" state regulation in its major areas of operation in New Mexico and Texas. El Paso Gathering Comments, *id.* at 5.

210. Oklahoma Corporation Commission Gathering Comments, *id.* at 7.

211. INGAA REPORT, *supra* note 60. The state totals of United States production in 1995 were Texas, 32.40%; Oklahoma, 9.4%; New Mexico, 8.23%; and Kansas, 3.67%. Data furnished by Micronomics and drawn from Department of Energy's Natural Gas Monthly.

212. The Texas comments are a bit schizophrenic. At the outset, Texas told the FERC that "as a threshold matter," it wanted the FERC to "regulate gathering rates in its traditional manner." Written Comments of Railroad Commission of Texas, FERC 1994 Gathering Conference, *supra* note 59, at 2.

Most of the rest of the comments, however, tried to establish that the Railroad Commission could do the best job watching over gatherers. The Railroad Commission said that because it was charged with regulating production, it "is more likely to recognize the negative effects of competitive gathering on Texas producers." *Id.* at 14. Of course, wellhead prices are deregulated but preempted under the NGPA, *see infra* notes 239-41 & accompanying text; all the Railroad Commission can regulate is production for purposes like safety and avoiding waste. These are not the same kind of issues as those involved in gathering and processing.

The Railroad Commission urged that the reduced burden on gatherers from hearings in Austin rather than Washington favored state regulation, *id.* at 14, thus fingering a factor that probably has biased the FERC hearings toward big companies.

It did not think that the consumer interest favored either agency. *Id.*

Kansas wanted to absorb the FERC's powers too and argued that state regulation would be more "cost and time" effective. Comments of the Kansas Corporation Commission, *id.* at 3-4. And on the topic of schizophrenia, while the Louisiana Public Service Commission joined the Arkansas Commission in urging the FERC to retain its powers, another Louisiana Department, the Department of Natural Resources, filed comments asking the FERC to hand the keys over to the states.

213. *Id.* at 16.

What the Commission did not tell the FERC is that its Gas Utilities Act generally does not apply to pipelines that did not exercise eminent domain, and that pipelines can avoid regulation merely by averring that they are competitive.[214] Texas also has a common purchaser statute, which originally applied to oil but at least parts of which now apply to gas.[215] The statute expressly brings oil gatherers within its purview.[216] Although the issue has not been decided, an amendment bringing natural gas under common purchasing provisions would seem to incorporate gathering.[217] But the precise scope of the gas incorporation remains undecided.[218]

Oklahoma generally is cited as one major producing state with a good statute about gathering.[219] In 1993, Oklahoma supplemented its Pipeline Act to require open access and nondiscriminatory gathering.[220] The Commission cannot order open access if the parties have a contract, if another gatherer "is willing . . . or can conveniently move the gas," or if the gas "cannot be reasonably carried by such gatherer."[221] While the Commission has authority to set rates, it cannot do so if there is a contract or without making a competitiveness determination.[222] Each rate must incorporate a wide variety of pipeline-favoring factors.[223] As of mid-1996, the Commission has not yet ordered open access or set the rate for any gatherers.[224] No dispute had traveled to final administrative resolution. .[225]

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214. The Railroad Commission told the FERC that its jurisdiction over gathering is "primarily defined" by Tex. Civ. Stat. Ann. art. 6050, sect. 4(a)(Vernon Supp. 1996), a section of the Cox Act, with help from the Gas Utility Regulatory Act, *id.* art. 1446e (Vernon Supp. 1994). *Id.* at art. 1446e C-1. It admitted that neither defines "gathering."

A pipeline in general must use eminent domain to fall under the statute. *Id.* art. 6050, sec. 1(b). Companies that did not use eminent domain can become exempt if they deliver their gas to a processing plant or to someone else for interstate transportation or sale either in the field or after processing. *Id.* sec. 4(b). By policy, the Railroad Commission has not regulated companies that only gather and transport their own gas. *See* Written Comments of the Railroad Commission of Texas, 1994 Gathering Conference, *supra* note 59, at C-3. And there is a big loophole: under Tex. Rev. Civ. Stat. Ann. art. 1446(e), gatherers can avoid regulation by averring that competition exists in their market, a claim they include in Rate Schedule No. 4.

215. Tex. Nat. Res. Code Ann. § 111.081 et seq. (West 1995).

216. *Id.* § 111.084.

217. *Compare* § 111.083 *with* §§111.084, 111.086-87.

218. Scott Anderson, executive Vice-President of TIPRO, the Texas producer and royalty owner group, has predicted that pipelines will argue that gathering does not fall under the Common Purchaser Act's purpose of protecting the terms of gas purchases, but predicts that the Railroad Commission will interpret the Act to apply to gathering if it has to face the issue. Bill Campbell, *No Easy Solutions Are Waiting For Gas Gathering Problems,* 36(Mar. 1996).

219. *See id.* at 36, col. 3.

220. Okla. Stat. tit. 52, § 24.3.A (Supp. 1994).

221. *Id.* § 24.3.B.

222. *Id.* § 24.3.C.

223. *Id.* § 24.3.D. The factors include rates paid by other shippers, the "financial risks" of installing and operating gathering, capital costs, and "such other factors" that the Commission believes are relevant, but "in no event is such fee to be computed on a utility rate of return basis." *Id.*

224. Interveiw with Ben Jackson, gas regulatory counsel, Oklahoma Corporation Commission (Mar. 25, 1996).

225. As of early 1997, only nine complaints had been filed. Only one had been decided. Cody Graves, *It's Time for a New Sheriff, or Why States Should Regulate Gas Gathering,* NATURAL RESOURCES & ENVTL., at 11, 13 (Winter 1997).

Neither Kansas nor New Mexico has a gathering statute. New Mexico has no specific statute, although it too of course has a common purchaser statute.[226] A survey conducted by the State in 1995 found no consensus on any needed state action.[227] In Kansas, the legislature considered a bill that would have prohibited discrimination, but not unreasonably high prices. The bill did not pass and the Corporation Commission seems to want power to regulate but no particular rules.[228]

One good reason for the lack of state activity is the lack of specific, demonstrated abuses. The Texas Railroad Commission, for instance, received only one complaint about gathering in all of 1993.[229] This is about what one would expect if the markets are very unconcentrated. Studying its markets on a district level for the FERC's 1994 Gathering Conference, the Railroad Commission found only 6.8% of its markets "highly concentrated," with 14.2% "moderately-concentrated."[230] These figures may understate, perhaps sharply, concentration: Texas did not consider contract terms, reserve dedications, staggered expirations, low volumes, the absence of multiple connections and the other factors that can increase power.[231] Moreover, given default contracts and the sensitivity among gatherers to the danger of reregulation, one would not expect a lot of rate changes in Texas right away. This lack of demonstrated abuse seems to be matched in

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226. N.M. Stat. Ann. § 70-2-19 (Michie 1995).

227. The state mailed out 700 questionnaires and got back only 45 responses, so bias is a problem that cannot be excluded. Of those responding, 20 producers favored some regulation, 4 "if the need arises" (these were obviously members of the beg-the-question club), and 21 did not. New Mexico Gas Marketing Newsletter, 4 (Apr. 1995). Independent producers and small producers were more likely to favor some kind of regulation. One presumably can deduce from the lack of any mention that no one sent the State evidence of actual abuse. Opinions were split on how safe the natural gas world is out there:

> Large producers were satisfied with the status quo.
>
> . . . .
>
> Unlike the major producers, the independents that support some form of regulation did not believe that there was sufficient competition present in their areas, especially for wells connected to a gathering system or for wells in close proximity to each other. Small producers also felt that their size within the industry is a factor to consider.

Id. at 4-5.

228. Bill Campbell, *supra* note 218, at 38, col. 3.

229. Written Comments of the Railroad Commission of Texas, 1994 Gathering Conference, *supra* note 59, at 10.

230. *Id.* at 9-10.

231. The Commission apparently counted the gathering volumes from its P-4 form and then tallied the Herfindahl-Hirschman market share figure as measured by volumes. *See id.* at 8-10 & Appendix A. It noted that this calculation may miss a few "particularly large packages of gas." In fact, the indice may significantly understate market power if it overstates the size or confuses the shape of submarkets, as Fosters did in its INGAA-sponsored statewide analysis. A county-sized area may be composed of a series of separate markets, sustained by long-term contract dedications and single gathering lines, perhaps also by low deliverabilities, in which there is no effective competition between or within systems.

Conversely, a market analysis might have shown that apparently concentrated markets were more open. It might be that entry costs were so low that gatherers in those markets were deterred from using their power. Contestable market theorists might be right—this is an empirical question that cannot be resolved just by counting the number of companies. Analysts need to look at contract terms and price and profit behavior to understand how these markets really operate.

Oklahoma and New Mexico. There is no hard evidence of an industry-wide problem.

The FERC's decision to deregulate gathering and most other natural gas functions rests on its assumption that these markets are fundamentally competitive. If so, the Commission must assume that it will be more cost effective to identify abuses as they occur than to maintain a large regulatory apparatus. Unless regulators are presented with very bad abuses, the odds are against the states developing enough momentum to install substitute systems.

Yet the absence of complaints has to be interpreted carefully. Old default contracts remain in effect, so producers and gas buyers have yet to feel the full force of deregulation. Most pipelines guard new contracts with confidentiality provisions, so injured parties may not know that they have been damaged.[232] The rapid dispersion of the buying market, with many producers selling their gas at the wellhead and not even paying (though their price will reflect) gathering and processing costs, cuts the flow of information. Pipelines may be proceeding cautiously because they know that the first years of deregulation are the time when overt abuse is most likely to prompt renewed controls. Small companies that may suffer the highest prices have to choose between challenging bad practices in expensive litigation, thus jeopardizing their finances and business relations, and negotiating the best arrangements they can. Small producers often mention that they have to live with the large gatherers in explaining why they have not been more active. This does not mean they think they are being treated fairly.[233] It is bad business to anger the only company in town.

In addition to the lack of tangible complaints, state inaction can be expected because monitoring large pipeline and gathering companies is very expensive. Regulation turns on complex facts like the allocation of joint expenses, overhead, inter-company loans, and depreciation rates. Administrative staff have to sift the records of a maze of interlocking affiliates. These records tend to opacity and pipelines, as rational organizations, will resist providing them. Discovery of such core data as the actual cost of a single gathering line can be very expensive.

Moreover, state-by-state regulation is inefficient. Interstate pipelines do not keep their books by state and each state will have to repeat the same involved, company-wide analysis, even though it only intends to monitor operations within its borders. The answers to questions about facilities in one state will turn on the dynamics of multi-state operations. States will

232. The problem of getting information is why Texas Railroad Commissioner Barry Williamson listed as one of his "serious concerns" "[a] lack of information." Williamson, *supra* note 168, at 10-11. Williamson continued that "[l]ike everything else in the world today, the modernization of an industry relies on the ability to access timely information." *Id.* at 19. As Williamson notes, "[i]f you don't have information, you have no facts on which to base a complaint." *Id.* at 18.

233. Commissioner Williamson reports having "heard serious concerns" about discrimination in pricing and access, including affiliate preferences, and about unreasonable rates, as well as a lack of information, at a Railroad Commission Gas Forum in Houston in February 1996. *Id.* at 10; *see also* the small producers' comments to the New Mexico survey. *Supra* note 225.

lack the economy of scale that the FERC enjoyed when it set rates and other terms of service once for all of a pipelines' operations.

The lesser scale of state oversight also means that states will lack the institutional sophistication the FERC accrued in decades of regulation. Commission staff studied many of the underlying issues in rate cases and other proceedings. The Commission built its expertise in these areas at great expense over many years. Its staff is, or at least was, familiar with the practices of the major pipelines; was used to gathering data from them; and understood pipeline accounting structures. States with their lesser scale of operation will not get the same training.[234]

The disproportionate cost of state-by-state regulation can be shown by the fact that though the FERC enjoyed economies of scale and embedded experience, even it did not feel it had the resources to analyze the many gathering markets one by one in a time of dwindling staff and funding. In the gathering hearing, Chairman Moler, addressing the possibility of individual market analysis, noted that

> I won't ask you how to figure out the staffing and how much more money we would need from the Congress in order to accomplish this case-by-case determination for gathering systems. If we accept that, we will leave that discussion for another day.[235]

This situation has worsened. In one of the bigger mistakes of deregulation, Congress cut the FERC's pipeline staff.[236] Congress has failed to recognize that administering new forms of more precise, less intrusive regulation may require *more* information and resources than the labor intensive, but fairly blunt, cost-of-service regulation.[237] Certainly the moment of creating new forms deserves more resources. Periods of standard formation, like a corporation's research and development for a new product, need to be times of intensive review and testing. While the largest gas producing states may be able (but probably are not willing) to apply the

234. Oklahoma's Commissioner Cody Graves has commented that, "[f]rom a practical standpoint, it seems very unlikely that the FERC could find the time, the staff, or the inclination to settle the literally hundreds of small gathering disputes that may arise." Graves & Seidler, *supra* note 207, at 425. That is certainly true; but how will the states afford this function? It is true that each state will have fewer total complaints to handle than any national body. And states may succeed in developing cheaper, less formal procedures than the FERC. But the states are going to face the resource problem with a vengeance when they take on a large gathering company that is determined to stand its ground. *Accord,* Comments of Kansas Corporation Commission, 1994 Gathering Conference, *supra* note 59.

235. FERC 1994 Gathering Conference, *supra* note 59, Hearing Transcript 123-24.

236. In a most short-sighted mistake for a time of generating new standards, Congress instructed the Commission to reduce its staff for natural gas and oil pipeline programs by 20% between 1995 and 1997. Foster Report No. 2073, *supra* note 2, at 1. These staff reductions are a big mistake. Congress seems asleep at the wheel when the social costs of losing this accumulated experience are considered.

237. Congress should heed Alfred Kahn's warning that regulation requires "a great variety of government interventions," Kahn, *supra* note 74, at 340; *see also id.* at 353 (stating that "free markets may demand governmental interventions just as pervasive and quite possibly [sic—certainly] more imaginative than direct regulation") and that "economic deregulation cannot mean firing the police force," *id.* at 349. This problem is accentuated because, as every business knows, the creation of new standards is a very resource intensive process. As Chair Moler said in a necessary understatement (given the political constraints under which she operates), the issues now facing the FERC "'are even more difficult than those we saw before Order No. 636.'" Foster Report No. 2073, *supra* note 2, at 1.

resources needed for this kind of innovation, most producing states will not and probably cannot follow suit.

2. The Jurisdictional Barrier Against the States

The separation of federal/state jurisdiction is a separate problem for state controls of field services. Even if states had enough money to regulate all the abandoned field services, they will face Supreme Court precedent that the production and gathering of gas flowing in interstate commerce falls under federal rate jurisdiction, in spite of the NGPA's production and gathering exemption.[238] The Eighth Circuit affirmed the Commission's jurisdiction over gathering just a few years ago.[239] The FERC appears to have reversed its approach to gathering in an effort to reverse this old precedent sub silentio, and its about-face has injected yet more uncertainty into this area.

The preemption bar that should apply state regulation can be read in *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board.*[240] Mississippi had responded to the NGA by passing a common purchaser rule. It wanted to make pipelines pay all producers in a field the same price if they had a contract with even one producer. Mississippi believed, or said it believed, that Congress' decision to get out of the price setting business was an invitation for the states to replace it.[241] The Supreme Court invalidated the Mississippi plan. The Court identified the defining characteristic of deregulation as shifting gas pricing from administrative control to the market. This purpose of letting the market control prices "is still a subject of deep federal concern," a concern that would be defeated if all that happened was that state regulators took over from the FERC.[242]

238. *See generally* cases cited in footnote 15 *supra.* The Court distinguished such price regulation from traditional state control over output when needed to avoid waste. This distinction may make very little economic sense (economists know that price and output are jointly determined, so a state could restrict output to boost price), but it is the governing demarcation between federal and state jurisdiction.

239. Northern Natural Gas Co. v. FERC, 929 F.2d 1261, 1269-70 (8th Cir. 1991).

240. 474 U.S. 409 (1986). For a detailed discussion of federal preemption of state regulators in the natural gas and electricity industries, see Frank Lindh, *Federal Preemption of State Regulation in the Field of Electricity and Natural Gas; A Supreme Court Chronicle,* 10 ENERGY L. J. 277 (1988). I have discussed the Supreme Court's price/quantity line between permissible and impermissible forms of state regulation of gas that flows into interstate commerce in John McArthur, *The Take-or-Pay Crisis: Diagnosis, Treatment, and Cure for Immorality in the Marketplace,* 22 N.M. L. REV. 353, 409 n. 241 (1992).

241. 474 U.S. at 422.

242. *Id.* at 421-22. The majority noted that Mississippi would have increased the price of gas, which Congress wanted the market to determine, by its own regulatory fiat. *Id.* at 418-19. Another sign of Congress' wish to keep gas prices away from the states was the fact that the NGPA extended its sway to intrastate gas prices before it phased-in deregulation of all gas.

Transcontinental falls in line with Northern Natural Gas Co. v. State Corp. Comm'n, 372 U.S. 84 (1963)(invalidating Kansas ratable take statute). Proponents of state regulation like to cite a seemingly contrary case about the gas makeup period, Northwest Cent. Pipeline Corp. v. State Corp. Comm'n, 489 U.S. 493 (1989)(allowing Kansas to regulate makeup period in Hugoton field). *See, e.g.,* Graves and Seidler, *supra* note 207.

The FERC has argued at each step of deregulation that its latest action was necessary to carry out Congress' market-driven purpose. The Commission designed each rule to make the components of gas pricing successively more open to the market. Moreover, while unbundling may be a structural change, the prices of unbundled commodities like gathering and processing feed directly into the consumer prices that are the ultimate concern of NGA and the NGPA.[243] These federal administrative steps would be defeated if states could reimpose the measures that the FERC has lifted so laboriously in a decade of administrative decisions. The only way the states are likely to be able to assume jurisdiction over these formerly regulated services is by an express delegation from the FERC, an Act of Congress, or the state/federal compact proposed in section V.C.

The lesson that could be read from the early abandonment orders confirmed that state regulation would be preempted. During the period when the FERC claimed "light-handed" jurisdiction, it expressly claimed continuing power in this field. Facilities that fell under the gathering exemption would be left to the states, but under the old primary function test many mixed interstate systems would fail that test. Two things have changed. The FERC expanded the systems defined as gathering, and it appears to have shifted from a position that facilities abandoned to pipeline affiliates *are* jurisdictional to holding that they are not. Though it is not clear whether these new decisions will stand —they ignore precedent on affiliate systems and make jurisdictional status turn on the form, not substance, of organization[244]— they invite state intervention. Indeed, the Commission expressly discusses default contracts as a transitional measure needed to let

243. It was the effect on end-consumer prices that justified the Supreme Court's extension of NGA jurisdiction to interstate production and gathering, in spite of the exemption. The Supreme Court worked out this position in its effect-on-interstate-commerce analysis discussed. *See supra* note 15.

244. The recent *Conoco* decision certainly is a powerful boost for unfettered gathering, and it will be interesting whether that opinion reaches the Supreme Court. Earlier, both the Supreme Court, and the Eight Circuit in its 1990 *Northern* decision, seemed to make it clear that changes in corporate form would not vary the jurisdictional status of gas was sold into interstate commerce. The *Conoco* court tried to pooh-pooh *Northern* by calling its language about affiliates dictum. Conoco v. FERC, slip op. at 19-20, No. 94-1726 (D.C. Cir. Aug. 2, 1996). But consider whether this sounds like dictum: "Any other reading would let pipelines evade regulation simply by restructuring their operations, putting gathering in separate corporations." Northern Natural Gas Co. v. FERC, 929 F.2d 1261, 1273 (8th Cir. 1991). Maybe the court of appeals decided that if FERC can get away with rewriting the law without admitting it, certainly reviewing courts ought to be free to do so, too.

At a time when in *Copperweld* the federal courts have held that affiliates have an "identity of interest" and will be viewed as incapable of conspiring, a decision that treats corporate separations as immaterial when determining the ability to inflict competiitve injury, *Conoco* reads as a form of directly contrary, magical thinking. Here the FERC and at least the D.C. Circuit treat what may be a purely formal change in management as sufficient to determine whether gathering is or is not jurisdictional. The FERC claims it will not let corporations manipulate their affiliate form (and will reregulate if they do), but it ignores the common parental direction of many pipeline families. For instance, all Noram told the FERC was that it would "conduct its business organizationally separate" from the interstate company. Conoco v. FERC, slip op. at 8, No. 94-1726 (D.C. Cir. Aug. 2, 1996)(citing Noram FERC petition). This hardly sounds like corporate separation. What will the FERC do about the Williams Companies, which like most parents provides a wide variety of managerial services for its subsidiaries? What spokes spin separately just because they meet only through the hub?

states get up to speed. This discussion is about substituting state for federal utility regulation.

Another form of state regulation is antitrust monitoring by the state attorney general. Because deregulation means an end to filing rates and related cost information, however, and because state antitrust agencies face constraints, too, such regulation will not replace the FERC. Indeed, the resource problem that hampers the FERC and state utility regulators will be worse for the attorney general because energy regulation is a smaller part of their job. Natural gas will have to fit between tobacco lawsuits and immigration, affirmative action and three-strikes laws. This is not a form of regulation that is likely to fill the void caused by the FERC's withdrawal.

Other state agencies may intervene on an ad hoc basis. For instance, state taxing authorities may challenge the costs a company applies against revenues in a tax audit.[245] But there is no sign that this indirect, case-by-case intervention will constrain most companies in their private contracts.

B. Customers Need Pipeline Financial Information to Have a Fair Chance in the Deregulated World

One option for markets problems is to let pipelines' business partners, producers and consumers, the parties with the most direct tie to the pipelines and those most affected by anti-competitive practices, identify abuses and sue.[246] This is where Congress generally struck the bargain in competitive markets.[247] The antitrust laws give injured parties a cause of action for market violations; Congress has stressed competitive standards by letting injured parties collect treble damages. Private parties may have the best incentive to ferret out abuses because, unlike regulators, they will keep any money they recover (and lose it if they suffer violations in silence). They may be the first to feel a change in prices. For the government, it can be cheaper to make pipeline customers bring problems to the attention of courts and regulators (in the case of full deregulation, presumably attorneys' general rather than utility regulators) than to fund a permanent administrative body *if,* and it is a big if, these customers have enough information to detect abuses.[248]

The FERC has thrown a major wrench into the works if private enforcement is to be the main safeguard for markets like gas gathering. The problem is information. As section III, D discussed, many market abuses involve costs and profits or the pattern of prices. As long as pipelines were

245. *See supra* note 111.

246. Matthew McCubbins & Thomas Schwartz, *Congressional Oversight Overlooked: Police Patrols versus Fire Alarms,* 28 AM. J. POL. SCI. 165 (1984)(discussing issue in context of congressional structuring of legislation).

247. "Free" markets are not markets without government intervention. The Federal Trade Commission oversees mergers, the Department of Justice and state antitrust agencies can bring antitrust claims, and so can private parties. But the orientation of unregulated markets is to allow a vast range of unscrutinized decisions and to leave it to injured parties to conduct a lot of the "regulatory" work.

248. This is why the complaint-driven procedure proposed by Texas Railroad Commissioner Barry Williamson is so information-dependent. *See supra* note 230 and accompanying text.

regulated, they had to make this information public. Pipelines filed detailed cost, revenue, and contract information annually in FERC Form 2. Whenever they wanted a higher rate, their pricing got a full hearing.

Once free of these requirements, pipelines have every incentive to hide information.[249] Customers are unlikely to have any way to uncover a pipeline's cost structure or pricing pattern short of litigation that will cost hundreds of thousands of dollars. Williams again is a telling example. In its new coal seam gathering contracts, Williams routinely requires confidentiality provisions.[250] One customer cannot tell another, much less tell Williams' competitors, the prices Williams charges. This secrecy poses a real problem. Williams did not send information about its market power or use of contracts to the FERC. Not a trace of these facts can be found in its gathering hearing comments. Nor would Williams make this information available to its customers. In litigation with a gas marketer over the San Juan Basin, Williams refused to produce internal financial documents after the marketer offered to enter a protective order. When the court finally ordered these documents produced, Williams marked many with extraordinarily restrictive stamps. The most critical documents could be seen only by outside counsel, not by the business people who could best judge the documents' significance.

In an affidavit, Williams' San Juan Director of Marketing swore that its rates, terms, and other contract conditions were "confidential and highly sensitive."[251] Disclosure "to competitors of Williams Field Services or to customers of Williams Field Services could economically harm Williams Field Services."[252] If competitors got hold of Williams' rates, "the competitor could undercut each and every contract between Williams Field Services and its . . . customers."[253] (Here, Williams was complaining about exactly the competition Williams told the FERC existed in gathering.)

Williams did not want its customers to know each other's prices, either, because if they knew these "rates, terms, and other conditions," "Williams Field Services could be competitively disadvantaged" and "significant economic harm" could result.[254] No ordinary customer is ever going to see this kind of information without very expensive litigation.[255]

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249. In the example of Williams, not only has it displayed extreme resistance against letting one customer know another's prices or even to producing this information in litigation, but Williams made very clear to the FERC its opposition to a continuing "transactional reporting requirement," including one on contract rates. Statement of Williams Field Services Group, 1994 Gathering Conference, *supra* note 59, at 28-29. Williams complained that such a requirement would disadvantage it vis a vis unregulated companies, and it made the same charge that having good pricing information would give Williams' customers an unfair advantage. If customers could "access the terms and conditions of other contracts" executed by Williams, they could "demand comparable treatment." *Id.* at 29. The company apparently was horrified that it might not be able to favor one customer over another.

250. Lloyd Hightower Trial Testimony 1998-99, 2000-01.

251. Affidavit of McMillan Hummel § 5 (June 22, 1994).

252. *Id.* (emphasis added).

253. *Id.*

254. *Id.* §§ 6,8.

255. For instance, the *Sunrise* litigation against Williams and its affiliate Northwest mentioned in many of these footnotes cost the plaintiff $1,370,413.25 in fees just through trial. Sunrise's

These are unusual arguments for a company that says it believes in competition. Competitive markets thrive on information, which is a necessary ingredient of price competition.[256] Free markets give consumers alternatives and let them make informed choices. Competitive markets drive out excess profits, but protect producers from illegal undercutting because companies that price below competitive levels will lose money and go out of business.

When Williams predicted that competitors armed with Williams' prices could "undercut each and every contract between Williams Field Services" and its customers, this could be true for one of two reasons. One would be if other companies were much more efficient and had lower costs. Then their competitive, marginal-cost price would be lower than Williams' equivalent price. Deregulation is designed to expose formerly regulated pipelines to just this kind of good, old-fashioned price competition.

The other reason Williams might lose business would be if through limited information, strategically wielded long-term contracts, or some other market problem, it had tricked its customers into paying too much. Here again an informed market would shift business to other companies.

When Williams foresaw that it would suffer harm if its customers learned the prices it charged other customers, this is because they would fight discrimination. That too is how a competitive market should work. Like many companies used to a regulated world and blessed with power in some of its markets, Williams wanted release from rate oversight but not full competition. Access to the kind of information Williams would not produce will be a key to protecting this market.

Pipelines will argue that their customers want confidentiality clauses.[257] And that certainly is true of favored customers. Companies with the leverage to extract better prices than their competitors don't want that information public. They are exploiting the pipeline's favors to enhance their own positions.

Memorandum In Support of its Request for Attorneys' Fees, at 2 (Nov. 20, 1995). The bankruptcy court dismissed the claims against Northwest's affiliate Williams on the grounds that they were precluded by its award against Northwest, a ruling that is on appeal. The total cost of the case is sure to exceed $2 million if the Williams claims are remanded. As one of Sunrise's attorneys, the author can attest to the fact that several hundred thousand dollars of discovery were devoted to fighting Williams and Northwest's refusal to produce information that was more than "reasonably calculated to lead to the discovery of admissible evidence."

256. In this jaded age, it is perhaps too much to talk about "perfect" information. What customers need is accurate enough information to let them to choose between offerings and to understand what they are getting, in a format that they can process as busy consumers. They must be able to tell a pig from a poke. It is "timely, accurate, easily accessible MARKET INFORMATION." Williamson, *supra* note 168, at 6 (emphasis in original).

257. In a morning meeting on gas gathering in the May 1996 New Mexico Natural Gas Gathering Conference, pipeline representatives made this argument after a prolonged discussion of why, if their prices truly are nondiscriminatory, they won't disclose those prices. The representatives said that some of their customers ask to keep this information secret. Yet if everyone can get the same prices, secrecy would have no commercial value. It is precisely because some companies get better terms than others that the pipelines and their favored customers need to keep things quiet.

The difficulty of figuring out what Williams was doing in its pricing even limited the FERC's decisionmaking. In the 1994 Gathering Conference, the State of New Mexico Department of Energy, Minerals, and Natural Resources complained that Williams Field Services increased at least some gathering prices upon deregulation. The State submitted a redacted contract, with the producer's name obscured.[258] Because there was no discovery or evidentiary hearing, the size of any increase could not be resolved on the record. If the FERC does not have even this simple information, customers who deal with companies like Williams one by one will have even less information.

To be effective, any form of regulation, be it designed to help private parties enforce their rights or agencies to decide when to intervene, needs to preserve the flow of information.

The premise that a mandated flow of information can prevent certain kinds of abuse is the cornerstone of securities regulation.[259] Information is just as clearly part of natural gas regulation, where Congress included filing requirements in the Natural Gas Act,[260] and most other traditional regulatory statutes.

The more far-sighted regulators will increase their emphasis on the role of information as a control mechanism.[261] Information regulation has a respectable pedigree and is a mild form of regulation:

> [The] standards governing disclosure, however, do not restrict conduct beyond requiring that certain information be provided. The freedom of action that disclosure allows vastly reduces the cost of deviations from the policy

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258. New Mexico Department of Energy, Minerals, and Natural Resources Gathering Comments Appendix A, 1994 Gathering Conference, *supra* note 59. While Williams presumably had enough political savvy not to punish the producer who gave its contract to the state, one assumes that this disclosure violated its confidentiality terms. Some Williams contacts even have clauses trying to limit their customers' ability to influence government proceedings. *See supra* note 109.

259. William Douglas & George Bates, *The Federal Securities Act of 1933,* 23 Yale L.J. 171 (1933); *accord,* Edward Gadsby, *Historical Development of the SEC—The Government View,* 28 GEO. WASH. L. REV. 6, 9 (1933) ("Inasmuch as the Act is thus premised upon the principle that full disclosure of all pertinent financial and other material data should be made to the prospective investor in order that he can make a sound investment decision, the Commission has not the power to evaluate any proposed security offering nor to prevent the sale of a security under a properly filed and fully truthful and frank registration statement."); THOMAS HAZEN, FEDERAL SECURITIES LAW i (Federal Judicial Center 1993)("After considerable debate, Congress decided not to adopt the merit regulation approach of the state acts, opting instead for a system of full disclosure. The theory behind the federal regulatory framework is that investors are adequately protected if all aspects of the securities being marketed are fully and fairly disclosed, leaving no need for more time-consuming merit analysis.").

As Louis Loss has put it, "there is the recurrent theme throughout these statutes of disclosure, again disclosure, and still more disclosure. Substantive regulation has its limits, but '[t]he truth shall make you free.'" LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION, 8 (3d ed. 1995). For Loss and Seligman's summary of how the Act ended up so predicated upon disclosure, see *id.* at 22-33. As they note, William Douglas initially was a strong *opponent* of the limited remedy of mere disclosure. *Id.* at 26 & n.12, *citing* William Douglas, *Protecting the Investor,* 23 YALE REV. 521 (1934).

260. 15 U.S.C. § 717(4)(c) (1976).

261. *See, e.g.,* Williamson, *supra* note 168, at 18.

> I envision the [Texas Railroad] Commission's role in the future as one of information resource. Information will be the force that regulates the market.

> planner's ideal. At worst, too much information or the wrong information has been called for.[262]

Disclosure "does [not] restrict individual choice as much as do the other classical forms of regulation."[263] While one objection to any regulation is cost, the limited incursion of information disclosure makes this objection less telling.

> [D]isclosure regulation does not require regulators to fine tune standards as precisely. The regulators need less information from industry, there are fewer enforcement problems, there is less risk of anticompetitive harm, and there is greater probability of surviving judicial review.[264]

Except in its gathering deregulation decisions, the Commission generally stresses the need for disclosure in its decisions. As already discussed, it has been careful to preserve filing requirements in its incentive rate rule and its capacity release proposals. And it stressed the role of information in its proposed secondary market rule.

> Even with elimination of bidding, the Commission's paramount goal — providing public disclosure of transactions — will still be achieved by continuing, and strengthening, and posting requirement . . . .[E]asily accessible and retrievable information about release transactions is crucial for the Commission and the industry to monitor capacity release transactions effectively.[265]

One of the interesting legal issues surrounding deregulation is whether the FERC has authority to disavow rate filings, even if it can deregulate gathering and production. Did Congress intend the filing requirement to be independent of the Commissions' rate-setting function? Or, as Congress is unlikely to have worried about the shape of deregulation when it passed the NGA, what *would* Congress have thought had it considered this issue?

The NGA imposes a direct obligation on pipelines to file the terms and conditions of their services in their "tariff."[266] The Supreme Court has noted in other contexts that rate filing performs a distinct function.[267] The

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262. BREYER, *supra* note 118, at 163.

That disclosure does not "restrict conduct beyond requiring that certain information be provided" is not exactly how information regulation works. Breyer's description is a bit disingenuous. The purpose of making companies disclose information is to produce a change in their behavior. If regulators believed companies were acting as desired, there would be no need for the companies to tell anyone about it. So disclosure is used to produce major changes. And it can have heavy costs. Disclosure can impose onerous reporting duties, and it creates the risk that agencies will misuse the information if the behavior of concern is hard to measure or control. Information invariably is tied to some standard that legislators or an agency want companies to obey.

That said, disclosure ordinarily will be a much less expensive form of control than direct standard setting. The standards that disclosure is intended to make companies match often are standards that they are supposed to obey anyway. The cost that do occur may not be the result of a new standard, but the effectiveness with which publicity and a little fresh air make companies obey existing laws.

263. *Id.* at 161.

264. *Id.* at 162.

265. Notice of Proposed Rulemaking, *supra* note 73.

266. 15 U.S.C § 717c(c).

267. The Natural Gas Act contains a statutory requirement that pipelines file their rates. Section 4(c), 15 U.S.C. § 717c (1976). For the Supreme Court's opinion about the significance of filing on an agency's ability to prevent unlawful pricing, see the Court's opinion about the trucking industry. Maislin Industries v. Primary Steel, 497 U.S. 116, 126 (1990)(invalidating rules that would not have

FERC itself has been careful to insist that it will maintain the filing requirement for mainline transportation rates.[268] This issue does not arise for systems that are truly nonjurisdictional (because the FERC has no power over them). But to the extent that the FERC chooses not to set rates under light-handed regulation, or is wrongly classifying gathering systems that pull gas into interstate commerce as unregulated, it may be required to collect information even if it does not set rates. If regulators construct a joint board or proceed under the IOGCC, as the next section suggests, they can design an information system that will cover all relevant companies.

One of the hopes of deregulation is that pipelines will compete with each other on price and quality. Price competition and full information are two of the elements economists mean when they talk about competitive markets.[269] Not only are these conditions incompatible with price secrecy, but secrecy can hide monopolistic and discriminatory pricing schemes.

If private enforcement is to have a chance, affected parties need to be able to compare pipeline costs and profits. In addition, they need access to the overall pattern of each company's prices to spot price discrimination. The latter information is not as easy to gather as might seem, because pipelines will argue that every small variation —in contract term, pressure, the presence of liquids, delivery points, the provision of fuel, gathering and processing, distance to the mainline[270]— justifies an added charge. Pipe-

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required filing of all negotiated rates; holding that under Interstate Commerce Act, "the duty to file rates with the Commission . . . [has] always been considered essential to preventing price discrimination and stabilizing rates" and noting "close interplay" between duty to file and pay filed rates and prohibition of discrimination).

268. *See* Incentive Rate Order, *supra* note 2, at 20, 58-59.

269. SCHERER & ROSS, *supra* note 8, at 15-19 (discussing price competition and absence of barriers); BRIAN BINGER & ELIZABETH HOFFMAN, MICROECONOMICS WITH CALCULUS 98, Ch. 13 (1985); on the need for good information, see ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 48-49 (1988). The quality of available information is a key element in the transaction-cost school of economics, with its emphasis on satisfaction and the constraints under which people have to make market decisions.

Though he did not mean his statement in this context, consider the following quote from Richard Bradley on how important information is to a free market:

> [T]here is a close correspondence between the wealth of an economy and its utilization of knowledge. That knowledge includes the ability of consumers to choose the best purchases, the ability of financiers to choose the best investments, and the ability of entrepreneurs to discovery and produce what the market demands at least cost. In contrast to the United States, where a wealth of knowledge has spawned general economic wealth . . . .

BRADLEY, *supra* note 8, at 33.

Bradley's point is that the dispersed planning of capitalism generates the right kind of knowledge, an argument he takes from F.A. Hayek, but this is also a powerful argument for regulators to intervene and keep information flowing when ostensibly competitive companies take steps to block the flow of facts about their markets.

270. Consider the numerous contract variations mentioned in the Williams gathering comments. *Supra* note 86. If anyone accuses Williams of discrimination, it will argue that every change in these terms carries a separate cost and warrants a separate price treatment. The company will try to make its gas services sound so complex that no one can construct a common scale. Without a measure of value, there is no ground from which to initiate the deregulation intervention.

lines will claim that no two contracts are comparable.[271] Pipelines have an incentive to multiply the theoretical reasons why prices might differ in order to make it harder to spot true, non-cost-justified price differences.

Disclosure must track the unbundled nature of natural gas services. Williams Field Services made this point effectively in a letter to the OIL AND GAS JOURNAL. The JOURNAL had published an article comparing interstate pipeline performance using annual reports and Form 2 data. A Vice-President of the Williams companies wrote the JOURNAL to complain that this data was misleading for their subsidiaries because their financials included a lot of activities that were not regulated, both non-pipeline activity, like its Wil-Tel communications system, and unregulated pipeline activity.[272] The information did not give a fair picture of how Williams' *regulated* services stacked up against the competition. (The JOURNAL noted in response that it had asked Williams to supply additional data, but the company chose not to.)[273] The FERC can remedy this problem by requiring financial reporting service by service. Williams is right: customers and regulators need information that tracks each unbundled market.

The FERC will face objections and battles over the form of disclosure. Texas is considering putting current pricing information on line.[274] Annual and even monthly information are not enough because gas markets change too quickly. Pipeline customers have a right to know the terms available to others at the moment of negotiation and other terms then in effect. This is why the FERC has made transportation discounts instantaneously available by electronic bulletin board. Regulators may permit pipelines to redact party names and volumes, as long as they have some procedure to make sure that other terms are not redacted and that redactions do not disguise material terms.[275]

Regulators must consider outlawing confidentiality provisions, at least as long as they apply to prices and terms and conditions of service. One way markets work as networks of information is that buyers and sellers talk to each other about going rates. Confidentiality provisions disrupt this natural flow of information. It makes no sense for pipelines to be able to hide the information that should fuel the new market.

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271. The immediate basis for this argument will be that there are so many contract terms that each contract is different, the Williams' argument discussed in the last footnote. A deeper argument will be that no possible intervenor knows enough to determine whether a particular firm practice is or is not competitive. *See* BRADLEY, *supra* note 8, at 44-45; *cf also* note 86, at 932 (arguing that there is no "average or normal" rate of return and "[e]ach project is unique," an argument that if accepted abandons any possibility of regulatory intervention). Either argument would put the government totally out of the market reviewing business.

272. *Data Questions*, Letter of Williams Companies Vice-President Jim Gipson, OIL AND GAS J. 8 (Jan. 29, 1996)(arguing that Williams' consolidated numbers could not reflect efficiency of its two regulated pipelines accurately when combined with other companies).

273. *Id.*

274. Williamson, *supra* note 168, at 17-18.

275. For instance, if prices vary by volume and if there is a cost-based reason for this, a gatherer might be able to redact the specified contract volume, but not the price-and-volume categories.

The issue of confidentiality drew a lot of attention at a May 1996 New Mexico Gathering Conference. A number of producer representatives complained that they could not learn what gatherers were making their contract terms secret. Pipeline representatives responded that confidentiality reflected the flexibility and customization of their new contracts.[276] But the fact that parties may want different terms (and the pipeline's right to offer a variety of prices and terms) should not prevent parties from talking about those terms. The reason pipelines want secret differences is that they do not want to offer the same terms to all. And that, of course, is the problem.

C. A State/Federal Compact to Maintain Price Oversight

If customers need information to ensure fair pricing, and the FERC stops watching pipelines while states lack the resources to do so, then deregulation will not increase antitrust enforcement. It will reduce it, but by default. The best bet as things stand is that a few states will regulate, those that do will do so ineffectively, and most will not. States that are active will face aggressive battles over preemption and confidentiality.[277] Some producers who suspect they are victims of improper pricing will persevere through costly discovery, but many will lack the price of admission.

Congress wrote a possible institutional solution to problems like these into the Natural Gas Act. Congress gave the Commission the power to "refer any matter" to a joint board with the states. The Board is "to be composed of a member or members, as determined by the Commission," from each participating state.[278] The board can assume the same powers as the Commission, so it can carry out the same functions. It can conduct proceedings under Commission regulations and serves at the FERC's pleasure.[279]

A joint board apparently has been assembled only once, over staff opposition.[280] Proposals to use this framework tend to draw skepticism from industry participants. To the extent that old hands can picture any successful joint operation, they tend to see the board as an information

276. The gathering industry representatives were Robert Phillips of El Paso Field Services, Hunter Rowe of Amoco (which has some of its own gathering facilities in New Mexico), Jack Taylor of GPM, and Ed England of Williams Field Services.

277. Indeed, one of the oddities of the deregulation struggle (and a good example of the perils of forgetting long-run interests) is the vigor with which pipelines resisted "light-handed" regulation. It should have been clear to them that the FERC was not going to regulate at all. This status might have offered pipelines the best of both worlds. The Commission pretty clearly would do nothing to regulate and affected parties would receive virtually no information on pipeline policies. At the same time, should a state have tried to regulate, pipelines would have cried "preemption."

Presumably the reason pipelines wanted out at any cost is that their long-run experience with regulation leads them to be skeptical of any regulator who says he or she wants power, but will not exercise it.

278. 15 U.S.C. § 717p(a)(Supp. 1996).

279. *Id.*

280. Graves & Seidler, *supra* note 207, at 422. The Commission apparently views joint boards as a mechanism appropriate only in "unusual cases." It has twice rejected state requests for joint proceedings. *Id.* at 422-23.

gatherer, not an adjudicatory body. Nor is it clear whether legal changes would be needed to enable such a board to issue joint regulations.

Even if it would require some statutory tinkering to build an effective joint body, a joint board has the potential to fill several gaps in the current regulatory scheme. The joint board could retain the FERC staff with rate experience, so it could avoid losing the embedded knowledge of years of ratesetting. Such a board even might achieve a greater economy of scale than the FERC, because this one body could study both FERC-jurisdictional and nonjurisdictional companies. Hearings still could be conducted by state if necessary for participation by affected parties.[281] (The cost of going to Washington and hiring the FERC counsel has defeated many small producers and consumer groups.) The board might end up serving primarily as a research and information clearinghouse, with each state adopting its own substantive standards and complaints process but using this common information base. A joint board could avoid the waste and repetition of each state's making a separate analysis. And it could spread costs that the FERC and the states find too great individually.

In addition, a joint board could solve some of the jurisdictional problems in the current scheme. First, it would avoid questions of whether state regulators are preempted. At least one member would have jurisdiction over almost any system. Though they might have to issue regulations separately, they surely would have the power to require single rate filings with a central body and to centralize data analysis.

Second, a joint board would overcome the imbalance created when the FERC regulated interstate gatherers but intrastate companies ran free.[282] The inequality of treatment between jurisdictional gatherers and the majority of the industry was one of the pipelines' strongest arguments against gathering regulation.[283] Even if separate regulations might have to issue by the FERC and state commissions, a joint board could (and should) give

281. It is true that, to the extent that sitting as a joint body required representatives from each participating state to attend, there might appear to be more regulators rather than fewer involved in policy formation. Yet unless many states simply do nothing, these regulators are likely to be spending time on the same matters anyway. Without some sharing mechanism, though, they will work in an isolation enforced by state lines, rather than learning from each other. Moreover, to the extent that many of these problems will be resolved at the staff level, there is no reason that each state would have to have, or even want, its own staff person involved in every decision. The states certainly would seem to have an interest in constructing an effective, single staff organization.

An argument against a joint board would be that the diversity of state jurisdictions is a strength because it allows experimentation. That might be the case, if a number of states had the resources to regulate and were carefully implementing alternative structures. The principal problem for the state, however, seems to be lack of resources and knowledge, and that is area where they can find some assistance by a bit of centralization.

282. The unfairness of capping rates for one set of gathering companies, but not another, without any finding of systematic differences in market power, was one of the stronger arguments made by pipelines for deregulation. *See supra* note 59.

283. Even at the May 1996 natural gas conference in Santa Fe, Ed England, a Vice-President of Williams Field Services, claimed that the gathering industry did not need any controls, but that Williams' much bigger concern was that any government regulations that were adopted apply equally to all field service companies. He wanted freedom to compete on exactly the same terms as companies that never had an interstate affiliation.

inter and intrastate companies the same reporting requirements. Its members could agree to treat all gatherers the same way without falling foul of jurisdictional problems.

Section V reviewed potential antitrust abuses to suggest the kind of information needed for this regulation. First, pipelines should have to file their rates for each separate service, with enough information to explain rate differentials, so that regulators and affected parties could determine if price discrimination exists. While some differences would be cost-based, the burden should be on the pipelines to establish the justification for differences. Second, in the long run regulators will have to address monopoly level pricing. Avoiding this abuse was the primary goal of rate regulation. The next section discusses this long-term issue.

In the absence of a joint board, the states could overcome the inefficiencies of separate regulation by using the Interstate Oil and Gas Compact Commission (IOGCC), or a newly created body, to create a single agency that would oversee gas markets. Although this agency would face the federal preemption issue that a joint board would avoid, it could surmount the waste and inefficiency of having each state study the same accounting records.[284] The IOGCC already is helping unify practices by designing a model gathering statute based on the Oklahoma statute, although the process has bogged down.[285] It can do far more if it creates an information center that lets states pool their resources.

D. The FERC and the States Will Have to Decide How Much to Intervene

The background question that will not disappear is what standards if any regulators still should set. This is the question of re-regulation, or where to constrain deregulation. The nation has embarked on an industry-wide gamble that natural gas and the other deregulated markets will function best if companies set their own rates and terms of service and if entry

284. As identified in its home page, the IOGCC is an organization of 29 member states and 7 associate states founded in 1935. Interstate Oil and Gas Compact Commission home page at 1 (accessed May 20, 1996). Among its services are "[r]egulatory coordination" and providing a forum for industry participants to share information.

285. The organization still is considering comments on a draft statute, but its proposal tracks the Oklahoma statue. It is a "complaints" procedure rather than traditional regulation. In a cover letter, the subcommittee chair described the Oklahoma statute as "based on the principal [sic] of open access and prohibits discriminatory prices and practices, although open access is not required in all cases." April 15, 1996 Draft Memorandum of IOGCC Natural Gas Gathering Subcommittee.

Though the Oklahoma statute can solve some problems, those commenting on it raised concerns about others. For instance, Lyn Hebert of the New Mexico Oil Conservation Division noted that the statute "contains no penalty or damage provision." Memo of May 7, 1996 from Lyn Hebert to IOGCC Gas Gathering Subcommittee. Texas Railroad Commissioner Williamson objected to the exemption from common carrier status, and claimed that some of the exceptions in the Oklahoma statute (like the one if another gatherer "is willing" to gather the gas, without any price qualification) make the statute fairly toothless. Comments of Texas Railroad Commissioner Barry Williamson on Kansas Corporation Commissioner Timothy McKee's Gas Gathering Memorandum. Of course, in this interest-driven world, the comments from private firms split on whether the statute was too little, too much, or just right.

and exit are returned to private decisionmaking. Regulators must not forget their gamble and need to test the outcome.

Regulators face a quandary. On the one hand, they have received few complaints about the newly deregulated markets. No one knows whether the lack of complaints has occurred because default contracts remain in existence; because small companies don't dare jeopardize their contracts; because the injured don't know they're being hurt (given their confidentiality provisions) or in contrast because these markets really are working competitively. Regulators do know that pipelines are likely to have power in many of their markets and that if they do, they have an incentive to discriminate, to tie products, and to bar entry by a variety of means.

1. Short-Term Complaint Processes

In this intermediate period, rational administrators will maintain a structure that preserves the flow of information, as discussed in the last sections, and efficiently gather complaints of discrimination, tying, and denial of access. They will adopt some measures against discrimination and denials of access. Some states have begun moving in this direction. The primary enforcement in Oklahoma appears to be a push for informal negotiations by parties that do raise complaints.[286] In Texas, Commissioner Barry Williamson is proposing an informal process in which a complaint will spark investigation by Railroad Commission staff. Williamson is vice-Chairman of the IOGCC, which hopes to publish a model gathering statute. The proposed statute is likely to involve a structure similar to Oklahoma's, i.e., it is likely to prohibit discrimination, have some form of open access, and establish a complaint procedure.[287]

Whatever the government body, regulators will need to address certain anti-competitive contract terms. Section IV discussed the Williams' confidentiality clauses, which disrupt the flow of facts needed to make competition work. Another clause that can raise barriers to entry and competition are dedication clauses. Companies making large capital investments understandably want to shift risks to customers through term contracts. Yet unrestricted dedications prevent future competition and can enshrine power in markets that seem to have a number of competitors. Williams, for instance, persuaded very large coal seam producers in the San Juan Basin to dedicate reserves far in excess of its existing capacity. Some dedication may have been necessary for it to risk its capital in building its initial, 360 million cubic feet a day Manzanares system. Yet the dedications undergirded its headlong expansion to 575, 750, and finally a billion cubic feet a day.[288] El Paso, a competitor in conventional gas gathering in the same

286. This is my inference from the failure of any of the roughly ten complaints filed under the Oklahoma gathering statute to reach final decision. Discussion with Ben Jackson, gas regulatory counsel, Oklahoma Corporation Commission on March 25, 1996.

287. *See supra* note 284. Texas Commissioner Williamson focuses on avoiding discrimination, with careful provision of information and a low-cost complaints procedure to implement these concerns. Williamson, *supra* note 168, *passim.*

288. *See supra* note 108 and accompanying text.

areas, apparently uses the same kind of long-term contracts to lock-in business on its system.[289] Competition will be an empty promise, just as it was on mainline systems before the FERC voided minimum bills and let customers convert firm sales to transportation, if no one can switch off existing systems.

Even if commitments to the extent of existing facilities or a particular expansion may be justified as an efficiency-enhancing allocation of risk, regulators should consider forbidding open-ended commitments that protect business indefinitely or for very long periods. Contract renewal, not just initial bidding, should be used as spurs. Regulators will need to be just as worried about extremely long-terms for contracts and staggered expirations that reduce the collective power of a company's customers.

An anti-competitive clause that may well be unenforceable, has no social benefit, and should be banned is the clause preventing customers from taking certain positions before regulators, like the Williams' clauses discussed above. A company's customers are any regulator's likeliest source of information. Regulators need free and open communication with affected parties. They should make it unambiguously clear that they will void such clauses and will penalize the companies that seek them.

In all of these measures, one aspect on which interstate pipelines are absolutely correct is that any new standard should apply to all companies in the market. It may be that interstate affiliates are on average larger and more concentrated than those of other companies or have certain embedded cost advantages from regulation, not from efficiency.[290] These companies may find ways to leverage their regulatory positions.[291] If these advantages are material, though, no one has made this case empirically.

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289. El Paso's annual reports made this claim about its San Juan Basin operations:

> EPFS's leverage to gas and liquids prices increased in 1995 *as a result of the completion of numerous long-term gathering, processing, and compression contracts* for services in the San Juan Basin. These contracts represent approximately 77 percent of EPFS's San Juan Basin throughput which totaled 1,012 MMcf/d in 1995 and include dedication of gas production and drilling acreage with gathering fees indexed to the San Juan Basin price of gas.

1995 El Paso Natural Gas Co. 1995 Annual Report, *supra* note 45, at 6 (emphasis added).

290. One of the major benefits the FERC conferred on many pipelines is to allow them to abandon gathering and processing assets at their depreciated cost rather than their replacement cost. This has enabled pipelines to establish new, stand-alone field service companies at costs below those that any entrant could match. For their part, the consumers who paid for these facilities do not get to share the benefit from any appreciation in value of these facilities or any excess of market over book value. Had these facilities remained regulated, these consumers would have enjoyed the fruits of below-market services.

291. If book-value transfers are one benefit for pipeline-connected field service companies, another is the ability to lean on the regulated market by shifting costs back to regulated customers. Although this is not the purpose of unbundling, it remains a major fear of unregulated gatherers. *See, e.g.*, Pain, *supra* note 52, at 3-25 to 27 (worrying that pipelines will attempt only partial unbundling that lets them load some field service costs onto mainline accounts). Pain's argument is a twist on capture theory. He believes that just as customers try to use regulation to push costs onto someone else, so "[t]he corresponding watchword for pipelines could be 'use the regulatory system to gain competitive advantage when you can.'" *Id.* at 3-25. In a partially deregulated world, the pipelines' advantage becomes their access to regulators, the very agents who were to protect the market. Discussing the advantages pipeline affiliates may have, Pain argues that the "overriding difference is the pipeline's

Pipelines and gathering lines generate economies of scale without regard to

ability to use the regulatory system to advantage, shifting field gathering and compression costs downstream to transmission customers." *Id.* at 3-31.

This problem would not arise if unbundled affiliates had complete separation from their parents. But the FERC avoided full legal separation. *See* Hollis, *supra* note 75, § 14.02[4] (describing procedures the FERC adopted to mimic independence). Even putting aside the advantage of book-value transfers, the problem of cross-subsidization remains when a single company provides the management services for the mainline and the field service company. In the *Williams* case, for instance, the parent Williams companies provide management services to all subsidiaries, including Northwest Pipeline and Williams Field Services. Issues like ensuring that services are billed at market value and that the costs of jointly used services are allocated properly involve wide areas of discretion. In the wrong hands or in careless hands, the allocation will produce improper billing.

The way Williams built the Manzanares coal-seam gathering system shows how unregulated affiliates can reap even greater advantages from their regulatory origin. Williams' Manzanares coal-seam system was built in the name of Williams Field Services, with capital apparently furnished from the parent company, but often using employees who were on the payroll of Northwest Pipeline Company (whose pipeline ran into the same area and which already had its own large conventional gathering system). The field service company allegedly reimbursed Northwest for the labor cost, *Lloyd Hightower* Trial Transcript at 1960-61, but it received many free benefits that would have cost competitors a lot of money.

For instance, Northwest let Williams use the Northwest gathering system for overflow gas before Manzanares came on line and each time it began to reach capacity. Thus Williams could bid for business before it had Manzanares up and running. It used the Northwest system as an overflow system, apparently without any reservation charge. Northwest let Williams cannibalize the Northwest system by appropriating three Northwest trunk lines and a compressor station. *Id.* at 1976. And Williams was able to use the staff and good will that Northwest had built up in decades of service—an experience paid for with the dollars of regulated customers— to lure new business to the unregulated Manzanares system.

Strikingly, after Manzanares was finished, Northwest acquiesced as Williams shifted coal seam wells connected to the Northwest system to Williams' Manzanares system. Williams would later build a second bypass of the Northwest system, a bypass into El Paso's mainline, that required Northwest's acquiescence. Northwest signed the necessary interconnect agreement with El Paso even though it and Williams officers were aware that this change would hurt the business of the regulated Northwest system, *Id.* at 2062-64.

Within a few years of its founding, Williams would be advertising its years of experience in San Juan Basin gathering. The company whose expertise it was using was Northwest, its predecessor, which was the only Williams-affiliated company that had done business in the San Juan Basin for more than a few years. One economist in the *Sunrise* litigation would list the value of Northwest employees as one of the major benefits Williams received from Northwest, Jeffrey Leitzinger Trial Transcript 784, a benefit for which Williams apparently made no payment.

These concerns of unregulated gatherers are the polar opposite of the abuse-of-power problem discussed in most of this paper. The fear there is that pipelines and pipeline affiliates with power will be able to impose a too-high single price or a discriminatory pricing structure. Unregulated gatherers fear that pipelines in otherwise competitive markets will be able to undercut unregulated companies by their artificially low costs.

One of the surprising facets of the abandonment movement is the lack of customers aggressively claiming that not only should the FERC require abandonment to occur at market value and not the lower book value, so that consumers would get a credit for the full benefit of facilities generated with their dollars, but also the lack of protest at getting no compensation for such items as the accrued good will generated with investor dollars. Moreover, in the Northwest/Williams case, one would expect consumers to complain about the reconnection of Northwest-system wells and the two bypasses, acts equivalent to a regulated company's voluntarily giving business to its deregulated sister. Had Northwest been acting competitively, it would have competed vigorously for the coal-seam business, not handed it to Williams.

Gas abandonments are the corporate equivalent of being born with a very silver spoon in one's mouth.

who owns them. One of the arguments for deregulation was that the great majority of gathering systems were unregulated intrastate systems, so that all the FERC was doing was handicapping interstate systems. A bigger flaw in the old system may be that many intrastate systems set discriminatory or monopolistic prices, but no one knows and no agency has a duty to take corrective action. The new regulatory structure needs to apply across-the-board and catch abuses in all parts of the industry. Pipelines are right to fear that any set of standards will deteriorate into a handicap for interstate companies. New standards should be applied even-handedly, with exceptions turning on specific showings of abuse.

2. Regulation and Long-Run Trends

The short run issue is how to capture isolated abuses. Of much more importance, however, will be the FERC and state regulators' position on long-term prices and concentration. Regulators need to be just as concerned about the deregulated market as they used to be regulated markets.

This is a harder issue than that of interim controls because, in spite of assurances from economists that "competition" provides a clear guide, there is little coherence within economics on what a workable market looks like. Point to barriers to entry and a neoclassicist can argue that potential entrants constrain pricing anyway, so there is no problem. Point to high prices and profits and they will argue this reflects (indeed, proves) higher than ordinary risk. Again, no problem. Demonstrate short-term monopoly and they will argue that concentration will produce innovation in the longer run.[292] Not to worry. The problem with each argument is that it is

292. Williams produced funny testimony on this issue in its *Sunrise* litigation, testimony that shows the problem of applying a contestable market vision. Its economist had argued that the San Juan coal-seam market is competitive, in spite of contrary (or at least seemingly contrary) Williams documents. *Compare* notes 101-03 & accompanying text *supra*. Faced with Williams' projected *increase* in market share, he argued that this was a sign of competition, not market power. Scott Harvey Trial Transcript 2342:

> Q. And if the Justice Department applied the normal market share analysis, would it be concerned about this or not?
>
> A. No, because they're interested in competition. And the fact that Williams Field service is projecting that they'll increase they're [sic] share, is not a source of competitive concern.
>
> Actually, if you thought they [were] a dominant firm and raising prices, what you'd see is them projecting—gradually trading off their market share over time and declining in exchange for—and keeping and harvesting the market with high margins.
>
> . . . .
>
> Q. It[s] your testimony that the increasing market share numbers on this exhibit, Exhibit 672-A, are actually a reflection of competition?
>
> A. Yes. . . .

Presumably what the economist meant is that if the market is competitive, even over time, a company charging above market prices is inviting losses. But the assumption of competition is just that, an assumption, not a proven fact.

The oddity of this position, of course, is that ordinarily falling market shares reflect competition. Under this Williams theory, rising market shares prove competitiveness as well. All that is left as a possible concern is a static market, which shows no trends at all. This version of damned if you do, damned if you don't is immune if you do, immune if you don't. While this kind of economist might admit certain theoretical conditions in which he would find

self-fulfilling; it does not tell regulators when to intervene. Indeed, strong deregulation arguments never would require intervention and would legitimate any type of market behavior.

The longer range issues that can only be solved empirically involve concentration and price levels. Section V.D showed that the antitrust laws generally do not concern themselves with the level of prices or concentration (in the latter case, except in merger or the dwindling "bad acts" cases). If a company grows into a monopoly position, it can set any price it wants. The courts have not decided if they will apply the "legitimate monopolist" standards to deregulated entities, but in today's judicial climate this is their most likely decision. So continued monopoly pricing, if it occurs, most likely will have to be met with new legislation and regulation.

Because the cultural force of deregulation ensured that many changes were made without empirical study, the FERC does not know how much of its unbundled industry is competitive. Nor do interstate pipelines or producers (although they have good ideas, often hidden from regulators, about the markets in which they operate). No one knows how much discrimination is occurring in these markets today, or how far the prices of unbundled services have changed after spin-offs and spin-downs. Nor do they know the effects of the FERC's loosening the rates in mainline transportation and the capacity release market.

Economists generally have very little idea about the long-term tendencies of specific markets. For instance, economists don't know whether gathering markets will tend towards concention. If they do, economists don't know whether innovation (or potential entrants) can counteract these pressures. Nor do is it known how long one has to watch these markets to decide what is happening.

There is surprisingly little agreement on the standards that should apply in testing for competition. For instance, there have been a large number of mergers among major pipelines since Order 380.[293] Many interstate pipelines are shifting assets into deregulated services like gathering.[294] One can predict at last some concentration in that market too, but neither the FERC nor state regulators seem to be collecting data on it.

It stands to reason that among the many companies flung into the deregulated market, some will be more efficient than others. Business should flow to these companies. Will profits attract new entrants and increase competition, or will the only result be concentration? And if there is concentration, is this just the market solidifying around more vigorous competitors? The fact that some companies grow sends an ambiguous message—are these dominant companies exercising their power or the best competitors winning new customers?

Moreover, economies may span energy markets. The skills needed to produce, market, finance, and deliver electricity are very similar to those

market power a problem, one has the strong feeling that he will never stumble upon these conditions in practice.

293. *See supra* note 204.

294. *See supra* notes 84-85.

needed for natural gas.[295] Government intervention probably has magnified the similarities because the FERC has imposed the same legal structures on both industries. Gas/electric concentration was a problem in the Thirties, and one can predict an increase of cross-industry mergers again. The trend has begun.[296]

Other measures like technological change and increased supply send ambiguous messages too. They are not unambiguously products of competition. Richard Pierce, an early and influential supporter of deregulation, has proclaimed gas deregulation a success in part because of the way the industry met demand during the cold 1993-1994 winter.[297] Yet some of the increased gas supplies come from two major technological advances, three-dimensional seismic mapping and horizontal drilling. Their development and spread may have little to do with deregulation[298] and it may be simple fortuity that these technologies appeared at this time.[299] A portion of the downward pull on price reflects the broader energy market.[300] And the large gas supply is in part a byproduct of the excessive purchasing policies of the take-or-pay period, when pipelines overcommitted to new reserves. Most currently have lots of gas. One cannot judge the deregulated market without knowing how fully regulated gas markets would have performed,[301] just as one should not condemn regulation without having a

295. *See supra* note 5.

296. Thus one finds the *Oil & Gas Journal* discussing the "power market," rather than just the gas or electricity markets, and the rise of "megamarketers" set in operation by PanEnergy Corporation's merger with Mobil Corporation and NGC Corporation's merger with Chevron. A.D. Koen, *Megamarketers' Rise to Benefit Consumers,* OIL & GAS J., Aug. 12, 1996, at 17. Then there is Enron's alleged acquisition of Portland General Corporation, the Portland-area electricity company; Houston Power & Lighting Company's acquisition of gas marketer NorAm Energy Corporation; and Texas Utilities' purchase of Enserch Corporation, the Dallas-based natural gas company. Barbara Saunders, *Oil/Gas Firms Take Lead among New Breed of Energy Megamarketers,* OIL & GAS J., Sept. 16, 1996, at 16, 18-19.

297. Pierce, *supra* note 2, at 324-25.

298. *See, e.g.,* William Fisher, The U.S. Experience in Natural Gas: Revitalization of a Resource Base Thought Exhausted, Speech at the Global Gas Resources Workshop, Vail, Colorado, Sept. 19, 1994 (noting that "reserve growth"—expansion of existing fields—has accounted for 80% of reserve additions in last 15 years and arguing that forecasters repeatedly underestimated technological improvements).

299. Fortuitous, that is, in that this stage of scientific development just happened to arrive at the time of deregulation. Some industry participants believe that these innovations are results of *regulation*—that it was the high prices and scarcity of reserves during regulation that created great pressure to find new methods of exploration and production.

300. Leitzinger, *supra* note 5, at 16-17. Leitzinger also notes that a lot of the price competitiveness reflects the restructuring of take-or-pay contracts which, in turn, stems in part from the fact that suppliers were "put at risk" for these costs. *See* Leitzinger, *supra* note 5, at 17-19.

301. Hahn & Hird, *supra* note 2, at 237 (noting that "[p]erhaps the most difficult task in estimating the impact of a regulatory change is specifying what would have happened in the absence of that change"). Hahn and Hird have noticed two counterfactual biases in measurements of deregulation. One is overstating benefits by assuming the change will result in an efficient competitive structure. The other is to underestimate benefits by ignoring changes in technology that deregulation may produce. *Id.* at 238.

As is shown by Richard Pierce's comments, observers may overestimate the technological and service benefits by assuming that all good things that happen after deregulation are a result of this

clear model of how competitive markets would perform the same tasks.[302] The rise in acquisitions is one sign of possible trouble, but it must be evaluated carefully. It will not be size per se, but market behavior that is important. Because regulatory limits on entry delayed and in some cases prevented companies growth, many pipelines perhaps were smaller than the most efficient scale. Given the economies of scale, it may be that a single company can serve some markets most cheaply. And it stands to reason that not all of these until-recently protected companies are equally efficient, so mergers and growth may be the market's sidelining the weak and infirm and rewarding the strong. In these instances, the question will be whether the residue of regulatory standards, potential entrants, and perhaps the fear of reregulation keep prices reasonably low, service constant, and preclude discrimination even in areas served by just one or two companies.

In the pricing area, the Article has shown that very few complaints have been brought before state regulators. No one knows what the silence reflects. A group of producers has complained that they are unable to match the power of deregulated pipeline services. They cite EIA data allegedly showing that while wellhead gas prices have not risen, the "residential consumer" price of natural gas has climbed since 1989.[303] Though

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change in control mechanism, rather than of independent technological advances or even residual impacts of the regulated regime. Hahn & Hird, *supra* note 2.

302. The same difficulty of separating market and regulated forces dogs the ongoing pipeline argument that the FERC has set their mainline rate of return too low. *See, e.g.,* INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA, INGAA WHITE PAPER, PIPELEINE RETURN ON EQUITY (Apr. 25, 1995)(arguing that the FERC rates of return tend to rely on unrealistic growth forecasts, the wrong comparative investments, and that the cap inadequately mirrors cyclical returns). This push is supported by William Tye's book, A. LAWRENCE KOLBE, WILLIAM TYE, & STWEART MYERS, REGULATORY RISK (1993). Tye argues that pipelines have underperformed their allowable return and the market for years. *See id.* at 174-79.

One weakness in this argument is that it assumes all stock buyers share the same risk preferences, when utility stocks traditionally have appealed to consumers seeking lower risks and willing to accept lower returns. (And presumably regulated companies have kept their capital in these industries because they share this preference, which is their supposed payoff for being regulated.)

A second, more fundamental problem is the assumption that pipelines should bear no responsibility for their disastrous take-or-pay contract commitments. It treats pipeline performance solely as a product of regulatory constraint. Yet the industry quite uniformly misread its gas purchasing market during the late Seventies and early Eighties. Economics yields no answer to whether the regulatory climate or pipeline management should be held most to blame. Yet putting blame to one side, these decisions would have bankrupted many more pipelines in a competitive market. Pipelines would not have had any statutory pass-through. It is arbitrary to place all the blame for low recoveries on the FERC and none on company mismanagement when one is discussing a blunder of this magnitude.

303. Raymond Plank, The Co-Op Solution, Slide 1 (Natural Gas Price Comparison), Speech presented in Lafayette, Louisiana on October 19, 1995.

It is not clear whether residential consumers are quite this bad off, although the biggest early savings do seem to be accruing to large customers like industrial users. As one would expect, pricing trends after deregulation vary with the experience, taste for risk, and leverage of groups of customers. It may be that most of the benefits of deregulation have gone to large industrial users with the ability to shift to alternative fuels and that most residential consumers have not seen prices fall, at least not by much.

it is not clear that any major group's delivered prices actually have risen, it is a problem for deregulation that virtually all of the decline to date appears to have come from wellhead prices and none in the many deregulated services.[304]

An exercise of power would explain the contract New Mexico filed with the FERC in 1994, showing a 250% increase in rates after deregulation.[305] And it would explain Oklahoma's claim that El Paso doubled its gathering rates after deregulation.[306] But inefficiencies of deregulation would also explain the increases if integrated services were the most efficient method of servicing gas customers. Unbundling would only have

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What does seem to be clear, however, is that on an overall basis, wellhead prices have indeed fallen sharply, while the margin for all the intermediate services of getting gas to market has stayed roughly the same. Leitzinger, *supra* note 5, at 15-20. Leitzinger's pricing chart, showing a drop from $2.51 to $1.59 in the average wellhead price between 1985 and 1995, but a nearly stable transmission margin that barely shifted from $1.24 to $1.19, is reprinted in Jeffrey Leitzinger, *Gas Experience Can Steer Power Away From Deregulation Snags,* OIL & GAS J., Aug. 12, 1996, at 49, 50. Average wholesale prices fell from $3.75 to $2.78. *Id.*

Falling wellhead prices are but part of large real-price declines for energy generally. *Id.* at 17. That trend in turn is due in good part to major technological advances in drilling (particularly horizontal drilling techniques and three-dimensional seismic techniques) and underestimation of recoverable reserves. Fisher, *supra* note 298. That is not an efficiency of pipeline deregulation. Another part of the price drop must be attributed to pipeline and producer absorption of take-or-pay costs, an absorption that to a large degree is a product of pressure from the FERC and that could have been achieved by strict imprudence review. Leitzinger, *supra* note 5, at 17-19.

304. Raymond Plank, a moving force behind the bill and head of Apache Corporation, one of the country's large independents, points to middlemen.

> [They] are the ones who are capturing the price spread by offering what they call 'services' but are in reality new profit centers that are little more than excuses to wring more money out of the hides of producers and consumers alike.

Plank, *supra* note 303, at comments to Slide 1.

Jeffrey Leitzinger's statistics, cited in note 303, confirm that deregulation seems not to have brought measurable reductions in overall middlemen costs.

Plank sees at least two problems with the middle industry of gas marketing. First, he claims that large pipeline affiliates are inserting an unnecessary step in gas delivery by deriving most of their income from speculation, "which amount to little more than moving tons of money around amid a chosen few." *Id.* page 5; *see* discussion in Bergstrom, *infra* note 308. Second, by handling large volumes, they gain unfair market leverage:

> Because they're able to aggregate large volumes, the majors and the big marketers are able to negotiate far lower gathering, transportation and marketing fees than any independent could ever hope to get. In the typical scenario depicted on this slide, the big boys are able to get their gas to market for as little as 59 cents per MCF, while an individual independent who can't aggregate large volumes would have to pay as much as $1.36 for the same services.

Plank, *supra* note 303, at 7 (although Plank does not name names).

Behind Plank's example lies the complexity of discrimination analysis. Assume his numbers *are* correct; how much of this difference is cost-based? Plank proposes to avoid that issue by aggregating small volumes into larger packages and competing at the same level as the large companies.

305. Statement of Department of Energy, Minerals and Natural Resources Department, Oil Conservation Division, 1994 Gathering Conference, *supra* note 59, at 18.

306. Comments of the Oklahoma Corporation Commission, 1994 Gathering Conference, *supra* note 59, at 4 ("Gathering rates for El Paso doubled between 1990 and 1994, while it [sic] transmission rates went up only a few pennies.").

opened the market to diseconomies and increased costs and prices.[307] Trends in end prices may include inflation in input costs, a lag before the effects of competition are felt, a less efficient delivery system, or amortization of major capital expansions. They also will include any extra, unnecessary costs that pipeline affiliates decide they can impose now that each bills for its services separately. The lack of a sharp residential price drop and resistance of field services to drops suggests that deregulation has not lead fully to the kind of welfare gains its proponents would predict. Regulators already need more information.

As one remedy, the producers group has sponsored a bill to create an antitrust exemption that would allow them to establish cooperatives to negotiate with pipelines.[308] The result would sanction concentration in both parts of the industry, not the most palatable prospect.[309] If the bill ultimately passes, regulators will need to make sure that the cooperatives themselves provide open, nondiscriminatory access to their services and are not captured by particular interests.

One company, El Paso Field Services, has proposed a related solution. It is considering entering the market as an aggregator of small-volume field services.[310] If this occurs, it suggests a world in which half a dozen or more large service companies compete with each other for business, a market structure more open than today's markets.

These issues will become more pressing because pipelines are shifting a large part of the capital that they accumulated in years of regulation—assets that were purchased by consumers under regulated terms—into deregulated activities. This shift in assets has been matched by the comparative advantage the FERC handed interstate affiliates by letting them

307. In a point that is almost never made in the deregulation debates, Jeffrey Leitzinger argues that "[t]here are plenty of reasons to believe that there exist significant economies of scope and coordination in operating generation in T&D as an integrated activity." Leitzinger, *supra* note 5, at 4. The "economies associated with the integration of delivery and commodity services are significant." Leitzinger, *supra* note 5, at 12. When Leitzinger adds this to the high costs of restructuring, he urges the Commission to focus more on competitive bidding for the market and less on surgery to insure competition within the market. One has to be an ardent convert to Harold Demsetz's model of franchise bargaining, however, to believe that the Commission can devise a franchising scheme that will maintain competition after the bargaining is over. It may need new kinds of information and remedies to meet this new challenge.

308. Natural Gas Competitiveness Act of 1995, H.R. 2342, 104th Cong. (1995). This Act would have legitimated the kind of large blocks of power that John Kenneth Galbraith argued years ago in his optimistic, pluralist vision would preserve democracy within a system of highly concentrated power. JOHN KENNETH GALBRAITH, AMERICAN CAPITALISM: THE CONCEPT OF COUNTERVAILING POWER (1957). The bill did not make it out of committee in its first year of life. As of summer 1996, it was still sitting in committee. Editorial, *The Gas Co-op Bill,* OIL & GAS J. 19 (Apr. 15, 1996).

309. Problems will arise if the large blocks decide that their joint interest is stronger than their opposition, because they have an incentive to collude. Moreover, the narrowing of standards to a few negotiations among very large power blocks raises the costs of error—a poor negotiation may provide great distortion—and removes the possibility of correction via competition among many firms.

310. In his presentation at the May 1996 New Mexico Gas Market Conference in Albuquerque, El Paso's Robert Phillips indicated that his company is considering offering aggregated field services. The idea at least is similar to the Natural Gas Clearinghouse, an unusual combination of major industry players, Morgan Stanley, and the Dallas law firm, Akin Gump. Bradley, *supra* note 8, at 958.

receive spun-down facilities at depreciated cost. The affiliate successors to regulated service companies enter the business at prices (and with good will) that can be impossible for competitors to match.

The combination of power in some markets, uncertainty over concentration tendencies, information imperfections, contract rigidities, and the significance of the consumer interest means that rational regulators must scrutinize deregulation carefully over time. Deregulation is an experiment. There is *no* broad support for a return to rate-setting. The lack of interest is reflected best in the fact that unregulated intrastate gatherers who want interstate companies controlled will not countenance the same standards for themselves. Yet economic theory provides no assurance that all natural gas markets will be competitive Measuring the success or failure of the experiment will require information on prices, profits, and other terms that pipelines will not disclose unless required by law. The commissions owe it to the public they serve to conduct a more searching analysis than merely pronouncing success because pipelines have not run out of gas.

Measuring and understanding the long-term changes will be extremely difficult. It deserves a great amount of regulatory attention (and resources). There is no agreement on the measure of success or how long a period is needed to capture the "real" trends in concentration and competition. Nor is there agreement on the relevant period for deciding whether the gains from innovation, if any, outweigh any increases in firm size. Controversy over how to declare success marks almost every other deregulation market, including early experiments like airlines.[311] And the long-term directions may take years to establish if the parties change business strategy slowly. Among the reasons for delay may be an unwillingness to risk capital until the dynamics of the new market emerge, time to grow confident regulators will not reregulate, and simply a lag as parties adjust their perceptions. The fact that it was some years before the Baby Bells have begun trying to merge is a reminder that long-term trends may be toward concentration even if there is little immediate effect.

The gas market may turn out quite differently than expected. Remedies to maintain competition within a concentrated industry with economies of scale may require new efforts. The FERC may find that some companies are measurably better performers than others and decide that the time has come to test Harold Demsetz's argument that natural monopolies can be made to function efficiently as long as there is spirited competition for the franchise.[312] It may turn out that franchises need to be rebid periodically to keep the spur of competition sharp. Pipelines are sure to

311. *Compare* the generally optimistic (if hedged) comments of former CAB Chairman Kahn, *supra* notes 74 & 114 *with* Paul Dempsey, *The State of the Airline, Airport & Aviation Industries,* 21 TRANSP. L.J. 129 (1992); Melvin Brenner, *Airline Deregulation—A Case Study in Public Policy Failure,* 16 TRANSP. L.J. 179 (1988); Theodore Harris, *The Disaster of Deregulation,* 20 TRANSP. L.J. 87 (1991); and James Lanik, *Stopping the Tailspin: Use of Oligopolistic and Oligopsonistic Power to Produce Profits in the Airline Industry,* 22 TRANSP. L.J. 509 (1995). One of the primary features of concern to these authors is the increase in industry concentration, Brenner, *supra,* at 184-91; Dempsey, *supra,* at 174-76.

312. Harold Demsetz, *supra* note 118.

point out, of course, that frequent rebidding raises their risk and cost of capital, and will reduce their efficiency. Or the FERC may decide to open bidding for expansions, letting outsiders compete in bids to loop existing systems, so that a more efficient rival could build on existing rights of way and other facilities of a current line. Or it may end up endorsing independent system operators, like those envisioned for electric deregulation, to run the natural monopoly portions of natural gas services.

Most of the empirical discussion in this article has been about the gathering market because that market is almost wholly deregulated. The Commission is just now beginning to reshape the transportation market with its incentive-based rates and experiments in lifting price caps for capacity release, interruptible transportation, and short-term firm. It may find that this seemingly little experiment is about as easy to contain as the FCC's decision to let MCI hook into AT&T on a few inter-city routes. It is going to be a rocky ride and one suspects that the Commission is not ready for either dozens of market by market determinations or the forces, competitive and monopolistic, that it is unleashing.[313]

The Nineties should be years of innovation and experimentation as we shift to new market forms. But its issues must be faced in a climate of knowledge, not ignorance.

VI. Back to Some Basics

Natural gas regulators, like their industry, live in a historical transition. As in any time of transition, there is opportunity and there is risk. The occasion presents a great opportunity for learning how this market really functions. The withdrawal of government controls has reopened questions that have seemed irrelevant for decades, including whether underlying

313. Under the present rules, if a marketer acquires firm capacity rights it is then allowed to resell gas and the value of the capacity used to deliver that gas at whatever charge the market will bear. Suppose I embark on a strategy as a marketer to acquire firm capacity rights to or from a specific market area whenever I can. Over time, I might well be able to acquire rights representing a large portion of the available capacity. Indeed, I might acquire control of sufficient capacity to create market power. And, as we all know, the natural monopoly characteristics of pipelines make it difficult for anyone to build a competing line. In effect, I will have taken pricing for transmission service —which the FERC still regards as uncompetitive and needing regulation—and removed it from regulatory control.

Leitzinger Letter, *supra* note 172, at 3-4:

The FERC's current thinking appears to be to keep price controls in place unless there is a showing of competitiveness, but it is not clear what this will mean. Say a pipeline shows that a market is competitive; the FERC says fine, please bid away; and a consortium of companies or a large ldc or two buy all the capacity. Is the FERC going to consider competitiveness only after bidding? Or should it limit the duration of bids, thus cutting off some long-term agreements that would be made in a competitive market?

See also the Natural Gas Supply Association comments on capacity release:

Producers are concerned about the sweep of the proposed changes, the speed at which the pilot program will be set up, and the limited opportunity for extensive before-the-fact pubic discussion and comment on these programs.

FERC Proposes Amending Rules for Interstate Capacity Secondary Market, Oil & Gas J. Aug. 12, 1996, at 34 (citing unnamed Natural Gas Supply source).

pressures are toward concentration, whether competition can be maintained or at least simulated in the face of large economies of scale, and how well the threat of entry works to keep prices down. For those with more abstract interests, these will be other pieces of evidence in the long-run debate about whether the unplanned nature of capitalism serves the public interest and whether the unconstrained human nature that emerges in capitalism is beneficent or not.[314]

One can make some additional comments on the deregulation experience. One is the unfortunate demonization of agencies and their members. Reformers like to caricature government employees as meddlers with otherwise healthy markets. Politicians seem to think they can't lose by running against bureaucrats. Deregulation attributes very high costs to regulation even though it tends to ignore the costs, imperfections, and barriers of "free" markets.

In fact, most regulators take the costs of regulation seriously. This is why the FERC and other agencies have reduced their intervention, a result inexplicable under many common organizational theories. Moreover, regulators have a far more thoughtful approach to the perils of government tinkering than the critics concede. As a society, we have accrued a large body of experience in the years of regulation. The challenge of deregulation should be to build on that experience, not to jettison it. In the current climate, politicians and (ironically) even regulators risk undervaluing the benefits of regulation, the skills of regulators, and the importance of that seemingly forgotten concept, the public interest.

Another lesson concerns the pitfalls of partial regulation. Though market domination may be disproportionately located in interstate pipelines and their affiliates, some intrastate companies dominate their markets too. Conversely, many interstate companies operate in competitive markets. One can predict that partial regulatory schemes are unlikely to succeed and probably shouldn't. Such imbalanced measures are unlikely be enacted because split regulation divides industry companies and fractures support for controls. In addition, imposing a standard for some but not others is an intellectually difficult, perhaps incoherent, standard. A complaints process may end up producing a partially regulated industry, if over time companies with power behave differently than other companies and need more restraint. But at least then there will be a rational basis for segmenting the industry and a showing of abuse before controls are imposed.[315]

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314. ALBERT HIRSHMAN, EXIT, VOICE, AND LOYALTY (1970). It takes little insight to spot the traditional conservative animus against any intervention in social ordering. We don't know enough to understand how markets work, but trust us that they work well and don't presume to tinker with structures built by so many hands. Pull back the first few layers of the deregulation onion, and soon we are back with Edmund Burke, arguing against Thomas Paine, against the French Revolution, and against tinkering with history.

315. Thus it is one thing to inject competition into a competitive section of a previously bundled service, as the FERC thinks it has been doing in the unbundling of field services. The Commission appears on the way to experimenting with the same thing in mainline transportation, in markets where excess capacity or the existence of multiple routes seems to make the market competitive. It is another thing to allow one or two firms to enter a market that has great economies of scale and no particular

Third, one can predict that regulators will continue to be plagued by the divisiveness and self-interested approach that characterizes regulatory debates. Parties will keep staking out positions by self-interest—there will continue to be a producer position, a pipeline position, an independent gatherer's position, an LDC position, etc. Although the natural gas players pretend to be factual in their briefs, their "facts" generally track their self-interest without regard for the true state of the marketplace. Like the Supreme Court in some recent antitrust cases and like many neoclassical economists, all sides are long on theory but short on facts. Producers (except those owning their own gathering systems) invariably argue there is great risk of market exploitation. Who doesn't want a little free insurance? Thus their comments usually give no consideration to costs and distortions of administrated markets.

For their part, pipelines treat all forms of intervention as burdensome and markets as ubiquitous and indomitable. They argue that gas markets are competitive nationally and should be deregulated entirely. If the world were limited to their arguments, one never would see a monopoly price. The Foster/INGAA study of gathering is an example of how far pipelines too can stray from factual analysis.[316] Neither pipelines nor producers are

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reason to expect better performance for the new firms. Firms will want to enter if cross-subsidies exist, as long as they can skim the cream of the regulated market. The incumbent firm will have the advantage of long-standing relations with its customers, though, and may find it quite easy to keep entrants at bay if the market is not itself competitive. We will learn a lot about these dynamics in natural gas in the next few years.

For a recommendation on partial deregulation, see Ayres & Braithwaite, *supra* note 74, ch. 5.

316. This perspective accurately reflects the strict economic theory discussed in *supra* note 142, in which there is no serious risk of market abuse. The kind of analysis to which that perspective leads is perhaps best illustrated in Robert Bradley's two-volume work on oil and gas regulation, an impressive institutional history but a *very* unrealistic market analysis.

Bradley semantically dodges the problem that capitalism is an unplanned system that may (1) produce unwanted results if the competitive pattern does not arrange itself in ways good for society overall, and (2) encourages applications of power as an efficient way for some companies to maximize profits (at the level of the firm, not of the market). He does so by calling free market theory a "theory of spontaneous order," Bradley, *supra* note 8, at 18, an idea common to thinkers like Hayek and Ludwig Von Mises. This is faith, not really even theory, and certainly it is not fact.

Like many conservative economists, Bradley decides to assume that high profits call forth competition. Thus we find such "arguments" as "[c]ompetition in a free market—which prominently includes *potential* competition— is inherent in all entrepreneurial activity where legal barriers to entry do not exist." *Id.* at 32 (emphasis in original) [by legal, Bradley presumably only includes government barriers, not legal barriers like long-term, dedicated acreage, confidential contracts.]. Potential competition has to carry a huge burden in this theory; "Potential competition is the omnipresent *check* on existing firms (including a 'natural monopolist')." *Id.* at 857 (emphasis in original). Markets are naturally healthy: "Competition is omnipresent for interstate gas carriers in an unregulated market. There is potential competition, competition from substitutes, and, in many cases, pipeline-on-pipeline rivalry." *Id.* at 922.

As in the new economic theory, not only competition but also perfect balance is presumed: "A more balanced view [perhaps literally, but not critically] is that free-market competition is neither insufficient nor overstimulated but continually *resource-adjusting* toward a consumer-dictated level of service." *Id.* at 922 (emphasis in original; citations understandably omitted in original)

This picture of automatic competition is funniest when Bradley discusses Standard Oil, which has become something of a rallying point for Chicago School theorists since John McGee's article. Had Standard not been divested by the government, "Producers could have banded together to counter

likely to be very close to the truth. Somewhere in the middle, unregulated gatherers try to walk a fine line. They don't want FERC or state agencies to touch *their* systems, but they want competing interstate companies to remain under government control.[317] Deregulation is too strong a medicine for them, but please apply it to their interstate competitors. This is the kind of argument that infuriates critics who believe that interest politics is

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seller advantage; indeed, this possibility encouraged vertical integration by pipeline firms in the first place." *Id.* at 783-84. "The mere possibility of such action would give leverage to producers to obtain competitive prices for their oil." *Id.*

Bradley has the same solution for gas consumers:

> Self-help and market processes can effectively substitute for public-utility ratemaking, not because the free-market alternative is perfect but because the regulatory solution, as argued later in this section, is relatively imperfect.
>
> New residences and business establishments have energy alternatives at the outset, although they become captive once the initial decision is made
>
> For existing captive users, contracting is also viable. . . . On the one hand, the utility could offer an unregulated 'take it or leave it' rate. If this default rate were unacceptable, an entrepreneurial opportunity would be created for consumers to organize to collectively bargain with the distribution company. In the jargon of economists, 'monopoly' would be countervailed by 'monopsony.'
>
> A contractual impasse could lead to new ownership of the gas firm or even customer ownership (the free market equivalent of municipal ownership).

Id. at 926.

At other points, Bradley seems to accept what ordinary observers call market abuse, but to think it beats the alternatives. Thus he argues that even if interstate pipeline markets are noncompetitive, "voluntary contracts and market processes can prevent 'monopolistic' outcomes. Correcting a 'lack' of competition with state franchises and the Natural Gas Act, moreover, is a 'cure' far worse than the 'disease.'" *Id.* at 914. This fits Bradley's more general point that markets are not perfect, but for him still relatively better than government-run economies, *id.* at 16-17, and that intervention is particularly ill-considered because economists don't understand enough to know competition when they see it, *id.* at 44-45 (so regulators are flying blind). Bradley is willing to accept a fair amount of monopoly to avoid the evil of government planning, though he offers no measure to compare the two:

> Second, extraordinary profits are necessary for some markets to be served at all. It is much better that consumers —even captive users—have the choice of natural gas at unregulated prices than be left with phantom gas at a 'competitive' rate. One firm created by market conditions is wholly preferable to no firms created by regulatory conditions.

Id. at 923.

317. The predictability of interest-driven briefs and motions can be infuriating. Foes of regulation are right to list it as a source of distortion and one reason to be skeptical about expansive regulation. A good example comes from the Independent Petroleum Association of America, an organization of independent producers.

On the one hand, IGPA claimed that the independent field services are "highly competitive in nature," with the predictable result that "there is no need for federal regulation of independent gathering and processors." Supplemental Comments of Indicated Gatherers and Processors, at 2 (Mar. 11, 1994). Their primary fear was to make sure that *they* not be regulated, a point they raised several times. But on the other hand they want the FERC to shackle interstate competitors. Thus they claimed that federal regulation of interstate G & P systems and state regulation produced a "balanced" system.

The problem, of course, is that the old system had no balance about it. States have not actively regulated intrastate systems, so this is comparing a system of true regulation with what has been no regulation. There may be an empirical basis for an interstate/intrastate distinction, but no one has made it. The necessary factual support certainly is not found in the IGPA filing.

an inescapable part of regulation, as (they believe) is a waste of resources spent trying to capture agencies and impose costs on each other.[318]

Regulators will have to continue to sift the facts from these partisan filings, develop an independent record, and make their determinations. Unfortunately, they will get little help from the affected parties.

It probably is true that the muting of market signals and dependence of the interstate pipelines on regulatory decisions rather than their efficiency has retarded the development of measures of pipeline performance.[319] Actual performance did not matter much when regulators protected markets and set rates to achieve target rates of return. Along with the growth of more efficient companies, the market should generate greater attention to measures of performance. With luck the development of such measures, which are part of the economic technology of the industry, will ease regulators' tasks.[320]

Polarization is unfortunate because it blinds the parties to each other's respective contributions. Even in regulatory regimes, our society leaves much of its policy planning to private business decision.[321] A society that regulates utilities but leaves them in private hands is delegating some of its most fundamental questions of resource allocation. At the same time, it asks large businesses like pipelines to risk billions of their capital in the public interest. Companies investing new capital in field services and other

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318. Judge Easterbrook makes the identity of the plaintiff one of his antitrust litigation screens because he believes that most competitor lawsuits are attempts to impose costs on rivals. Easterbrook, *supra* note 121, at 34. In most cases, to him, "[t]he identity of the plaintiff is all the court needs to know." *Id.* at 36. Show him a competitor and it's thumbs down.

319. Not many people pay much attention to the role that general industry performance standards play in improving economic exchange. On the general issue, *see* Bradley, *supra* note 8, at 24. ("A subtle part of the industry's success story has been the compilation and dissemination of industry data in publications such as [listing major industry journals]. Distilled supply, demand, and price statistics improved economic calculations, and how-to technical articles shared the wealth.").

Although it certainly is not Bradley's point, I argue in my articles that the flow of information has been biased toward industry companies, not investors, and that this has distorted oil and gas investing. Performance information on pipelines has been retarded because, under regulation, there was less risk and less need for this information. If it works, deregulation should improve investor behavior and capital flows into the pipeline industry, as well as company performance.

320. For an argument that a yardstick of other pipelines' costs would be a good target, see Adam Jaffe & Richard Kalt, *Incentive Regulation for Natural Gas Pipelines* (Kennedy School of Government Research Paper No. 93-19 (May 1993)). Kalt and Jaffe argue that "[t]ying a pipelines' rates to the cost performance of similarly situated companies would establish a form of efficiency tournament in which a pipeline able to outperform the yardstick would be able to profit." *Id.* at 1.

321. Charles Lindblom argues that businesses in market systems like ours, when left to make fundamental decisions about investment, jobs, resource allocation, and virtually every economic aspect of life, make decisions that are "public in the sense of mattering to everyone, and decisions about them are as important as decisions made by government." CHARLES LINDBLOM & EDWAD WOODHOUSE, THE POLICY MAKING PROCESS 7-8 (3d. ed. 1993). "What remains invariant is that there is this second set of public officials, and that policy making by the 'private sector' constitutes a system of control over society's directions that rivals government in overall import." *Id.* at 8.

It is a "rival system of public policy making, one in partial competition with the governmental system." *Id.* at 90. After a chapter describing the advantages given to business when it is operating the governmental system, Lindblom and his co-author Woodhouse conclude that this privilege "renders the task of intelligent, democratic government policy making extremely difficult." *Id.* at 102.

areas are improving social welfare. This should not get lost in the narrower battles over how they price the services that result.

Fourth, regulators need to pay particular attention to market imperfections and impediments during this transitional period. It is these costs, risks, and uncertainties that will determine the gap between the real world and the way reform economists think it will operate. Regulators must be very careful to protect an information lifeline if they are to accomplish this task. Moreover, they need to make sure that affected parties get enough information to identify injuries and seek their remedies under the antitrust laws and other causes of action. They should wield the mechanisms of antitrust, information, and complaints that are discussed in detail in this article.

The hardest decisions will be those involved in defining what competition is going to mean in these new markets. At one extreme are old theories that require interventions and rate capping for natural monopolists, prohibit discrimination broadly, and turn heavily on market share; at the other are the new economic theories that treat the world as if monopolists pose no greater threat to consumer welfare than firms in competitive markets, every high return is a response to risk, and every price difference is a legitimate market response.

This article has argued that the answers to these questions are likely to depend upon empirical knowledge, not pure theory. Neither "competition" nor "monopoly" (nor "regulation" for that matter) is a self-sufficient concept.[322] Economic theory alone cannot determine whether potential entrants could discipline markets and transactions costs rather than matter. But one can predict some of the issues and likely outcomes. Regulators are going to provide open access to facilities with strong natural-monopoly, to encourage competition for the use of these facilities. Regulators do not yet know whether most instances of discrimination will be justifiable market responses of applications or power, and without this knowledge cannot yet decide what burden to apply to discrimination issues. Deregulation has occurred without a careful analysis of the economics of integration, and regulators may have to deal with deregulated markets again dominated by a few large firms in markets where customers prefer single products. And regulators have not faced the real issues about inserting competition by

322. The Chicago School has made the case against simplistic applications of "monopoly" very persuasively, but they often turn around and try to use "competition" in the same incorrect, blunt manner.

> Traditional economic advice rests on inadequate conceptions of market possibilities, on the one hand, versus unmitigated speculation about the efficacy of nonmarket arrangements, on the other . . . [T]he public institutional structures we choose are important determinants of public economic progress. However, our methods for studying this choice and deriving policy recommendations are not yet well-developed.

Lee Friedman, *Public institutional Structure and Resource Allocation: The Analysis of Adjustment,* 2 J. POL. ANAL. & MGMT. 303, 306, 322 (1981); *accord,* Ayres & Braithwaite, *supra* note 74, at 3. The need for much more institutional sophistication is the lesson of much of the best policy analysis, *see* Richard Nelson, THE MOON AND THE GHETTO (1977); *see also* ALICE RIVLIN, SYSTEMATIC THINKING FOR SOCIAL ANALYSIS (1971).

bidding, including the scope of facilities involved and the frequency with which bids should be reopened.

In the long run, society will have to decide whether deregulation has lived up to its promise market by market. The answer may change as technologies change, again market by market. This is an inescapably messy undertaking. "Competition" is not the clear standard that the Chicago school promised.[323] At least in the current state of knowledge, theories, like contestable markets and strategic deterrence, depend upon speculation about possible business responses. It seems unlikely that economics will remove much of this uncertainty. Moreover, projections about how long-run innovation relates to market structures are, at least today, highly speculative. Regulators must navigate this theoretical world while paying attention to direct measures of welfare like prices, costs, output, service levels, and profits.

"Deregulation" promises to be the beginning, not the end, of a paradigm shift. Regulators have a duty to see that both regulation and its absence serve the public interest.

323. *Compare* Robert Bork, The Rule of Reason and the Per Se Concept: Price Fixing and Market Division, 74 YALE L.J. 75, 829-847 (1965)(arguing that consumer welfare is the only "judicially" standard for antitrust laws; *see also* Bork, *supra* note 173 (developing argument that consumer welfare is the only purpose Congress intended the Sherman Act to serve).