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In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 890

FEDERAL POWER COMMISSION, CITY OF AKRON AND PENNSYLVANIA PUBLIC UTILITY COMMISSION, PETITIONERS

v.

HOPE NATURAL GAS COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Solicitor General on behalf of the Federal Power Commission, the Director of Law on behalf of the City of Akron, and Commission Counsel on behalf of the Pennsylvania Public Utility Commission pray that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit, entered on February 16, 1943, which set aside an order of the Federal Power Commission reducing the rates of respondent, Hope Natural Gas Company, and which set aside the Federal Power Commission's "Findings as to Lawfulness of Past Rates" charged by respondent.

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. IV, 169–207)[1] is not yet officially reported. The opinion of the Federal Power Commission is found at R. I, 1–89.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 16, 1943 (R. IV, 207). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, and Section 19 (b) of the Natural Gas Act.

STATUTE INVOLVED

The pertinent provisions of the Natural Gas Act of 1938 (52 Stat. 821; 15 U.S.C. § 717) are set forth in Appendix A, *infra,* pp. 29–35.

QUESTIONS PRESENTED

The Federal Power Commission, after complaints by the Cities of Cleveland and Akron and the Pennsylvania Public Utility Commission, and after extensive hearings, found that respondent's interstate rates were unreasonable and unlawful and issued an order reducing respondent's future rates by $3,609,857 annually. The Commission adopted a prudent investment rate base. The court below invoked the "present fair value"

[1] In the record citations, roman numerals refer to the volume, arabic numerals to the page.

theory to set aside the Commission's findings and order. The questions presented are:

1. Whether, for rate-making purposes under the Natural Gas Act, the Commission is authorized to use a rate base determined exclusively upon the basis of prudent investment, measured by "actual legitimate cost" less depreciation,[2] or whether it must use a rate base which reflects estimates of the extent and effect of post-investment fluctuations in labor and material prices.

2. Whether the Commission must include in "actual legitimate cost" amounts previously and correctly charged by respondent to operating expenses, in accordance with industry practice of the time, and determined by the Commission to have been recouped through revenues received from rate payers.

3. Whether the Commission may determine actual existing (accrued) depletion and depreciation, and the annual allowance in operating expenses for these factors, upon the basis of "actual legitimate cost", or whether the Commission must base such

[2] "Actual legitimate cost" (which Section 6 (a) of the Natural Gas Act authorizes the Commission to ascertain for natural-gas companies) less existing depreciation has been interpreted by the Commission to be "prudent investment." *Re Canadian River Gas Company*, 43 P. U. R. (N. S.) 205; *Detroit* v. *Panhandle Eastern Pipe Line Co.*, 45 P. U. R. (N. S.) 203; see *Re Chicago District Electric Generating Corp.*, 39 P. U. R. (N. S.) 263.

determinations upon estimates of the "present fair value" of the property.

4. Whether the court below erred in holding that in determining the actual existing (accrued) depletion and depreciation, the Commission failed to take into account "the present condition of the property."

5. Whether the economic-service-life principle, as applied by the Commission in this case, is a reasonable method of determining the actual existing depletion and depreciation and the annual allowance therefor.

6. Whether the court below erred in holding that $165,963 for an experimental deep-test well, which was completed dry and charged to operating expenses in 1941, should have been included in 1940 operating expenses.

7. Whether the rates fixed by the Commission are just and reasonable in the statutory sense and nonconfiscatory in the constitutional sense.

8. Whether the Commission has jurisdiction to determine the *lawful* rates for interstate sales of natural gas at wholesale after the effective date of the Natural Gas Act of 1938 and prior to the issuance of a Commission rate-fixing order.

9. Whether the court below erred in holding that the Commission's "findings as to past rates * * * should be set aside."

STATEMENT

THE RESPONDENT

Hope Natural Gas Company ("Hope"), a wholly owned subsidiary of the Standard Oil Company (New Jersey), is conceded to be a "natural-gas company" within the meaning of the Natural Gas Act (R. III, 19). Hope purchases and produces natural gas in West Virginia, transports it in pipe lines to the West Virginia-Ohio and West Virginia-Pennsylvania state lines, and there sells it in interstate commerce to its affiliates, East Ohio Gas Company and River Gas Company, for resale to ultimate consumers in Ohio; to its affiliate, Peoples Natural Gas Company, for resale to ultimate consumers in Pennsylvania; and to the nonaffiliated Manufacturers Light and Heat Company and Fayette County Gas Company for resale in Pennsylvania (R. I, 17). About 80% of Hope's total sales are in interstate commerce and 95% of such sales are to its aforementioned affiliates (R. I, 18). About 20% of Hope's total volume of gas is sold in intrastate commerce to local consumers in West Virginia. Hope has been purchasing, producing, transporting and selling natural gas for more than forty years. Hope's interstate sales in 1940 amounted to about 53,000,000 MCF, and its interstate gross revenues in that year amounted to $19,296,755 (R. I, 51).

THE STATUTE

The Natural Gas Act (the "Act"), effective June 21, 1938, requires that all rates or charges in connection with the transportation or sale of natural gas subject to the Act be just and reasonable and declares any rate or charge that is not just and reasonable to be unlawful (Sec. 4 (a)). It provides that the Federal Power Commission (the "Commission"), upon complaint of any State, municipality, State commission, or gas distributing company, or upon its own motion, whenever it finds that any rate is unjust or unreasonable, shall determine the rate to be thereafter observed and in force, and shall fix the same by order; and, further, that the Commission "may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates" (Sec. 5 (a)). Any State, municipality, or State commission, complaining of anything done or omitted to be done by any natural gas company in contravention of the provisions of the Act, may file a complaint with the Commission (Sec. 13).

Under Section 14 (a) the Commission may investigate any matter "to determine whether any person has violated or is about to violate any provision of this Act" and "make available to State commissions and municipalities, information concerning any such matter." Section 16 empowers the Commission to perform any and all acts it

may find necessary or appropriate to carry out the provisions of the Act. And Section 17 (c) requires the Commission to make available to the several State commissions "such information and reports as may be of assistance in State regulation of natural-gas companies."

THE PROCEEDINGS BEFORE THE COMMISSION

In July 1938, the Cities of Cleveland and Akron filed complaints with the Commission, charging that the rates collected by Hope from East Ohio Gas Company were excessive and unreasonable (R. II, 1, 7). In October 1938, the Commission, on its own motion, instituted an investigation to determine the reasonableness of all of Hope's interstate rates (R. II, 28). In March 1939, the Pennsylvania Public Utility Commission filed a complaint with the Commission, charging that the rates collected by Hope from Peoples Natural Gas Company, Manufacturers Light and Heat Company, and Fayette County Gas Company were unreasonable (R. II, 18). The City of Cleveland's complaint, as amended and modified, prayed specially for a determination by the Commission that Hope's collected rates from East Ohio were unreasonable and therefore unlawful, and for a determination of just and reasonable Hope-East Ohio rates from June 30, 1939, to the date of the Commission's decision, requesting such determinations "in the aid of State regula-

tion" and particularly to afford the Public Utilities Commission of Ohio a proper basis for disposition of a fund collected by East Ohio under bond from Cleveland consumers during the period since June 30, 1939 (R. II, 14).[3] In October 1939, the Federal Power Commission consolidated the three complaint cases and its own investigation of Hope's interstate wholesale rates for hearing (R. II, 34). Hearings were held in 1940[4] and 1941, and after briefs were filed, the

[3] The fund represents the difference between East Ohio's previous rates and the lower rates established by ordinance of the City of Cleveland, which East Ohio is collecting pending its appeal from the ordinance to the Public Utility Commission of Ohio, under §§ 614–44 *et seq.* of the Ohio General Code. See *Public Utilities Comm. of Ohio* v. *United Fuel Gas Co.*, No. 87, October Term, 1942, decided January 11, 1943, slip sheet, p. 5.

Representing that the Ohio Commission's determination of the reasonableness of the retail rate established by the City of Cleveland for sales by East Ohio to Cleveland consumers, for the years in which the fund was accumulated, "was ultimately dependent upon the lawfulness" of Hope's charge to East Ohio (R. II, 45), the City in its amended complaint of January 6, 1939, requested the Power Commission to determine the lawful wholesale rates from and after June 21, 1938, to the effective date of its order fixing Hope's rates. In a brief subsequently filed before the Power Commission, it limited the request to cover rates charged from and after June 30, 1939, for the reason that a settlement had made the question moot with respect to the earlier period originally covered.

[4] On December 20, 1940, the Commission denied without prejudice a motion of the Cities of Cleveland and Akron for an immediate order reducing the Hope-East Ohio rate upon Hope's own testimony, for the reason that "there is

case was argued orally before the Commission sitting *en banc* on October 27, 1941 (R. II, 48). The Commission decided the case on May 26, 1942, when it entered an "Order Reducing Rates" charged by Hope and, in addition, separate "Findings as to Lawfulness of Past Rates" collected by Hope from East Ohio (R. I, 1, 8).

The Commission's Determinations

The Commission's "Order Reducing Rates" required Hope to reduce its interstate rates for the future to reflect a reduction of not less than $3,609,857 in operating revenues on an annual basis (R. I, 6). More particularly, the order required minimum reductions of 7 cents per MCF from the 36.5¢ and 35.5¢ rates previously charged East Ohio and Peoples Natural Gas, respectively, and 3 cents per MCF from the 31.5¢ rate previously charged Fayette County Gas and Manufacturers Light and Heat Company (R. I, 73–74). The Commission's "Findings as to Lawfulness of Past Rates", made in deciding the complaint of the City of Cleveland, determined that the rates collected by Hope from East Ohio were unjust, unreasonable, excessive, and therefore unlawful, by $830,892 in 1939, $3,219,551 during 1940, and

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insufficient evidence of record, at this time, to support the prayer for relief requested by the movants," and subject to the reservation that "this order is not to be construed as a determination of any of the issues in the pending principal proceedings" (R. II, 43).

$2,815,789 on an annual basis since 1940; and further determined just and reasonable rates for gas sold to East Ohio for resale for ultimate public consumption to be $11,528,608 for 1939, $11,507,-185 for 1940, and $11,910,947 on an annual basis for 1941 and the first half of 1942 (R. I, 12–13).

The Commission founded its "Order Reducing Rates" upon a rate base of $33,712,526, upon which it granted respondent a 6½% rate of return, or $2,191,314 annually (R. I, 4). This rate base was determined to be the actual legitimate cost of Hope's interstate property less existing depletion and depreciation, plus allowances for unoperated acreage, working capital, and future net capital additions (R. I, 50).

The Commission's rate base was arrived at substantially as follows: The Commission found that Hope had kept complete documentary evidence, through books, records and vouchers, of its expenditures throughout its existence, so that no estimates were required to ascertain the actual legitimate cost (R. I, 23, 174). Pursuant to a check of the inventory of Hope's property in service, and pursuant to an examination, analysis, and audit of respondent's records, the Commission determined the cost to be $52,174,873 for the property devoted to the interstate sales, as of December 31, 1940 (R. I, 34–36; R. III, 25–32, 69, 287). From this amount, the Commission then deducted accrued depletion and depreciation, which it found

to be $22,328,016 (R. I, 45, 50).[5] It arrived at this figure by applying the economic-service-life method to actual legitimate cost (R. I, 41). In making these determinations the Commission was guided by a study conducted by a qualified staff engineer, who made a field inspection of the Company's physical properties to aid in the determination of service lives (R. I, 42; III, 158). The Commission then added $1,392,021 for future net capital additions, $566,105 for useful unoperated acreage, and $2,125,000 for working capital, yielding the total rate base of $33,712,526 (R. I, 50).

Using 1940 as a test year to forecast future revenues, and forecasting expenses at the 1940 figure plus $421,160, the Commission allowed respondent operating expenses and taxes amounting to $13,495,584 (R. I, 62, 70, 72). Of this total $1,460,037 represented the annual allowance for depreciation and depletion (R. I, 53). This allowance was determined by the Commission in the same way as the actual existing depreciation and depletion, by the application of the economic-

[5] The actual existing depletion and depreciation found by the Commission came to about $24,000,000 less than the depletion and depreciation which the Company had accrued on its books (R. I, 81). One of the Commissioners dissented on the ground that the Commission should have deducted accrued depreciation and depletion of not less than $38,000,000, the reserve remaining on the Company's books after it had transferred $7,500,000 from the reserve to surplus (R. I, 81).

service-life method to the actual legitimate cost of respondent's properties (R. I, 51–52).

The Commission's "Findings as to Lawfulness of Past Rates" were arrived at on the same principles and in substantially the same manner as the "Order Reducing Rates," except that they were based on actual operating experience for the years in question, instead of a test year (R. I, 11).

In issuing its order and findings the Commission rejected respondent's argument that post-investment changes in price levels had to be reflected in the rate base and in computing both accrued depreciation and depletion and the annual allowance in operating expenses for these items (R. I, 20–23, 36, 41, 52). It condemned as hypothetical and without probative value the "reproduction cost new" and "trended original cost" estimates (amounting to approximately $97,000,000 and $105,000,000, respectively) submitted in evidence by respondent in support of its claimed rate base of some $66,000,000 (R. I, 20–23). The Commission also rejected respondent's contention that, in any event, the rate base should have reflected an additional sum of about $17,000,000, representing largely expenditures for well drilling prior to 1923, which respondent had charged to operating expenses (R. I, 24–34). Likewise unsuccessful was respondent's espousal of the "percent condition" theory of measuring accrued depreciation (R. I, 38).

Pursuant to Section 19 of the Act, Hope filed an application for rehearing (R. II, 51), and upon denial petitioned the United States Circuit Court of Appeals for the Fourth Circuit for a review of the Commission's "Order Reducing Rates" and the Commission's "Findings as to Lawfulness of Past Rates" (R. IV, 3).[6]

The Opinion Below

On review, the court below, with one judge dissenting, set aside the Commission's "Order Reducing Rates" on the basic grounds that: (1) the Commission's use of a prudent investment rate base failed to reflect "present fair value", in view of the post-investment "decided change" in price levels shown by the record and by judicially noticeable facts (R. IV, 172, 183–184); (2) the Commission erroneously excluded from the rate base the well-drilling costs previously incurred and charged to operating expenses prior to 1923 (R. IV, 172, 184–189); (3) the Commission improperly determined accrued depreciation on the basis of "theoretical formulas", without considering the present physical condition of respondent's property (R. IV, 172, 189–190); (4) the Commis-

[6] Hope did not seek a stay of the Commission's order from the Circuit Court of Appeals and such order has not been stayed; instead Hope agreed with its customer companies to charge the ordered rates pending litigation, upon the customers' agreement to make Hope whole if the Commission's order should be finally invalidated.

sion should have based its annual allowance in operating expenses for depreciation and depletion upon the "present fair value" of the physical property, instead of upon actual legitimate cost (R. IV, 192–198); (5) the Commission should have included in 1940 operating expenses $165,963 for an experimental deep-test well, which was completed dry and charged to operating expenses in 1941 (R. IV, 198); (6) the Commission should have made an annual allowance for depreciation and depletion on capital added to the rate base after 1940 (R. IV, 196).

The court also set aside the Commission's "Findings as to Lawfulness of Past Rates", holding that: (1) the Commission had no jurisdiction to make findings as to lawfulness of past rates "to be given effect in rate proceedings before state commissions", and that rates filed with the Commission under Section 4 (c) of the Act became the only "lawful" ones which the utility could charge or accept until changed by the Commission; (2) the Commission could investigate "the conditions and rates of the past" as an incident of its power to fix future rates, but that so viewed the findings in question were invalid for the same reasons as its "Order Reducing Rates", and were also objectionable in that they were based on actual experience for the years in question, rather than reasonable estimates of ex-

pense based on experience during a prior period (R. IV, 200, 202).[7]

REASONS FOR GRANTING THE WRIT

This case is one of great public significance. The vital issue underlying the main questions presented is whether the Federal Power Commission may employ the prudent investment method of rate-making. The decision of these questions is of first importance not only in the adminstration of the Natural Gas Act of 1938,[8] but in the general

[7] On March 8, 1943, the Circuit Court of Appeals granted a motion for the stay of its mandate pending further order, upon the condition that a petition for writ of certiorari be filed with the Supreme Court of the United States within thirty days (R. 209).

[8] Four Power Commission cases involving gas companies, with prudent investment rate bases aggregating $87,000,000, are now pending in the Eighth and Tenth Circuit Courts of Appeals. *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, No. 12466 (C. C. A. 8th); *Colorado Interstate Gas Co.* v. *Federal Power Commission*, No. 2550 (C. C. A. 10th); *Canadian River Gas Co.* v. *Federal Power Commission*, No. 2551 (C. C. A. 10th); *Colorado-Wyoming Gas Co.* v. *Federal Power Commission*, No. 2561 (C. C. A. 10th).

The $3,750,000 interim rate reduction approved in *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575, was followed by a final consent rate reduction of an additional $2,750,000 and was based solely on prudent investment. F. P. C. Order Accepting Reduced Rates For Filing And Terminating Proceedings, September 19, 1942. Additional consent reductions in natural gas rates were obtained by the Commission's insistence upon prudent investment rate bases in the following cases: *Lone Star Gas Co.*, F. P. C. Docket Nos. G–208, G–209, May 4, 1942, Order Re-

field of public rate regulation—to every rate-making body throughout the nation, to the public utilities regulated, and to the countless consumers of public utility services. In passing upon these questions the court below divided, being unable to agree upon the proper meaning, and application to the facts at bar, of this Court's recent decision in *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575, which arose under the same statute. The correct meaning and application of that decision are matters which only this Court can finally resolve, and which in the public interest should be resolved. Moreover, in our view the decision of the majority of the court below on several of the basic questions presented is in conflict with decisions of this Court.

(1) The Commission's "Order Reducing Rates" was upset below on the fundamental ground that both the Constitution and the Natural Gas Act command the Commission to adopt a rate base which reflects "present fair value" by giving effect to post-investment fluctuations in price levels, and accordingly that the Commission lacks

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ducing Rates by $2,053,564 per year; *El Paso Natural Gas Co.*, F. P. C. Docket Nos. G-242, G-257, October 29, 1942, Order Reducing Rates by $526,000 per year; *Northern Natural Gas Co.*, February 4, 1943, Order Making Effective Reductions In Rates by $2,087,000 per year.

There are now pending before the Power Commission rate cases involving companies with properties showing investment per books of about $574,000,000 and whose annual revenues total $110,000,000.

authority to use a rate base representing actual legitimate cost less depreciation (i. e., prudent investment), except where such base also reflects "present fair value" (R. IV, 183).[9]

The net effect of the decision below, in both its constitutional and statutory aspects, is to confine the Commission's freedom to use prudent investment to cases in which its application would yield a rate base equivalent in general to that which would be derived under theories founded on the eminent-domain concept of present value, such as "reproduction cost new" and "trended original cost."[10] But, from the standpoint of sound economic, accounting, and legal principles alike, there is grave doubt whether eminent-domain concepts of present value have any proper place in public-utility rate making. See Brief for the Federal Power Commission and Illinois Commerce Commission, Nos. 265 and 268, October

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[9] The dissenting judge, on the other hand, construed this Court's decision in the *Pipeline* case to hold that there was no constitutional objection to the Commission's exclusive use of the prudent investment method and concluded that the Commission's order was within the scope of its statutory authority, reasonable, and supported by substantial evidence (R. IV, 203–205).

[10] The substantial identity of the "reproduction cost new" and "trended original cost" theories is well illustrated by respondent's respective valuation estimates under each of those theories in the present case—$97,000,000 under the former and $105,000,000 under the latter. These estimates contrast sharply with the actual legitimate cost of $52,000,000 found by the Commission (R. I, 20–21, 36).

Term, 1941, p. 112, *et seq.* Much less should it be judicially enforced as the exclusive determinant of the constitutional validity of every exercise of the rate-making power, for "the Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas." *Federal Power Commission* v. *Natural Gas Pipeline Co.,* 315 U. S. 575, 586. The view of the majority below would restrict that freedom of choice by imposing the condition that the formula chosen in any case must yield a result generally equivalent to that which would be obtained under eminent-domain formulas. There is no reasonable basis for interpolating any such condition into the *Pipeline* opinion. As the Court there held, the limit of judicial inquiry in these cases is to determine whether "the Commission's order, as applied to the facts before it and viewed in its entirety, produces [an] arbitrary result." *Federal Power Commission* v. *Natural Pipeline Co.,* 315 U. S. 575, 586.[11]

[11] The *Pipeline* case forecloses the contention that a rate order founded upon a prudent investment rate base is arbitrary simply because a larger rate base would result from the adoption of a formula reflecting prevailing price levels. For example, the decision there sustained the use of an amortization base reflecting actual legitimate cost regardless of the fact that another basis of determination, taking into account post-investment fluctuations in price levels, would have yielded a larger sum. It is immaterial whether the question concerns the propriety of using actual legitimate cost in determining the rate base or in determining the

The decision below is equally inadmissible upon statutory grounds. If, as this Court held in the *Pipeline* case, the Commission is authorized under the Natural Gas Act to use actual legitimate cost to determine the amortization base, it is equally authorized to do so in determining the rate base. The one is no more integral in the rate-making process than the other (*cf. Lindheimer* v. *Illinois Tel. Co.*, 292 U. S. 151, 164), and nothing in the statute suggests that a different result was intended. See Sections 5 (a) and 6. Indeed, as the dissenting judge below concluded, the statute grants the Commission a very broad discretion with respect to its rate-making powers within its jurisdictional sphere (R. IV, 205).

(2) The majority below incorrectly held that $17,000,000, largely representing well-drilling costs incurred prior to 1923 [12] and charged by re-

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amortization base; the principles involved are the same and in terms of the ultimate issue, namely, the rates which the utility is entitled to charge, the answer is of comparable importance. *Cf. Lindheimer* v. *Illinois Tel. Co.*, 292 U. S. 151, 164–170.

[12] The $17,000,000 figure is before depreciation. After depreciation it amounts to about $4,000,000, as the court below noted (R. IV, 184).

Although the lower court's opinion suggests otherwise, not all of the $17,000,000 in question represented well-drilling costs which the Commission rejected because they had previously and properly been charged to operating expense. In particular, one item of $632,000 included in this aggregate figure, claimed as "interest during construction," was dis-

spondent to operating expenses, must now be capitalized and reflected in the rate base. This result was reached on the rationale that the items in question were "erroneously charged to expense" (R. IV, 189), instead of to capital, and that it was immaterial whether, as the Commission found, the cost of these items had been recouped in the form of revenues realized from rate payers because—

> * * * the customers paid for gas, not for the construction of wells, and * * * neither the cost of the wells nor the company's ownership thereof is affected by the fact that it may have paid for them with the proceeds of rates that were unreasonably high (R. IV, 186).

This reasoning embodies two fundamental errors. First, the items in question were not in fact "erroneously" charged to expense. As the Commission found in accordance with the evidence, until 1923[13] it was Hope's "consistent practice * * * to charge the cost of drilling wells to operating expense" (R. I, 27, 251–254; IV, 206); in so doing, Hope followed the general practice of the natural gas industry and "the well-

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allowed by the Commission on the ground that it was never incurred (R. I, 24, 180). The failure to notice this below was apparently an inadvertence.

[13] In 1923, the West Virginia Public Service Commission, pursuant to its jurisdiction over intrastate rates, required Hope to change this accounting practice for future well-drilling expenditures (R. I, 28).

established practice of extractive industries," a practice which was based upon the underlying theory "that additional wells were constantly needed to keep the Company in business, hence the cost incurred was not for the purpose of adding to the property but rather for the purpose of maintaining the business" (R. I, 27).

Secondly, in overriding the Commission's determination against capitalizing items previously and properly [14] treated as operating expense to be compensated from revenues received from rate payers, the prevailing judges below failed to give effect to prior decisions of this Court, *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575, 590–591; *R. R. Comm.* v. *Cumberland Tel. & Tel. Co.*, 212 U. S. 414, 424 *et seq.* The applicable rule was plainly stated in the *Pipeline* case as follows (315 U. S. 575, at 591):

> * * * They [the companies] have thus treated the items now sought to be capitalized in the rate base as operating expenses to be compensated from earnings, as in the case of regulated companies * * *.
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> * * * * *
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> We cannot say that the Commission has deprived the companies of their property by

[14] The Commission stressed the fact that the charge to operating expense was proper under the universal accounting practice prevailing in the industry at the time. It recognized that "genuine" accounting errors would probably warrant correction, and actually made such corrections where such errors were found in this case. See R. I, 31, 33, 35.

> refusing to permit them to earn for the future a fair return and amortization on the costs of maintenance of initial excess capacity—costs which the companies fail to show have not already been recouped from earnings before computing the substantial "net profits" earned during the first seven years.

This proposition is decisive here, since Hope has failed to show that the well-drilling costs "have not already been recouped from earnings." [15]

(3) The decision below erroneously condemned the Commission's application of the economic-service-life principle to determine actual existing (accrued) depreciation and depletion and the determinations based thereon. Conceding that the "formulas" which the Commission used were "undoubtedly important matters for it to take into consideration" (R. IV, 190), the court below rebuked the Commission for failing to consider, in addition, the "actual present conditions" of re-

[15] Nor could respondent in good conscience make such a showing. For, as the Commission pointed out, Hope not only claimed and was allowed the expenditures in issue here as operating expenses when it successfully sought a rate increase in 1921 before the West Virginia Public Service Commission, but its "average rate of earnings on the annual average invested capital (capital stock and surplus) was more than 15%" between 1898 and 1923, the period when the well-drilling expenditures in question were made (R. I, 34; III, 13–14). See *Re Hope Natural Gas Co.*, P. U. R. 1921 E, 418, 433, 440.

spondent's properties, and for allegedly computing accrued depreciation solely on the basis of theoretical formulas (R. IV, 172, 190).

These objections ignore the fact specifically explained by the Commission and noted by the dissenting judge (R. IV, 205) that the determinations in question were based upon the testimony of "a properly qualified Staff engineer who * * * considered the functional and physical aspects of depreciation [and] as an aid in the determination of service lives * * * made a field inspection of the Company's physical properties" (R. I, 42; III, 158).[16] Moreover, the "formula" employed is the very economic-service-life principle which this Court has heretofore endorsed (R. I, 37). Cf. *Lindheimer* v. *Illinois Tel. Co.,* 292 U. S. 151, 167; *Federal Power Commission* v. *Natural Gas Pipeline Co.,* 315 U. S. 575, 592–593.

(4) Relying on *United Railways* v. *West,* 280 U. S. 234, 253–254, the court below condemned the Commission's action in computing the annual allowance for depreciation and depletion upon the basis of actual legitimate cost. This holding runs counter to prior decisions of this Court. *Cf. Federal Power Commission* v. *Natural Gas Pipeline Co.,* 315 U. S. 575, 592–593; *Lindheimer* v.

[16] The result reached by the Commission is hardly arbitrary or confiscatory inasmuch as the amount it found came to some $24,000,000 less than the reserve accrued on respondent's books for depreciation and depletion.

Illinois Tel. Co., 292 U. S. 151, 164, *et seq.;* [17] compare *United States* v. *Ludey,* 274 U. S. 295, 300–302.

The majority below sought to distinguish the *Pipeline* case in this connection on the ground that the Court there "dealt with * * * 'a wasting-asset business of limited life,' " rather than "an ordinary public utility which is required by law to continue its service to the public." (R. IV(195.) But this ignores the controlling principles recognized in the *Pipeline* case. The mere absence here of an accord as to the time of exhaustion of respondent's gas reserves, present in the *Pipeline* case, should not endow respondent with a constitutional right to have its depreciation and depletion allowance computed upon a basis which will compel rate payers to return more than the amount invested. Regardless of the nature of respondent's business,[18] it suffices in reason and principle that the annual allowance provided by the Commission is based upon equitable determinations of the life of respondent's existing investment and

[17] Although the court below refused so to acknowledge, the *Lindheimer* opinion recognizes cost as a permissible basis of computing the depreciation allowance, and thus modifies the doctrine of the earlier *West* case, *supra,* that the allowance must reflect post-investment price advances. This was plainly recognized by Mr. Justice Butler, one of the majority in the *West* case, concurring specially in the *Lindheimer* case. *Lindheimer* v. *Illinois Tel. Co.,* 292 U. S. 151, at 176.

[18] The utility involved in the *Lindheimer* case, for example, was hardly "a wasting-asset business of limited life."

will reimburse respondent to the amount of that investment.

To insist, as did the court below, upon a present value yardstick for computing the annual allowance, on the theory that plant replacements will eventually have to be made, obscures realities. Present value at any given date has no predictable relation to future replacement cost (see Brandeis, J., dissenting in *United Railways* v. *West,* 280 U. S., 234 at 278) and is certainly no more reliable a test for this purpose than the cost basis adopted by the Commission. See Stone, J., dissenting, *id.,* at 289–291. On the other hand, actual replacement costs are reflected by the Commission's method. If replacements are in fact made at a cost higher than the original cost of the property retired, the actual legitimate cost will be correspondingly increased, as will the annual return and the annual allowance for depreciation and depletion. To use the cost basis is "the rule sanctioned by the universal practice of business men and governmental departments" (see Brandeis, J., dissenting, *id.,* at 275; and see Brief for the Federal Power Commission and Illinois Commerce Commission in Nos. 265 and 268, October Term, 1941, pp. 72–74). The Commission's adherence to regular business usage cannot reasonably be condemned as arbitrary or confiscatory.

(5) The court below erred in setting aside the Commission's "Findings as to Lawfulness of Past

Rates." The gist of the decision below in this aspect seemingly is that while the Commission, in fixing future rates, may examine into the reasonableness of past rates, its determination that they were unreasonable does not affect their past lawfulness. This anomalous result, besides depriving Section 4 (a) of any meaning, is incompatible with the purpose of the Act and with prior decisions of this Court. For if the Commission is without authority to determine lawful past rates, either rate payers will be subjected to the risk of being left without a forum in which to challenge the validity of interstate wholesale gas rates prevailing between the date of the Act's passage and the effective date of a Commission rate-fixing order. (*Cf. Public Utilities Comm. of Ohio* v. *United Fuel Gas Co.*, No. 87, October Term, 1942, decided January 11, 1943; *Texas & Pac. Ry.* v. *Abilene Cotton Oil Co.*, 204 U. S. 426) or, if other forums might nevertheless be found to have jurisdiction over such issues, the way would be paved for inconsistent adjudications by a variety of tribunals—the very "confusion of functions" which the Act was designed to avoid (*United Fuel Gas* case, *supra,* slip sheet p. 8) and which this Court long ago condemned in the *Abilene* case, *supra* (204 U. S. at 440).[19]

[19] Moreover the rationale underlying the lower court's conclusion in this regard is untenable. There is no warrant for contorting the Commission's lack of authority to award

Conversely, the recognition of the Commission's jurisdiction to determine what are lawful interstate wholesale rates dating back to the passage of the Act will effectuate the legislative objective of a "harmonious, dual system of regulation of the natural gas industry—federal and state regulatory bodies operating side by side * * *. See *Public Utilities Comm. of Ohio* v. *United Fuel Gas Co., supra,* slip sheet p. 8.

To the extent that the substantive grounds for the lower court's rejection of the "Findings as to Lawfulness of Past Rates" are the same as those upon which is disapproved the "Order Reducing Rates," the considerations outlined in points 1 to 4, *supra,* are equally applicable. The independent substantive point raised in opposition to the findings, that the Commission erred in using actual experience to determine the reasonableness of past rates, is answered conclusively by *West Ohio Gas Co.* v. *Public Utilities Comm.,* 294 U. S. 79, 82.

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reparations into a proscription of its jurisdiction to inquire into the lawfulness of past rates. *Cf. Atlantic Coast Line R. Co.* v. *Florida*, 295 U. S. 301, 312; *United States* v. *Morgan*, 307 U. S. 183, 192. And the significance ascribed to the act of filing rates overlooks entirely the distinction drawn by this Court between "legal" and "lawful" rates. *Cf. Arizona Grocery Co.* v. *Atchison, Topeka & Santa Fe Ry. Co.*, 284 U. S. 370, 384.

CONCLUSION

For the foregoing reasons it is respectfully submitted that the petition for a writ of certiorari should be granted.

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APRIL 1943.

APPENDIX

The pertinent provisions of the Natural Gas Act of 1938, c. 556, 52 Stat. 821, *et seq.* (15 U. S. C. § 717) are as follows:

> SEC. 4. (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.
>
> (b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.
>
> (c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this Act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and

charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

* * * * *

SEC. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

* * * * *

SEC. 6. (a) The Commission may investigate and ascertain the actual legitimate

cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property.

* * * * *

SEC. 9. (a) The Commission may, after hearing, require natural-gas companies to carry proper and adequate depreciation and amortization accounts in accordance with such rules, regulations, and forms of account as the Commission may prescribe. The Commission may from time to time ascertain and determine, and by order fix, the proper and adequate rates of depreciation and amortization of the several classes of property of each natural-gas company used or useful in the production, transportation, or sale of natural gas. Each natural-gas company shall conform its depreciation and amortization accounts to the rates so ascertained, determined, and fixed. * * *

* * * * *

SEC. 13. Any State, municipality, or State commission complaining of anything done or omitted to be done by any natural-gas company in contravention of the provisions of this Act may apply to the Commission by petition, which shall briefly state the facts, whereupon a statement of the complaint thus made shall be forwarded by the Commission to such natural-gas company, which shall be called upon to satisfy the complaint or to answer the same in writing within a reasonable time to be specified by the Commission.

SEC. 14. (a) The Commission may investigate any facts, conditions, practices, or matters which it may find necessary or proper in order to determine whether any person has violated or is about to violate any provision of this Act, or any rule, regulation, or order thereunder, or to aid in the enforcement of the provisions of this Act or in prescribing rules or regulations thereunder, or in obtaining information to serve as a basis for recommending further legislation to the Congress. The Commission may permit any person to file with it a statement in writing, under oath or otherwise, as it shall determine, as to any or all facts and circumstances concerning a matter which may be the subject of investigation. The Commission, in its discretion, may publish in the manner authorized by section 312 of the Federal Power Act, and make available to State commissions and municipalities, information concerning any such matter.

* * * * *

SEC. 16. The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this Act. Among other things, such rules and regulations may define accounting, technical, and trade terms used in this Act; and may prescribe the form or forms of all statements, declarations, applications, and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commission shall be effective thirty days after publication in the manner

which the Commission shall prescribe. Orders of the Commission shall be effective on the date and in the manner which the Commission shall prescribe. For the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours.

* * * * *

SEC. 17. (c) The Commission shall make available to the several State commissions such information and reports as may be of assistance in State regulation of natural-gas companies. Whenever the Commission can do so without prejudice to the efficient and proper conduct of its affairs, it may, upon request from a State commission, make available to such State commission as witnesses any of its trained rate, valuation, or other experts, subject to reimbursement of the compensation and traveling expenses of such witnesses. All sums collected hereunder shall be credited to the appropriation from which the amounts were expended in carrying out the provisions of this subsection.

* * * * *

SEC. 19. (b) Any party to a proceeding under this Act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in

the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be served upon any member of the Commission and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall

be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in while or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 346 and 347).

U. S. GOVERNMENT PRINTING OFFICE: 1943