Land & Water Law Review

Volume 10 | Issue 2 Article 2

1975

Public Utility Regulation of the Oil Industry: Solution or Illusion

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LAND AND WATER
LAW REVIEW

VOLUME X 1975 NUMBER 2

Recently, various proposals have been made to place the oil industry within the ambit of regulation as a public utility. The authors, Mr. Verleger, Mr. McClintock, and Mr. Benshoof, examine these proposals from practical and legal points of view. Emphasis is placed on the constitutional implications of public utility regulation of the oil industry with respect to the commerce clause and the doctrine of federal preemption.

PUBLIC UTILITY REGULATION OF THE OIL INDUSTRY: SOLUTION OR ILLUSION?

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INTRODUCTION

FROM the end of World War II to the fall of 1973, the real price of petroleum products generally declined. If one subtracted the taxes, and made even a partial allowance for inflation, gasoline was available to the consumer for less money in 1972 than in 1946. This was a history which was unique among commodities. Over the same span of time, the price of the typical automobile doubled. Whether one selected

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beef, lettuce, refrigerators, tablecloths, or whatever, as one's standard, almost everything else went up much more.

This was a condition which could not last forever. It was brought about largely by the success of oil exploration in finding large deposits, first within the United States: in Texas, California, Louisiana, Oklahoma, and in later years in the remote parts of the world, such as Saudi Arabia and Nigeria. As demands for energy have exponentially increased, as sources have come to be under direct control of nations other than the United States, forecasts of ultimate shortage have abounded. Those forecasts, however, received little attention until the fall of 1973, when the Arabian nations imposed an embargo on shipments to the United States, and shortages developed with dramatic promptness. At roughly the same time, exporting countries raised prices of their products to levels many times those prevailing previously. Under these combined influences, prices for petroleum products rose sharply in the United States and throughout the world. Even with those increases, the increase in the price of gasoline between 1946 and the present date is less than the increase in housing cost, the increase in beef prices or almost anything else. It has been more sudden, that is all.

Those sudden increases in price have stimulated, quite understandably, a great deal of public complaint. That complaint, in turn, has resulted in a variety of legislative proposals. One such proposal is to make the oil industry a "public utility". While, inevitably, there are variations from bill to bill and proposal to proposal, this suggested legislation has had some basic characteristics.

There is, first, a general proposal that the oil industry be treated as a "public utility" rather than enacting a specific body of legislation adapted to the particular characteristics of the industry. In order to analyze the effect of that sort of legislation, it becomes necessary to review the way in which public utilities are regulated, and to see how such regulation would apply to the oil industry.

The second common proposal is that some provision be adopted which would exclude various categories of the industry from "public utility" regulation. For example, retailers, unless controlled by an integrated oil company, are commonly excluded from such regulation by some proposals.[1]

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1. The following is an initiative proposed by the President Pro Tem of the California Senate, James R. Mills:

Section 1. Section 216.5 is added to the Public Utilities Code, to read:

216.5. (a) Petroleum is a depletable resource that is essential to the economy of the state and the health, safety and well being of its citizens. It is, therefore, necessary to provide for the regulation of the exploration, production, processing, transportation, and sale of crude or refined petroleum and petroleum products in such a manner to assure, insofar as possible, an adequate supply for all uses and at just and reasonable prices.

(b) Effective July 1, 1975, every corporation or person engaged in the exploration, production, processing, transportation, or sale of crude or refined petroleum or petroleum products in this state, and every corporation or person owning, operating, managing, or controlling facilities in this state for such exploration, production, processing, transportation, or sale, is a public utility subject to regulation by the Public Utilities Commission, except as provided in subdivision (c) hereof.

(c) No corporation or person engaged solely as a service station, wholesale distributor of refined petroleum or petroleum products, transporter of refined petroleum or petroleum products, distributor or transporter of asphalt or asphaltic products, petroleum driller, petroleum geologist, engineer or consultant, or engaged only in the sale to the public at retail or refined petroleum or petroleum products shall be a public utility so long as such corporation or person is not owned, managed, or controlled by a corporation or person subject to regulation under subdivision (b) hereof. The commission may, by regulation or order, exempt from regulation such other corporations or persons engaged in the petroleum business to such a limited extent that their regulation would not be in the public interest, so long as such corporation or person is not owned, managed, or controlled by a corporation or person subject to regulation under subdivision (b) hereof.

(d) No corporation or person owning, operating, managing or controlling the exploration, production, processing, or transportation of crude or refined petroleum or petroleum products, or corporation or person owned, managed, or controlled by such corporation or person may, in any calendar year, sell to the public at retail through service stations in this state (other than independent service stations, including those operating under leases or franchises) more than the greater of the following amounts of gasoline or other motor vehicle fuel:

Gasoline: (1) The total gallonage of gasoline sold by such corporation or person at retail through service stations in this state (other than independent service stations, including those operating under leases or franchises) during the year ending March 15, 1974; or (2) Ten percent of the total gallonage of gasoline sold by such corporation or person at retail, and sold by such corporation or person to others for sale at retail, in this state through all service stations during such year.

Other Motor Vehicle Fuel: (1) The total gallonage of other motor vehicle fuel sold by such corporation or person at retail through service stations in this state (other than independent service stations, including those operating under leases or franchises) during the year ending March 15, 1974; or (2) Ten percent of the total gallonage of other motor vehicle fuel sold by such corporation or person at retail, and sold by such corporation or person

The benefits claimed for such legislation are that it would:

Prevent oil corporations from receiving windfall profits,

Protect against skyrocketing gasoline prices,

Provide government the information it needs to predict shortages and take steps to prevent them,

Encourage development of new petroleum resources,

Spur a continuous and reliable supply of gasoline to service stations,

Allow dealers a means of filing grievances against suppliers,

Prevent massive service station closures,

Stabilize unemployment due to the energy crisis.[2]

One may reasonably assume that the legislation is rooted in a suspicion of oil companies and rested on the belief that under "public utility regulation" prices will be lower and service better. This article will explore the legal and practical problems of this idea.

CHARACTERISTICS OF PUBLIC UTILITY REGULATION

Because these proposals are general in nature, one has to look at the characteristics of public utility regulation, as applied to other industries, to see what it would mean in the oil industry. The following are the basic ideas typical of public utility regulation:

to others for sale at retail, in this state through all service stations during such year.

(e) If any provision of this section or the application thereof to any person or circumstances is held invalid, such invalidity shall not affect other provisions or applications of this section which can be given effect without the invalid provision or application, and to this end the provisions of this section are serverable.

(f) The legislature may amend this section by two-thirds vote . . . both houses concurring.

Letter from James R. Mills to The Honorable Evelle J. Younger, Feb. 14, 1974.

2. Press Release by Senator Mills issued Feb. 7, 1974.

Limitation of Competition

Public utility-type regulation is based on a recognition that particular businesses by their nature will not tolerate competition. One cannot practically have two gas companies, two electrical companies, two telephone companies, or two water companies serving the same plot of ground. Duplication of pipelines, power lines, and gas pipes is both uneconomical and inconvenient. In the case of trucking, the fear seems to have been that "cutthroat" practices would erode the economic basis for the industry.

Public utility regulation involves the deliberate acceptance of a certain amount of monopoly and the regulation of that monopoly. It is an essential principle of such a regulation that no more companies will be allowed in a particular area of service than can be profitably operated. The vehicle for controlling the number of competitors is most commonly known as the "certificate of convenience and necessity". The threat of withdrawal of such a certificate is the primary tool available to the commission to deal with the utility which is reluctant to give adequate service. A request for such a certificate is the tool by which a new company enters a particular regulated field.

Regulation of Rates and Practices

With utilities, the typical public utilities commission is directed to determine and fix ". . . by order, the just, reasonable, or sufficient rates, classifications, rules, practices, or contracts to be thereafter observed and enforced."[3] The authority granted extends not only over rates, *i.e.,* prices, but "practices" and "contracts". It is the general practice of public utilities commissions in fixing rates: (a) to establish a rate base—a valuation of the property owned by the public utility which is useful and used in its public utility business; (b) to ascertain the necessary operating expenses of the utility; and (c) to fix a rate of return which the utility will be permitted to earn on a rate base. Establishment of the rate base is generally the most important part of the operation,

3. *E.g.,* CAL. PUB. UTIL. CODE § 728 (West Supp. 1975).

and the method of valuation is critical to the establishment of the rate base.[4]

Rate determination has its effects in other areas. In general, a prudent public utility obtains the approval of the commission before entering into any substantial contract. The practical reason is that, without such approval, there is a danger that the costs involved may not be included as costs for rate fixing purposes. And, typically, before it acquires, disposes of, or encumbers property to be used in its business, it must have permission.[5]

How would these requirements be applied in the oil business, and what are the legal problems involved? In general, the certificate requirement means that any company proposing to do business as a railroad, gas company, electric corporation, water company, telephone company, or the like has to apply for a certificate from the public utilities commission before it may do business. Similarly, it must also apply if it proposes to extend the area in which it will do business. The making of such an application generally requires a showing that the area in question is not adequately served by existing certified utilities.[6]

DIFFICULTIES IN REGULATING THE OIL INDUSTRY

It is not generally realized by proponents of public utility-type regulation for the oil industry that a principal purpose of public utility regulation is to *protect* existing industry from competition. Such protection is a basic part of the statutory and case law that becomes applicable under such legislation. For example, it has been stated:

> The commission ordinarily should refuse to premit a utility to invade territory occupied by another utility furnishing adequate service at reasonable rates; and an existing utility ordinarily should be afforded opportunity to furnish necessary additional

4. *See* Comment, *Rate Base For Public Utilities*, 8 ARK. L. REV. 105 (1935).
5. CAL. PUB. UTIL. CODE § 851 (West Supp. 1975).
6. *See* Martinez Bus Line, Inc. and Julius Dorman, 50 Cal. P.U.C. 220 (1950).

or extended service before a certificate is issued to a competitor.[7]

This concept, which is basic to public utilities law, is so completely foreign to the situation in which the oil industry has operated that it is not surprising that its application will give rise to extraordinary problems. One may start with the production of oil.

Regulation of Production

If a certificate of convenience and necessity is required before one is allowed to drill in an oil field, the simple task of processing such certificates would be a considerable task. There are hundreds of producing companies and individuals in each producing state. Furthermore, if such certificates were required, a radical revision in conventional ideas concerning oil and gas rights would be required. In some states, the owner of land containing a part of an oil field does not actually own the oil. He has a right to extract oil from his land, in competition with his neighbor, and the oil belongs to whoever brings it to the surface first.[8] In other states, different conceptual schemes prevail, but running through all is the idea that, unless and until some form of unitization is imposed, everyone develops in competition with others.[9]

Fitting these ideas into a system of public utility regulation, which typically involves a total or partial monopoly serving an entire area, presents some problems. It might be argued that such legislation does not contemplate utility-type regulation of the drilling process. However, the typical bills thus far reviewed contain no such general exception. The exceptions, on the contrary, typically exclude particular types of operation, such as exploration or production, only when carried on by non-integrated companies. That suggests that the integrated company would require utilities commission consent, although whether this would be for each well, each area, or each field, it is hard to forsee.

7. 73 C.J.S. *Public Utilities* § 42, at 1099 (1951).
8. Callahan v. Martin, 3 Cal. 2d 110, 32 P.2d 788, 39 Cal. Rptr. 471 (1935).
9. This is the "Rule of Capture" universally applied. 1 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 204.4, at 50 (1972).

It is also hard to see how typical utility principles of administration are to be applied to a mixture of regulated and unregulated companies. The matter is doubly difficult because, if a commission system of controlling prices is to be attempted, control over costs is essential, and crude costs, including royalties, are significant. But control over this cost through the vehicle of a certificate of convenience and necessity and regulation of royalties is irreconcilable with the idea of leaving the "independents" unregulated and probably irreconcilable with the basic concepts of applicable property law, *i.e.,* that each landowner has a right to develop in competition with adjoining owners and thus should not have to deal with a quasi-monopoly driller assigned to him by the commission.

Problems of omission will also arise with respect to offshore operations. A state cannot regulate production, transportation, or other operations in the Outer Continental Shelf where jurisdiction is exclusively federal.[10] The Outer Continental Shelf, however, is likely to be the principal source of new United States production. Thus, as applied to production, utility-type regulation omits the most significant probable area of new production, and seems to run counter to existing property rights.

Regulation of Processing and Refining

Application of public utility principles is at least as difficult at the next stage—processing and refining. Every refinery produces in some degree different products, such as heavy oils for steamship bunkers and for power plant use; diesel and stove oil for trucking and for heating; jet fuel for airplanes both within and without the state; insecticides and fertilizers for agriculture; asphalt for highways, and in the manufacture of roofing and asphalt tiles for floors; and raw materials for plastic manufacture. On each occasion, when someone who did not make such a product wished

10. 43 U.S.C. § 1333(a)(1) (1970).

to embark in the business; on each occasion when some company wished to stop making such a product, presumably permission would have to be obtained from the public utilities commission. For again, it is fundamental that a public utility, in return for a protected market, has an obligation to continue to serve.

Regulation of Marketing

Regulatory problems would also exist at the marketing stage. If a certificate were to be required for every gas station, the administrative burden would undoubtedly be enormous. It would involve the commission in countless neighborhood wrangles presently decided by local zoning authorities. The authority to decide whether or not a gas station (or a refinery) should be built in a given neighborhood, under generalized public utility regulation, would be transferred from the local city council to the state public utilities commission. Moreover, the notion of giving each station operator a service area—a sort of protected empire—like the gas company or the Edison Company, does not really seem to fit. But that is what it means, to make each a public utility, without being more specific. How that can be done consistently with exemptions for "independent" dealers is a puzzle.

PUBLIC UTILITY REGULATION AND THE COMMERCE CLAUSE

It needs to be emphasized that there is no experience in the United States of an attempt to treat as a utility a business with this sort of complexity. The telephone company, the gas company, the water company, and the trucking and railroad industries are essentially one-product operations. This would be something new.

Let us assume, nonetheless, that the idea is tried and that a certificate of convenience and necessity is required for each oil well, each collection network, each refinery, and each gas station, and that similarly, state commissions attempt to regulate the price of crude oil and each product. The central legal question which arises is that of authority. Specifically, the problem is whether or not the state has the power to require a certificate of convenience and necessity for each stage of the petroleum business or otherwise so to regulate?

In answering this question, one needs to have the flow of petroleum in mind. Production, refining, and sale are not normally confined to a single state. For example, probably fifty percent of the crude used in California comes from out of state. That crude is blended at a refinery with crude from California. The products of that refinery may move out of California into Nevada, New Mexico, Hawaii, or elsewhere. Products will be used by airplanes and trucks in interstate commerce. The equipment of the refinery does not distinguish between products which will be consumed in California and products which will be consumed elsewhere: the gasoline which is used in Los Angeles or which is transported to Phoenix comes out of the same stream in the refinery. Streams of interstate and intrastate commerce are totally mixed.

The whole process is continuous. When the Alaska pipeline to Valdez is completed, tankers will leave daily to bring products down to southern and northern California, to discharge those products, and to return. Likewise, products will flow in a steady stream out of the refinery, some to California users and some elsewhere. This flow is undoubtedly interstate commerce. For example, in *Munson v. Richfield Oil Corp.*, the court held that Richfield's sale of petroleum products to lessees of its service stations for resale to interstate travelers was not local but rather an activity of interstate commerce. The court stated: "A nationwide business is not deprived of its interstate character merely because it is built upon local sales contracts."[12]

In *Deep South Oil Co. v. Federal Power Commission*,[13] a small gas producer, operating solely within the state of Texas, sold all of its products to the Texas Gas Corporation, which in turn made retail sales both within and outside the state. Deep South maintained that its sales were local in nature and that it was not engaged in interstate commerce

11. 91 F. Supp. 171 (S.D. Cal. 1950).
12. *Id.* at 172.
13. 247 F.2d 882 (5th Cir. 1957).

so as to subject it to the Federal Power Commission's jurisdiction. The court disagreed noting that the intrastate sales made at the wellhead were "immaterial," and did not "affect the essential interstate nature of the business."[14]

Given the interstate (indeed, even international) character of the oil industry, regulation by the state becomes affected with constraints arising from the commerce clause of the United States Constitution. The operation of this provision has been described by the Supreme Court as follows:

> A State is also precluded from taking any action which may fairly be deemed to have the effect of impeding the free flow of trade between States. It is immaterial that local commerce is subjected to a similar encumbrance. . . .
>
> These principles of limitation on State power apply to all State policy no matter what State interest gives rise to its legislation.[15]

A state, even in the absence of action in the field by the federal government, is without authority to regulate businesses engaged in interstate commerce when such regulation imposes substantial burdens upon and leads to a disruption of commerce. This is no less true where a state purports only to regulate *intrastate* activities for it is the *interstate effect* which is controlling.[16] In addition, the proscription against state regulation is especially strong where such action touches matters where uniformity is essential. Indeed, the criteria of uniformity is often held to mark the limits beyond which state power may not reach.[17] At the purchase end, the petroleum business would appear uniquely to fit this criteria. There is no way that a company can purchase crude oil in Alaska at one price for California and at a different price for Washington. Furthermore, there is no way that the state of Washington can regulate the price of products in

14. *Id.* at 887. *See also* Eureka Pipeline Co. v. Hallahan, 252 U.S. 265, 271-72 (1921); Lone Star Producing Co. v. Gulf Oil Corp., 208 F. Supp. 85, 89 (E.D. Tex. 1962); Mid-America Pipeline Co. v. Iowa State Commerce Comm'n, 125 N.W.2d 801 (Iowa 1964).
15. Freeman v. Hewitt, 329 U.S. 249, 252 (1946).
16. Lockheed Air Terminal, Inc. v. City of Burbank, 318 F. Supp. 914 (C.D. Cal. 1970), *aff'd*, 457 F.2d 667 (9th Cir. 1972), *aff'd*, 405 U.S. 1034 (1973).
17. Morgan v. Virginia, 328 U.S. 373, 377 (1946).

Seattle while leaving uncontrolled the price paid in Alaska. The decision as to whether or not a particular state regulation unduly burdens interstate commerce rests upon the facts of each individual case. Several decisions suggest that wellhead to gas station regulation of petroleum products would be an impermissible burden on interstate commerce.

In *Federal Power Commission v. Corporation Commission of Oklahoma,*[18] a state commission, finding the price of gas to be wastefully low, purported to set a minimum price at which gas could be sold at the wellhead, the minimum price being significantly higher than current contract rates. The court found that such action offended the commerce clause on several grounds. First, by purporting to fix the price of a commodity which moved in interstate commerce, the state had placed unconstitutional conditions on that movement.[19] Second, the court found that such regulation further burdened interstate commerce in that it jeopardized the interstate supply of natural gas.

> Oklahoma is the third largest gas producing state in the nation. It supplies approximately nine percent of the total domestic gas sold in interstate commerce.
>
> The Record confirms the dependency of the interstate market on natural gas produced in Oklahoma.[20]

Thus, the court found that Oklahoma's price scheme would have the effect of "withdrawing a large volume of gas from an established interstate current" and thus imposed an unconstitutional burden on commerce.[21] Finally, the court noted that Oklahoma's regulation of the price of gas at the wellhead would have the further effect of "indirectly fixing prices to interstate consumers" in violation of the commerce clause.[22]

That it is beyond a state's powers to regulate the price paid by interstate consumers is well settled. In *Public Util-*

18. 362 F. Supp. 522 (W.D. Okla. 1973).
19. *Id.* at 533.
20. *Id.*
21. *Id.* at 535.
22. *Id.* at 533.

ity Commission v. Attleboro Steam & Electric Co.,[23] the state of Rhode Island purported to apply its rate structure to sales of electricity made by a local utility to a Massachusetts utility. The Supreme Court held that it could not. In *Baldwin v. G.A.F. Seeling, Inc.,*[24] the Supreme Court invalidated a New York statute that prohibited a dealer from bringing in milk from out of state that had been purchased for less than the minimum price fixed by statute.

Nor may the state accomplish the same result by indirect methods. In *Polar Ice Cream & Creamery Co. v. Andrews,*[25] the state of Florida attempted to regulate milk prices by requiring local dealers to purchase milk from intrastate sources before they looked beyond Florida's borders for the sources of their milk. The Court held that the exclusion of foreign milk from the local milk market was an undue burden on interstate commerce, which could not be justified as an economic measure or as a health measure designed to insure the existence of a wholesome supply of milk. The Court said, "Florida has no power 'to prohibit the introduction within her territory of milk of wholesome quality acquired [in another state] whether at high prices or at low ones'."[26]

A recent example of state regulation unconstitutionally burdening interstate commerce can be seen in *Baltimore Shippers & Receivers v. Public Utilities Commission of California.*[27] In that case the California Public Utilities Commission attempted to establish minimal rates to be charged by motor carriers within certain commercial zones in the state. Plaintiff, an interstate shippers association, claimed that the state could not constitutionally require it to pay such rates on the basis, *inter alia,* that such regulation was void under the commerce clause. The court, noting the increased costs such rates would impose upon plaintiff, held that "[A]ccordingly, there can be no doubt that the rate regulation by the State of California would result in a substantial burden on commerce."[28]

23. 273 U.S. 83 (1921).
24. 294 U.S. 511 (1935).
25. 375 U.S. 361 (1964).
26. *Id.* at 377.
27. 268 F. Supp. 836 (N.D. Calif. 1967), *aff'd,* 389 U.S. 583 (1967).
28. *Id.* at 845.

Such a burden was sufficient in itself to void the regulation, but the court continued on to note testimony in the record "that the increase in costs would result in a drying up of some of the traffic and an impairment of the ability of some out-of-state producers to compete in the California market."[29] This, held the court, was unconstitutional. "The commerce clause clearly protects interstate commerce from actions by any state which result in an unreasonable disruption of the free flow of commerce."[30]

Under these and other authorities, state regulations which attempt to directly influence prices which an interstate purchaser must pay or the costs and expenses he must bear are invalid. The commerce clause, as noted in the *Baltimore Shippers* case, places a premium on the free flow of commerce across state lines. Local regulations which disrupt this flow are difficult to justify, especially where it is apparent that uniformity is necessary .

Today, there can be little doubt that a strong policy exists at the federal level of our government which recognizes the dependence of certain areas of this nation upon the oil producing states and the need to assure adequate distribution with respect to crude oil and its refined products from one area to another.[31] Comprehensive regulation of the oil industry by each individual state, where different prices are fixed for each state, where financing is regulated differently by each state, and where different standards for physical equipment would be required by each state would tend to halt the flow of interstate commerce. Such regulation closely resembles the situation in *Southern Pacific Co. v. Arizona.*[32] There the Court held Arizona's regulation of train length to be unconstitutional as a serious impediment to the free flow of commerce in the presence of a strong national interest "in an adequate, economical and efficient railway transportation service . . ."[33] Similarly, in *Transcontinental Gas Pipe Line*

29. *Id.* at 846.
30. *Id.*
31. *See* 39 Fed. Reg. 1931-49 (1974).
32. 325 U.S. 761 (1945).
33. *Id.* at 783-84.

Corp. v. Hankensack Meadowlands Development Commission,[34] the Third Circuit struck down a state administrative agency's decision denying plaintiff permission to build a natural gas plant on the basis that such a decision amounted to an unwarranted burden on interstate commerce in view of "the needs of the New York-New Jersey metropolitan area for the adequate and efficient supply and delivery of natural gas."[35]

If, as is indicated here, the local commission cannot regulate the price at which crude is acquired outside the state; cannot regulate the price of local crude purchased if used for export; and equally cannot control the movement of a refinery product out of state, the power to regulate at all falls into serious doubt. Since the refinery's output is shared between foreign and domestic commerce, and foreign commerce cannot be restricted, the refinery retains at all times the power to ship the entire output outside the state. That leaves little left of an obligation to serve the local market. Moreover, since the cost of raw material is in any event largely outside local control, little remains of the power to control prices. This is a difficulty with utility-type control that would obtain at any time. At the present time, there are other difficulties.

FEDERAL PREEMPTION OF OIL INDUSTRY REGULATION

Since enactment of the Economic Stabilization Act of 1970, various aspects of this nation's economy, including the oil industry, have been subjected to numerous phases of price control. This control expired, in large part, on April 30, 1974. However, in November of 1973, Congress passed the Emergency Petroleum Allocation Act of 1973[36] which resulted in subjecting the oil industry to continuing controls in two areas—price and allocation of supplies. In enacting this legislation, Congress found that a "national energy crisis" existed, the effective and efficient resolution of which required "prompt action" by the executive branch of the federal gov-

34. 464 F.2d 1358 (3d Cir. 1972), *cert. denied,* 409 U.S. 1118 (1972).
35. *Id.* at 1363.
36. 15 U.S.C. § 751 (Supp. III, 1973).

ernment.[37] Accordingly, the President was instructed to "promulgate a regulation providing for the mandatory allocation of crude oil, residual fuel oil, and each refined petroleum product . . . at prices specified in . . . such regulation."[38] With respect to such regulations, 15 U.S.C. § 755(b) (Supp. III, 1973) provides:

> The regulation under section 753 of this title and any order issued thereunder shall preempt any provision of any program for the allocation of crude oil, residual fuel oil, or any refined petroleum product established by any State or local government if such provision is in conflict with such regulation or any such order.[39]

Acting under the authority of this legislation, the Federal Energy Office promulgated a series of regulations on January 15, 1974, designed to control the price and allocation of crude oil and its products.[40] Coverage of these regulations is comprehensive. With limited exceptions, they are applicable to all crude oil, residual fuel oil, and refined petroleum products produced in, refined in, or imported into the United States.

The control imposed is thorough. Among the general provisions, each supplier's "allocable supply" is defined[41] and maintenance of excessive inventories is proscribed.[42] Wholesalers are declared to be entitled to receive amounts of petroleum proportional to volumes received in certain base periods, and suppliers are obligated to provide such wholesalers with amounts equal to a prescribed formula.[43] Should these levels need readjustment to deal with fluctuation in the marketplace, seasonal demand, or other similar factors, that is also provided for.[44] To meet "hardships" experienced by wholesale purchasers and end-users, "set-aside" programs are established within each state to be administered as temporary relief by state officials.[45]

37. 15 U.S.C. § 751(a)(3) (Supp. III, 1973).
38. 15 U.S.C. § 753(a) (Supp. III, 1973).
39. 15 U.S.C. § 755(b) (Supp. III, 1973).
40. *See* 39 Fed. Reg. 1931-49 (1974).
41. 39 Fed. Reg. 1933 (1974).
42. 39 Fed. Reg. 1936 (1974).
43. 39 Fed. Reg. 1933 (1974).
44. 39 Fed. Rep. 1934 (1974).
45. 39 Fed. Reg. 1935 (1974).

After establishing the above general provisions, detailed regulations are prescribed for the control of refinery yield and the allocation of crude oil, propane, butane, motor gasoline, middle distillates, aviation fuels, residual fuel oil, petrochemical feedstocks, and other products.[46] Reporting and accounting practices are mandated with respect to all these programs.

In addition to controls regarding the distribution of crude oil and refined products, it was determined by Congress that a successful allocation program necessitated price controls.[47] Thus, as an integral part of the federal program, regulations were promulgated which prescribe in great detail what a producer, refiner, reseller and retailer might charge for his product.[48] Rents on leased real property used in the retailing of gasoline are also controlled.[49]

Altogether, the program of the Federal Energy Office effects a system of regulation over the oil industry that would take much more than the above brief summary to fully describe. However, from the general provisions outlined above, it is at least apparent that the federal scheme of regulation is sweeping. In its essentials, the program controls the manner in which crude oil and its refined products are to be distributed among the various segments of the oil industry, the amounts of such distribution, and the prices that might be charged at almost every level.

Given the nature of the current federal system of controls, there would not seem to be any conceivable manner in which a state utilities commission could constitutionally purport to regulate the prices charged by the oil industry in its production, refining, and retailing operations. Two governmental bodies quite obviously cannot fix separate prices for the same commodity. In *Federal Power Commission v. Corporation Commission of Oklahoma*,[50] the state of Oklahoma purported to fix minimum prices for natural gas at the wellhead. This

46. 39 Fed. Reg. 1939-49 (1974).
47. *See* H.R. REP. No. 531, 93d Cong., 1st Sess. 12 (1973).
48. 39 Fed. Reg. 1940-43 (1974).
49. 39 Fed. Reg. 1944 (1974).
50. 362 F. Supp. 522 (W.D. Okla. 1973).

action was taken despite the fact that the Federal Power Commission had its own rate regulation in effect covering the same producers. Noting the fact that differing prices set by federal and state authorities would place producers in a position of being unable to comply with both regulatory schemes, the court held: "Where such a situation obtains, state regulation is preempted."[51]

In *Case v. Bowles*,[52] a question was presented as to whether or not the sale of timber on certain state-owned lands in Washington was controlled by the Federal Emergency Price Control Act, and regulations promulgated thereunder, or by provisions of state law. Specifically, the Washington Constitution provided that such sales were to be made "at a public auction to the highest bidder."[53] An auction was accordingly held and a bid received which exceeded the maximum price allowable under the federal regulatory program. Suit was brought by the Federal Price Administration to enjoin consummation of the sale. In granting this relief, the court held that, inasmuch as Congress had subjected the sales of all commodities to federal authority, the state of Washington was without power to enforce a conflicting law.[54] In the area of rent controls, it has also been often held that federal regulation of this subject preempts any state legislation on the matter.[55]

With respect to the oil industry, the federal government provides for the price at which crude oil and refined products might be sold. Because of the supremacy of this law, the states are simply without any constitutional authority to attempt to set separate prices on the same commodity, whether under the guise of public utility regulation or otherwise.[56]

51. *Id.* at 540.
52. 327 U.S. 92 (1946).
53. WASH. CONST. art. 16, § 2.
54. Case v. Bowles, 327 U.S. 92, 102-03 (1946).
55. *See e.g.*, United States v. Beatty, 88 F. Supp. 646 (S.D. Iowa 1950), *modified and aff'd*, 191 F.2d 317 (8th Cir. 1951); Lovett v. Bell, 30 Cal. 2d 8, 180 P.2d 335 (1947); Hunt v. Gilmore, 98 N.Y.S.2d 322 (1950); Farmer's Gin Co. v. Hayes, 54 F. Supp. 43 (W.D. Okla. 1943), where federal price controls apply to cotton ginning industry, a state cannot fix rates for such services.
56. *See* cases cited note 55 *supra*.

Indirect regulation similarly directed would meet the same fate. It is established that state laws may not be administered in such a way as to obstruct or defeat clearly expressed federal policy.[57] A pertinent decision in this regard is *Public Utilities Commission of California v. United States*.[58] There, in an apparent attempt to deal with the rate-cutting practices of California carries in competing for the heavy volume of military traffic in the state, the California Legislature amended Section 530 of the Public Utilities Code to extend rate regulation to carriers dealing with the federal government. However, the Supreme Court found such attempted regulation to be in conflict with federal policy expressed in statutes and regulations favoring rates individually negotiated between the Government and a carrier. Noting that such a conflict "seems to us to be as clear as any that the Supremacy Clause . . . was designed to resolve", the Court held the attempted regulation void.[59]

It is difficult to conceive of any action a state public utilities commission could take with respect to regulation of the oil industry that would not have an impact upon the federal policy of price and supply control. To the extent that, on such matters as transfer of property and issuance of securities, such regulation would increase costs, discourage investments, limit expansion, or otherwise hamper traditional operations of the industry, such action would certainly tend to have an adverse effect upon amounts of crude oil and refined products available and the cost of the same, both of which the federal government seeks to control. Such frustration of a national policy by application of state law defeats the supremacy of federal law and is contrary to the Constitution.

The material above was written in light of the present situation, *i.e.*, one where petroleum allocations and petroleum prices are comprehensively regulated by federal authority. If petroleum products become more commonly avail-

57. Barton v. United States, 75 F. Supp. 703 (S.D. Cal. 1948).
58. *Id.* at 544.
59. Brotherhood of Railroad Trainmen v. Jacksonville Terminal Co., 394 U.S. 369 (1969); Cloverleaf Butter Co. v. Patterson, 315 U.S. 148 (1942).

able, it is to be anticipated that,in the not very distant future, the federal system will be less comprehensive. This does not mean, however, that the states will then be constitutionally free to go forward with one or another of these hybrid public utility proposals. In fact, there are powerful reasons for suggesting that the states are not free to so legislate.

In the short term, a decision by the federal authorities no longer to regulate petroleum prices would have as its predicate a determination that such regulation is no longer necessary.[60] By the terms of the Act, allocation remains in effect, except that the President may terminate it on a finding that it is unnecessary. The provisions as to termination state:

> If at any time after November 27, 1973, the President finds that application of the regulation under subsection (a) of this section to crude oil, residual fuel oil, or a refined petroleum product is not necessary to carry out this chapter, that there is no shortage of such oil or product, and that exempting such oil or product from such regulation will not have an adverse impact on the supply of any other oil or refined petroleum products subject to this chapter, he may prescribe an amendment to the regulation under subsection (a) of this section exempting such oil or product from such regulation for a period of not more than ninety days.[61]

Termination, then is allowed only if allocation is not "necessary to carry out this Act." The purposes of this act are as follows :

> Sec. 751. (a) The Congress hereby determines that—
>
> (1) shortages of crude oil, residual fuel oil, and refined petroleum products caused by inadequate domestic production, environmental constraints, and the unavailability of imports sufficient to satisfy domestic demand, now exist or are imminent;
>
> (2) such shortages have created or will create severe economic dislocations and hardships, includ-

60. 15 U.S.C. § 753(g)(2) (Supp. III, 1973).
61. 15 U.S.C. § 753(g)(2) (Supp. III, 1973).

ing loss of jobs, closing of factories and businesses, reduction of crop plantings and harvesting, and curtailment of vital public services, including the transportation of food and other essential goods; and

(3) such hardships and dislocation jeopardize the normal flow of commerce and constitute a national energy crisis which is a threat to the public health, safety, and welfare and can be averted or minimized most efficiently and effectively through prompt action by the Executive branch of Government.

(b) The purpose of this chapter is to grant to the President of the United States and direct him to exercise specific temporary authority to deal with shortages of crude oil, residual fuel oil, and refined petroleum products or dislocations in their national distribution system. The authority granted under this chapter shall be exercised for the purpose of minimizing the adverse impacts of such shortages or dislocations on the American people and the domestic economy.[62]

Moreover, termination is effective only for a ninety-day period. It must then be re-enacted. The comprehensive nature of the purposes, plus the short period of termination (really suspension) suggest that federal control is intended to be exclusive until August 28, 1975. It is hard to imagine setting up a state system to operate only during a ninety-day period of suspension. So, effectively, pre-emption is complete until August, 1975 (or until such later date as the Act may be extended). What then?

EQUAL PROTECTION CONSIDERATIONS OF REGULATION

There remains the classic doctrine that, to be regulated as a utility, an industry must be to some extent "affected with a public use." Treatment as a "public utility" comprehends regulation more drastic than otherwise exists. Whether a person may or may not go into the business of being a public utility is regulated; whether the public util-

62. 15 U.S.C. § 751 (Supp. III, 1973).

ity may issue the stock which is the essential precedent to acquiring capital; what property the public utility may own, by or sell; at what price its products are sold, and what services it renders are all subject to regulatory determination. The authority of the commission is nearly as great as in the case of complete government ownership. The difference is that in a private utility, risks are borne by the stockholders.

Historically, the courts have consistently recognized that this form of drastic regulation may not be imposed upon everyone. Running through the cases from 1900 to the present, there has been the concept that, in order to be so regulated it is necessary that the utility in some sense "dedicate" its business to a "public use," or that the business be "impressed with a public use."[63]

The vitality of this concept has been questioned[64] but it continues to be applied.[65] To attempt to analyze the cases on this topic at length would be beyond the scope of this article. For our purposes, it is enough to note that a legislative scheme which made some oil producers public utilities, but not others, fixed the prices of some refiners, but not others, and required certificates of convenience and necessity

63. *See* Tyson & Brother v. Banton, 273 U.S. 418 (1927). On the question of whether the ice industry in Oklahoma was charged with a "public use", the Court held otherwise. Newh State Ice Co. v. Liebmann, 285 U.S. 262, 277 (1932). In Williams v. Standard Oil Co., 278 U.S. 235 (1929), the Court was presented with the question of whether the retail sale of gasoline was so affected with a public interest as to justify a state statute which purported to fix the price for such sales. It was held that it was not. Whether a 1929 case will apply today is, of course, always a question. But in Pulitzer Publishing Co. v. Federal Communications Comm'n, 94 F.2d 249, 251 (D.C. Cir. 1937), the United States Court of Appeals for the District of Columbia denied public utility status to radio broadcasting companies, observing that:

> We have never said that a radio broadcasting station is a public utility in the sense in which a railroad is a public utility. Generally speaking, that term comprehends any facility employed in rendering quasi public service such as waterworks, gas works, railroads, telephones, telegraphs, etc. The use and enjoyment of such facilities the public has the legal right to demand; but its right to the use and enjoyment of the facilities of a privately owned radio station is of a much more limited character.

64. *See* Richfield Oil Corp. v. Public Utilities Comm'n, 54 Cal. 2d 419, 354 P.2d 4, 6 Cal. Rptr. 548 (1960), relying on Nebbia v. New York, 291 U.S. 502 (1934).

65. City and County of San Francisco v. Western Air Lines, Inc., 204 Cal. App. 2d 105, 22 Cal. Rptr. 216 (Ct. App. 1962) and Greyhound Lines, Inc. v. Public Utilities Comm'n, 68 Cal. 2d 406, 488 P.2d 801, 67 Cal. Rptr. 97 (1968) are cases cited by the *Richfield* court.

for some, but not others, would in any event probably be unconstitutional.[66]

THE FULL EMPLOYMENT ACT

One notes finally that, in a somewhat different way, Congress may effectively have legislated the old limits on the power to impose "public utility" type regulation into statute. The critical statute is The Full Employment Act which provides:

> The Congress declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote *free competitive enterprise* and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power. (emphasis added).[67]

The policy of fostering "free competitive enterprise" is repeated in Section 1023(a) which directs the Council of Economic Advisors "to formulate and recommend national

66. Up to the present, legislation which has provided for rigid regulation of certain people in a given business while completely exempting others, has generally met with disapproval. Thus, long ago in Cotting v. Kansas City Stock Yards Co., 183 U.S. 79 (1901), the Court struck down as a denial of equal protection a statute which fixed prices at stockyards doing a certain volume of business but allowed smaller stockyards to operate freely without price controls. In that case, larger stockyards were characterized by statute as public utilities. The Court found that large and small stockyards were operating under essentially the same conditions, and concluded that a discrimination based simply on the quantity of business done was arbitrary and could not be justified by calling it a classification. More recently, in Hartford Steam Boiler Inspection & Insurance Co. v. Harrison, 301 U.S. 459 (1937), the statute which provided for far easier licensing for mutual insurance company agents than for stock company agents was upset as a violation of equal protection. And still more recently, in Morey v. Doud, 354 U.S. 457 (1957), a statute which exempted the American Express Company from regulations applicable to smaller sellers of money orders was invalidated.

67. 15 U.S.C. § 1021 (1970).

purchasing power under *free competitive enterprise*". (emphasis added).

The Full Employment Act has not been the subject of significant litigation but was the model upon which the National Environmental Policy Act[68] was based, and the numerous cases under the latter act leave no doubt as to the enforceability of such policies.

CONCLUSION

The manufacturing and use of sources of energy comprise virtually the entire modern economic structure. Comprehensive treatment of suppliers of energy as "public utilities" would leave very little left of "free enterprise." It would seem, for a variety of reasons, that such attempts at regulation go far beyond the limits of state power.

68. 42 U.S.C. §§ 4321-4347 (1970).