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The Rule of Capture: Government and the Oil Industry

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THE RULE OF CAPTURE: GOVERNMENT AND THE OIL INDUSTRY

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I.

The Oil Follies of 1970-1980 by Robert Sherrill, is a broad account of an important decade for energy law and politics. In a capsule review of the book, I noted that it is a journalistic, rather than an academic, look at the theory of capture as a way of talking about government regulation.[1] Because Sherrill was writing for a predominantly lay audience, he did not undertake a systematic and rigorous analysis of the legal regulations concerning the petroleum industry. Nevertheless, his book does provoke a serious question: Is Big Oil bad, and if so, how should government regulate it? This essay is about the relationship between the government and the oil industry in our political economy. The discussion is timely because of the current mood of merger in the oil industry,[2] and because of government's perceived

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[1] The full title of the book is THE OIL FOLLIES OF 1970-1980: HOW THE PETROLEUM INDUSTRY STOLE THE SHOW (AND MUCH MORE BESIDES) (1983). All page citations in the text are to the book. A brief book review appears at _ ENERGY L.J. _ 1984.

[2] *See* Beazley & Levin, *Tempting Target: Gulf's Failure to Take Bold Defensive Steps Set It Up for Takeover*, Wall St. J., Mar. 7, 1984, at 1, col. 6 and related articles at 6-8; and Greenhouse, *An Unsettling Shift in Big Oil*, N.Y. Times, Mar. 11, §3, at 1, col. 2. Aside from the complexity attendant with any industries of this size, the normative issues regarding mergers present interesting trade-offs. As far as concentration is concerned most observers hold that the oil industry is not concentrated according to general antitrust standards even apart from the Reagan Administration's hands off attitude. *See, e.g.*, W. JOHNSON, R. MESSICK, S. VAN VACTOR & F. WYANT, COMPETITION IN THE OIL INDUSTRY 1-7 (1975); E. MITCHELL, U.S. ENERGY POLICY: A PRIMER 85-103 (1974). The argument is that the major oil companies do not control enough of a percentage of the market to violate the antitrust guidelines. According to this reasoning, if mergers are allowed the industry will be "streamlined" and efficient economies of scale will result which means lower consumer prices. However, the concept of percentage of market share is only a partial picture of market power. The critics are concerned over the vast amounts of wealth that are being accumulated and concentrated in fewer and fewer hands. The most current merger proposal will be the largest merger in history with Socal (Standard Oil Company of California, the country's third largest oil company) acquiring Gulf Oil Co. for $13.2 billion. Concentration in other parts of the industry is also occurring with Royal Dutch Shell acquiring the 30% of Shell Oil it does not already own, and Mobil Oil's acquisition of Superior Oil. Merger critics fear that capital used for acquisition is capital taken away from production and the result will be higher consumer prices. Other anticompetitive industry practices are noted *infra* §IV.

inability or lack of concerted effort to do much about it.[3]

Sherill's book focuses on the petroleum industry during the decade of the 1970's and reveals an important confrontation that must take place in a modern administrative state in a post-industrial society. In a showdown between a large, capital intensive and financially powerful industry such as Big Oil[4] and an over legislated,[5] highly bureaucratized Big Government, who will win and with what consequences? More narrowly, what is the impact of that confrontation on legal institutions? The tentative conclusion is that during the 1970's the legal system failed in its attempts to regulate Big Oil. We therefore must address the question of whether the legal system of the 1980's is equipped to handle enterprises the size of the oil industry. The consequence of the inability to manage large markets remains uncertain, although two possible directions seem evident. (I would note that the choice of paths is based on the decisionmaker's ideological principles as much or more than on substantive policy preferences.)

First, leave Big Oil alone. It is a waste of resources (time, labor, money and spirit) to try and manage the unmanageable. Not only is it wasteful, but it is also counter-productive because the costs of these wasted resources will be passed through to the citizenry. This is a straight-forward economic analysis of government regulation. It is premised upon an efficiency criterion: if the quantifiable costs of regulation outweigh the presumed benefits, then do not regulate.

The second path is guided more by a political justification: it is

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[3] Democratic Senator J. Bennett Johnston proposed a bill which would place a moratorium on mergers among the nation's top 50 oil companies for six months until federal agencies can assess the impact of merger.

When it was introduced the general reading of observers of the measure is conveyed in a recent headline, *Congress is Seen Unlikely to Block Recent Oil Mergers*, Wall St. J., Mar. 16, 1984, at 6, col. 3. About two weeks after introduction the measure was withdrawn. *See* Pasztor & Rogers, *Senate Fight Against Recent Oil Mergers is Abandoned, But the Issue Isn't Settled*, Wall St. J., Mar. 22, 1984, at 3, col. 2.

[4] The only comparable industries that come to mind are the computer industry with IBM and telecommunications with AT&T. In their confrontation with government it is a fair assessment to say that both IBM and AT&T bested the government even with the AT&T consent decree. *See* Boudin, *Book Review*, 97 HARV. L. REV. 835 (1984) (review of F. FISHER, J. MCGOWAN & J. GREENWOOD, FOLDED, SPINDLED, AND MUTILATED: ECONOMIC ANALYSIS AND U.S. V. IBM, discussing why the government's antitrust suit failed); and MacAvoy & Robinson, *Winning by Losing: The AT&T Settlement and Its Impact on Telecommunications*, 1 YALE J. REG. 1 (1983) (questions the economic wisdom of the consent decree). It should also be noted that both IBM and AT&T stand alone in their industries, and compared to the oil giants are much smaller.

[5] *See, e.g.*, G. CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES 1-8 (1982); D. HOROWITZ, THE COURTS AND SOCIAL POLICY 1-21, 255-98 (1977).

precisely because Big Oil is unmanageable that we must regulate. There is no way of acquiring adequate information otherwise. Due to the accumulation and concentration of wealth and power, government cannot afford to stand idly by while Big Oil exercises control over the marketplace; either the government is assured of a healthy market free of failure or it regulates until that assurance is forthcoming.

It is clear that the attempt at regulating the petroleum industry during the 1970's was at best a temporary fix which slowed the rise of oil prices. More likely, it can be considered a failure. The legal system simply was incapable of regulating the industry and the system broke down, with significant administrative costs associated with the effort. We are thus left in an uncomfortable position. We do not know, even though we may suspect, that Big Oil creates oligopolistic market distortions. We do know that a decade of attempted regulation shows signs of legislative and regulatory failure.[6]

Sherrill's book, with much rhetorical flourish and little analysis, views the problem as a rapacious conspiracy by Big Oil to control everything. A better subtitle for the book would be "The Great Betrayal." Sherrill sees conspirators all over. Every President he mentions is co-opted by political contributors; state and federal legislators are fatally corrupted by lobbyists; executive and administrative advisors cavort with industry officials; and oil companies are incestuously involved with foreign governments. The bed of the conspiracy would have to be as large as the East Texas oil field in order to hold everyone involved. The only group that is seemingly exempted from indictment is consumers. By using Sherrill's logic it is not a far step from including them in league with the other devils. After all, consumers buy the stuff at the pump and therefore acquiesce or even aid and abet in the oil industry's evil scheme by pumping profits out of their own pockets and into company coffers. Indeed, Sherrill does argue that motorists became too complacent in paying "well over a dollar a gallon" for gasoline (p. 486). Consumers thereby became active participants in the conspiracy. Environmentalists are also tainted when Sherrill raises the rhetorical question: "Were the conservationists whose lawsuits blocked construction of the [Alaska] pipeline themselves unwitting agents of Exxon?" (p. 91). The single-minded

[6] For discussion of this failure, *see infra* text accompanying notes 23-44.

search makes Sherrill see ghosts everywhere. Even the Vietnam War is cast as being fought, at least partially, in an effort to benefit the profit picture of Big Oil (pp. 120-22).

I mean to be only half facetious with the assertion that consumers, environmental activists, and the Vietnam War are part of the great betrayal. How can anyone seriously assert that environmental activists, consumers, and the military are in cahoots with the oil company conspirators and are involved in a scam directed by Big Oil to transfer, according to Lester Thurow's zero-sum equation,[7] hundreds of billions of dollars of payments from consumers to the major oil producers? An insight lies in the very rhetoric that Sherrill uses. Cutting through the polemics, Sherrill makes an important point. Even though there is no single oil gnome who has written the screenplay in which Big Oil wins in the end, the dialogue colors how we talk and think about the oil industry. Big Oil is a mindset. In its own way, the oil industry can be competitive, at least *inter sese*, and can influence the way oil industry matters are discussed by the general public. The mindset has captured the debate. Once that is recognized then debate can start fresh, and reforms, if necessary, can be addressed. I first want to address the ways in which the debate has been captured.

II.

I have titled this essay the Rule of Capture. Historically, the rule allowed the owner or producer of a well to pump as much oil out of the ground as he was able to capture, with no regard for property boundaries. In theory, the rule promoted the production of a natural resource.[8] That old common law rule gave way to state regulations that were designed to protect differently situated owners of property by equalizing the amount of oil that could be extracted. State regulations also protected producing states and their natural resources by restricting the amount of oil and gas that could be produced.

The rule has another application. As a political theory of government regulation, the concept is also known as the theory of capture.[9] An agency becomes captured by a regulated firm or industry through various inelegant political influences that subvert the public interest in order to move the regulator to favor the regulatee. That theory of

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[7] L. THUROW, THE ZERO-SUM SOCIETY 26-40 (1980).

[8] *See, e.g.*, R. HEMINGWAY, THE LAW OF OIL AND GAS 153 (1971); H. WILLIAMS, R. MAXWELL & C. MEYERS, OIL AND GAS 13-14, 213-23 (1979).

[9] *See, e.g.*, R. LITAN & W. NORDHAUS, REFORMING FEDERAL REGULATION 34-58 (1983); T. LOWI, THE END OF LIBERALISM 92-126 (2d ed. 1979); Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MANAGEMENT SCI. 335, 341-43 (1974).

the capture of administrative agencies has been in disfavor as of late.[10] The theory of capture as a rule of administrative agency politics and government regulation has been displaced, to some degree, by an economic theory[11] of regulation. The economic theory holds that government regulations should be considered as benefits which go to those persons who are most willing to pay for them.[12] The basic metaphor used by the economically minded is that the supply of government regulations follows demand.

Sherrill's book goes a long way in resuscitating and extending the theory of capture. His argument is that the power of Big Oil captures more than the theory allows.[13] The theory of capture dealt with the capture of a single agency by a single regulated firm or industry. Under Sherill's account, not only is a particular agency captured but so are Presidential administrations, sets of agencies, and Congresses; indeed the entire decade of the 1970's was captured by Big Oil. In this sense, Big Oil is a world view in which it is almost impossible to have the scales fall from our eyes in an attempt to see through the voracious greed that motivates oil companies in their monomaniacal attempt to capture power and profits.

In part, Sherrill is captured by his own characterizations and his analysis suffers from his unremitting desire to prove his case. For example, when he discusses the role of the United States Synthetic Fuels Corporation in the development of oil shale, either way he interprets the development of that resource it ends up in Big Oil's favor. If the Synfuels Corporation grants Exxon loan guarantees or price supports or financial assistance of any nature, then the federal government is handing over precious plums to a major integrated firm in order to rape the land and steal from the people even further. However, if Exxon drops out of the Colony Oil shale project, as it has, and temporarily chooses not to develop that resource, then under Sherrill's analysis it is merely a question of time before Exxon does de-

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[10] *See* Posner, *supra* note 9; Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MANAGEMENT SCI. 1 (1971); Schuck, *The Politics of Regulation*, 91 YALE L.J. 702 (Book Review) (1981); and THE POLITICS OF REGULATION (J. Wilson ed. 1980).

[11] *See* Posner, *supra* note 9; Stigler, *supra* note 10.

[12] Given the scope of the oil industry, both in its diversity and in its size, it is not unrealistic to argue that all of the theories apply at different times and to different segments. What is lacking is a broader or meta-theory to explain the symbiotic relationship between Big Government and Big Industry.

[13] There is another political theory of regulation which posits the reverse of capture and partially rejects the economic calculus of the supply and demand of benefits. This is known as the corporatist theory which holds that in many instances the state, i.e., the government, directs private industry in an effort to further the ends of the state. *See* J. CHUBB, INTEREST GROUPS AND THE BUREAUCRACY: THE POLITICS OF ENERGY 18-57 (1983).

velop shale to its own financial advantage. At the same time, the delay in development is to the detriment of the consuming public. Either choice, develop or wait, favors the industry. A similar "damned if you do and damned if you don't" analysis pertains to Sherill's discussion of the entitlements program and oil allocation regulations during the mid to late 1970's. Any activity by the Department of Energy (DOE) or the Federal Energy Regulatory Commission (FERC) to allocate oil from one refiner to another refiner means that the government is favoring industry. If a court chooses to rule against Ashland Oil,[14] the consequence of that ruling is to favor the larger integrated firms and thereby also favor the oil industry. A ruling which favors Ashland by providing entitlements also favors the oil industry. There is no way out of the dilemma. It is here that I find Sherrill's book to be most intriguing. He has worked himself into a double bind. The mindset has become all-consuming.

There can be little doubt that government regulation promotes oil industry interests. There is ample evidence, not cited by Sherrill, embedded in positive laws demonstrating the existence of government policies which favor the oil industry. One of the marks of what Thomas Kuhn calls a paradigm is when certain ideas gain a wide degree of acceptance.[15] One place to look for evidence of acceptance is in the textbooks[16] that are used in a given field. The texts in the field of energy law[17] generally accept the fact that the federal government

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[14] *See, e.g.*, Marathon Oil Co. v. Department of Energy, 482 F. Supp. 651, 655 (D.D.C. 1979) (Ashland Oil awarded increased allotment of oil from other refiners because Ashland's Iranian supply of oil was terminated).

[15] T. KUHN, THE STRUCTURE OF SCIENTIFIC REVOLUTIONS 10-22, 43-51 (2d ed. 1970).

[16] Id. at 19-20.

[17] *See* D. ZILLMAN & L. LATTMAN, ENERGY LAW 458 (1983):

> On balance, the federal government served far more as promoter than regulator of the oil industry in its first century. The federal endorsement of state production limitations has already been noted. A generous federal tax depletion allowance provided substantial benefit to domestic oil producers. Additional tax rulings allowed a dollar-for-dollar writeoff of expenses for the acquisition of foreign oil. This allowed American-based multinationals to recoup on their American tax returns the amounts paid in tax or royalty to foreign governments. While it reduced United States tax revenue, this program served as a means of providing indirect assistance to the governments of Middle East oil producers. Lastly, pressures from the domestic oil industry encouraged a government imposed limitation on petroleum imports from 1959 to 1973. Presidential Proc. No. 3279, Mar. 12, 1959. While justified as necessary to meet a threat to "national security," this mandatory oil import program helped to preserve a market for domestic production in the face of competition from what were then cheaper foreign imports.

Although less explicit about government favoritism these texts do not contradict the quote. *See also* A. AMAN, ENERGY AND NATURAL RESOURCES LAW ch. 5 (1983); and W. RODGERS, ENERGY AND NATURAL RESOURCES LAW ch. 8 (2d ed. 1983).

has been a promoter of Big Oil, and that the promotion and development of this natural resource is good for both economic and security reasons, and is ultimately good for the consumer. Because of the mindset which equates the needs of Big Oil with the needs of government, it seems that no one is able to break away from the idea that promotion of this natural resource, by joint Big Oil and government endeavors to maintain a healthy economy, has an effect other than to benefit the industry. That cooperative relationship went relatively unchallenged prior to the multiple price hikes of the 1970's. The decade of the 1970's, however, witnessed government intrusion into the regulation of the oil and gas industries in ways never before experienced by those industries. But the intrusion, at least as far as crude oil regulation is concerned, was short-lived. The decade also witnessed the demise of the regulatory structure because of an inability of the government to deal with the size of the problems involved.

Additional evidence of governmental involvement in the promotion and the development of these natural resources is the acceptance of a pro-industry policy position by all branches of government. Sherrill argues that all of the Presidents who touched the decade of the 1970's favored helping Big Oil; he also could have cited judicial opinions[18] and congressional statutes.[19] Statutes and case law repeatedly refer to the wisdom of promoting the interest of industry. That pervasive governmental pro-industry policy shows that Sherrill's search for conspiracy in high places has inadvertently uncovered a central problem with oil and gas regulations: The central problem of bigness is its ability to create a mindset, to color debate, to limit the focus of problems, and to let assumptions go unquestioned.

The impact is far-reaching. Any conference concerning the regulation of the utility or oil industries, or financial management and government regulations, generally is characterized by discussions of issues contained within rather narrow limits. Issues that are discussed

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[18] The explicit basis of some decisions is that a healthy oil industry is an important policy goal and that government regulations will be applied or interpreted to reach that end. Other cases do so implicitly. Recent pro-industry cases include Public Serv. Comm'n of New York v. Mid-Louisiana Gas Co., _ U.S. _, 103 S.Ct. 3024 (1983) (allowing a broader reading of what constitutes a "first sale" thereby giving some gas pipelines favorable rate treatment); Watt v. Energy Action Educ. Found., 454 U.S. 151 (1981) (upholding OCS bidding systems that favor front-end cash payments, and with them Big Oil); Federal Energy Regulatory Comm'n v. Pennzoil Producing Co., 439 U.S. 508 (1979) (opening the way for producers to pass through higher royalty costs to their customers).

[19] *See, e.g.*, Emergency Petroleum Allocation Act of 1973, 15 U.S.C. §751; Trans-Alaska Oil Pipeline, 43 U.S.C. §1651; Energy Conservation and Production Act of 1976, 42 U.S.C. §6801 (1976).

start with assumptions that go unquestioned. Topics pertain to how government and industry can best promote production and distribution so that firms engaged in those industries can be competitive. This is another way to say that everyone involved in the market will have a profitable enterprise. There are few, if any, opposing voices to be heard. Those who do speak up question the wisdom or the desirability of sustained economic growth in a post-industrial society, or whether government should exist to facilitate growth by shoring up market imperfections and failures. More empirically, they question the application of efficient economies of scale to big oil companies.

Those and other similar issues, which generally remain submerged in talks about energy policy, are raised and discussed in *Oil Follies*. Even though the book's analysis is not systematic or critical, it does attempt to talk about oil politics in ways that people who are more directly involved cannot talk — precisely because they *are* more directly involved. Too often those of us in the energy field, particularly lawyers, are too consumed by what we perceive as more important and more immediate tasks at hand — such as protecting our client's position in the marketplace — to think grander thoughts or to ask impertinent questions.

III.

Having argued that all branches of the government are involved in actively promoting the interest of the oil industry and that, prior to the 1970's, consumer acceptance of that promotion was at a high level, further arguing that all of this means there is an insidious conspiracy to help private oil managers is not necessarily persuasive.

Nevertheless, even in the absence of a conspiracy, there are serious problems attendant with an industry as large and as cohesive as this one. The size of the industry brings with it management and information problems. Why have not state and federal governments had success in price setting and allocation of oil in a way that would reduce the large margins of profits, prevent overcharges, and also reduce the threat of a negative impact that the industry can have on the economy? How and why has the crude oil industry escaped the regulation of public utilities like natural gas and electricity? If the response to those questions is that the oil industry is competitive, it would seem to be enough of a refutation to direct the respondent to read the list of the first twenty companies on the Fortune 500 list to see how dominant oil is. Imagine the effect that a severe price shock in this industry would have on national or world-wide inflation, or the effect that any major movement of capital would have on

financial institutions.

Is there something to the position of those industry critics who believe that big is bad? It is not that big is bad because companies make profits; it is that they make such big profits and that big profits reverberate in the economy in big ways. In a more political vein, wealth and power are concentrated in fewer hands. Exxon, for example, has assets just shy of $1 trillion. In comparison, our staggering national debt is $1.4 trillion. Why not nationalize Exxon and bail out the United States Treasury? Assuming that proposal could clear the legal and political impediments, there would be no buyers because there is no market for such a colossal corporation. It is something of a contradiction to say that the oil industry is competitive and to acknowledge that there are only a handful of very large players in their own market.

It would be of negligible economic consequence for a small Cupertino, California software company to close its doors and stop producing software. The economic effect of an oil company's decision to shut-off or drastically reduce the flow of oil through its pipes, or to defer exploration, is of a much greater economic magnitude. Yet there is no way to stop oil companies from completely shutting off supplies or drastically cutting back production if they choose to wait until the time is right to make more profits. The problem with Big Oil playing with the market is the extreme effect that such a maneuver has throughout our economy and our society. The skeptic's response is that the chance of this happening is nil. Sherrill's book argues that industry manipulation happens all the time.

The critics of the current oil merger movement make similar arguments. One of the reasons that oil companies are taking over other companies is to acquire oil reserves. An acquiring company can take over a target and buy crude oil assets at less than the market price per barrel. Two possible negative effects of that maneuver are first, that the newly acquired oil can be sold at the market price resulting in very favorable "economic rents" (windfalls) to the seller; second, no new oil is produced—the money used for exploration is tied up in acquisition.

With regard to Big Oil, big is bad because when big is inefficient or wasteful, big is inefficient or wasteful in a big way. In addition, when big is *this* big there are serious information, management, and enforcement problems which perhaps are intractable. There is not enough government time, money, and manpower to oversee the operations of companies the size of Exxon in an effort to check company compliance with regulatory controls. There are not accountants

enough to perform audits, nor are there geologists enough to test reserves that will give accurate pictures of how much oil exists and where money is flowing throughout the corporate enterprise.

Companies of that size, when they devote assets to normal activities such as lobbying and advertising, are capable of allocating absolute dollars in ways that dwarf the capabilities of other entities who seek access to the avenues which influence legislatures and public opinion makers. Sherrill cites statistics in his book about money spent in advertising campaigns aimed at defeating congressional efforts to regulate or control natural gas, the amount of which cannot be labelled as anything but manipulative. Likewise, when such companies engage in profit taking they are profiteering in ways that are inexplicable. The size and complexity of the corporate structures of those firms allow the shifting of costs and tax benefits to generate profits in ways that are unavailable to others in the corporate sector. Recall how quickly the price of gas at the pump rose, often within days, after the announcement from the Middle East that OPEC was raising the price of a barrel of oil. Corporate profit taking in the short term produced ridiculously high, even obscene, economic rents for firms.

Big Oil's big profits have naturally led to a close relationship between oil companies and major financial institutions. Sherrill talks about the crossovers between boards of directors of those two institutions that are just shy of violating rules against interlocking directorates. That closeness, and the not-so-subtle influence of massive deposits of oil money in major banks, puts the financial interests of major lending institutions in line with those of Big Oil.

All of the above arguments against bigness can be reduced to this: Firms and industries of that size may be unmanageable. Even if we can assume that the industry is capable of being monitored, we cannot assume that the administrative costs of monitoring will outweigh the benefits of compliance and enforcement.

A brief survey of the statutes, regulations and ensuing litigation indicates that the crude oil pricing and allocation scheme was fraught with regulatory difficulty. The signs of regulatory failure are there, and I believe that a closer, more empirical look would demonstrate that the regulatory scheme was economically inefficient and politically ineffective. This essay can only suggest failure and point to the signs.

The regulatory framework is comprised of both statutes and agency regulations. The description of the statutory scheme governing crude oil pricing and allocation is simple compared with

describing the agency's promulgation, implementation and interpretation of rules and regulations and the litigation that those statutes and regulations engendered. There are at least two causes for the failure of that regulatory structure. First, although the statutory scheme can be described fairly simply, it did not work. For every enactment of a major statute there was a response from another segment of the industry that cried foul. The statutes proved to be a perfect example of what is known as a polycentric problem. Using Lon Fuller's analogy of a spider web, a pull on one strand distributes tensions throughout the web; doubling the pull does not double the tensions, it merely rearranges them in a new pattern.[20] That is an example of legislative failure,[21] and describes what happened with the petroleum legislation, discussed below. Agency inability to regulate the industry effectively is the second cause of the system's failure.[22] For reasons discussed below, the Department of Energy was not able to administer the set of very complex regulations designed to govern the industry.

A. *Legislative Failure*

In 1970 President Nixon responded to the economic problem of "stagflation," a period of stagnant economic growth and rising inflation, by pushing the Economic Stabilization Act of 1970[23] through Congress. That legislation established wage and price controls across many segments of the economy. The oil industry was not regulated until August, 1973, when the President's Cost of Living Council (CLC) imposed price controls on petroleum products.[24] The next event to affect oil prices and the regulation of the industry was the Arab oil embargo of October, 1973. Congress responded with the Emergency Petroleum Allocation Act of 1973 (EPAA)[25] and with corresponding regulations.[26]

The idea behind the CLC pricing rules was two-fold: First, keep prices down in order to protect consumers from high price shocks,

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[20] Fuller, *The Forms and Limits of Adjudication*, 92 HARV. L. REV. 353, 395 (1978); *see also* M. WESSEL, SCIENCE AND CONSCIENCE 4-10 (1980); Yellin, *High Technology and the Courts: Nuclear Power and the Need for Institutional Reform*, 94 HARV. L. REV. 489, 494-508 (1981).

[21] *Supra* note 5.

[22] *See* S. BREYER, REGULATION AND ITS REFORM (1982); Breyer, *Analyzing Regulatory Failure: Mismatches, Less Restrictive Alternatives and Reform*, 92 HARV. L. REV. 549 (1979).

[23] As amended 12 U.S.C. §1904 (1976).

[24] 6 C.F.R. §§150.353-150.363 (1974).

[25] 15 U.S.C. §§751 - 760(h) (1976).

[26] The earlier Phase IV Cost of Living Council regulations, *supra* note 24, were slightly modified and were contained at 10 C.F.R. §§212.1-212.170 (1975).

and second, keep prices high enough to encourage domestic production in an effort to reduce dependence on foreign oil. It was thought that those goals could be accomplished with a "two-tier" pricing scheme. Old oil[27] was given a lower price under the theory that crude that was already being produced had established costs and could be sold profitably at controlled prices. New oil was set at a higher price in order to promote production.

That scheme proved to be too simplistic because it did not account adequately for the structure of the industry. Large integrated firms were able to sell lower priced crude to their own refiners, while selling the higher priced crude to independent refiners. In that way the integrated firms could maximize their profits and put a price squeeze on independent refiners. That situation caused the Federal Energy Administration to promulgate the Old Oil Entitlements Program.[28] The Entitlements Program was supposed to equalize the opportunity to purchase crude by regulating the distribution of old oil through paper entitlements based on historic patterns of production. That, however, created market dislocations among refiners who had either foreign sources of crude or foreign refineries.[29] Additionally, the EPAA also did not greatly stimulate production and the Energy Policy and Conservation Act[30] was passed to create different categories of oil in the hope of encouraging production and raise prices. That scheme created other pricing tiers.[31] Throughout the passage of the legislation, another market dislocation was occurring. The pricing regulations were at first not applicable to "stripper" wells, wells that produced ten barrels per day or less. That was an obvious incentive to keep oil production of these wells at or below the ten-barrel limit rather than pump more oil to be sold at a lower controlled price. Then the FEA eliminated the exemption; then Congress reinstated the exemption with the Energy Conservation and Production Act.[32]

Those were the primary statutes pertaining to oil regulation.[33]

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[27] A contributing reason for the collapse of the regulatory structure was that pricing rules were variously defined according to the time of the oil's capture. Another reason was that the purposes of the act conflicted. *See, e.g.*, the nine goals of the Emergency Petroleum Allocation Act, 15 U.S.C. §753(b)(1)(A)-(I) (1976).

[28] 10 C.F.R. §211.67 (1975).

[29] *See, e.g.*, New England Petroleum Corp. v. Federal Energy Admin., 455 F. Supp. 1280 (S.D.N.Y. 1978).

[30] 15 U.S.C. §§757 - 760(h) (1976).

[31] The FEA amended its regulations in response to industry criticism and pursuant to congressional directives in the EPAA; *see* United States v. Exxon Corp., 561 F. Supp. 816, 818-22 (D.D.C. 1983).

[32] 15 U.S.C. §757(i) (1976).

[33] Cases which discuss the pricing regulations include: Husky Oil Co. v. Department of En-

They offered a quick fix to a complex problem. It seemed that patching up one segment of the industry caused problems at another end. The legislative directives seemed to not work. The statutes created market dislocations that required either new legislation, flexible administration, or deregulation. The latter alternative won out,[34] but not until after much havoc had been wrought in the attempt to administer the regulations.

B. *Regulatory Failure*

The oil pricing regime was substantively and procedurally complex and spawned a high volume of very technical and complex litigation[35] in the course of its relatively short life span. The litigation involved hundreds of millions of dollars and continues today, years after decontrol. There is no single characteristic that we can say constitutes regulatory failure; instead, the total experience of the administrative structure was one of much confusion that seemed to be ironed out only as decontrol set in. Rather than develop a close analysis of each point, I want to highlight a few of the characteristics that indicate how roughly the regulatory structure functioned.

The regulations were difficult to administer. Sometimes they were improperly adopted,[36] other times they were frequently amended,[37]

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ergy, 582 F.2d 644 (Temp. Emer. Ct. App. 1978) (discusses the entitlement program); Pasco, Inc. v. Federal Energy Admin., 525 F.2d 1391 (Temp. Emer. Ct. App. 1975); Consumers Union v. Sawhill, 525 F.2d 1068 (Temp. Emer. Ct. App. 1975) (pricing under the two-tier system); Cities Service Co. v. Federal Energy Admin., 529 F.2d 1016 (Temp. Emer. Ct. App. 1975), *cert. denied*, 426 U.S. 947 (1976); United States v. Exxon Corp., 561 F. Supp. 816, 818-22 (D.D.C. 1983).

[34] The EPAA scheduled decontrol for September, 1981. President Reagan advanced that date to January 28, 1981. *See* Executive Order No. 12,287, 3 C.F.R. 124-15 (1982), *reprinted* 15 U.S.C.A. §757 app. at 35 (West 1983).

[35] A small sample of complex cases include Seneca Oil Co. v. Department of Energy, 712 F.2d 1384 (Temp. Emer. Ct. App. 1983) (district court held DOE ruling invalid, and Temporary Emergency Court of Appeals reversed holding that rule regarding newly discovered crude was interpretive and did not require notice and comment); Wiggins Bros., Inc. v. Department of Energy, 667 F.2d 77 (Temp. Emer. Ct. App. 1981), *cert. denied*, 456 U.S. 905 (1982) (injection wells not counted as wells that produce crude oil under the marginal property rule); *In re* Department of Energy Stripper Well Exemption Litigation, 520 F. Supp. 1232 (D. Kan. 1981) (after two appeals to the Temporary Emergency Court of Appeals on whether injection wells were also exempted, the district court held that the administrative interpretation was contrary to the intent of Congress and was arbitrary and capricious); Mobil Oil Corp. v. Department of Energy, 520 F. Supp. 420 (N.D.N.Y. 1981), *cert. denied*, 454 U.S. 110 (1982) (district court granted injunction against DOE's issuance of entitlements after decontrol of crude oil prices).

[36] Mobil Oil Corp. v. Department of Energy, 610 F.2d 796 (Temp. Emer. Ct. App. 1979), *cert. denied*, 446 U.S. 937 (1980) (rules regarding "covered products" formula procedurally defective and hastily adopted); *see also* Cockrell, *Invalidation of Federal Petroleum Regulations on the Basis of Procedural Rulemaking Deficiencies*, 57 TEX. L. REV. 535 (1979).

[37] *See, e.g.*, Naph-Sol Refining Co. v. Murphy Oil Corp., 550 F. Supp. 297 (W.D. Mich. 1982)

and they were varyingly interpreted. The conflicting interpretations come in two forms, one obvious, the other less so. Naturally, regulated firms and their attorneys would interpret regulations favorable to themselves. That means that if a rule or regulation could be read to produce higher profits, then the industry would prefer that interpretation.[38] This type of partisan advocacy for one's client is obvious, and it naturally results in differing interpretations which often require litigation for resolution. Nevertheless, the extent to which firms would go to bend interpretation and then litigate based on that interpretation seems high. This was because the stakes were high, and delayed resolution could mean millions of dollars. All of which is much beside the point of the country's attempt to implement a substantive energy program.

The other source of interpretive confusion was internal to the agency responsible for administering the regulations. There were conflicting interpretations by the DOE. Sometimes the regulations would conflict with the enabling statute.[39] Other times there would be conflicts between the interpretation in the field and in the home office.[40] The only thing strange or unsettling about complex regulations and attorneys attempting to interpret in a manner favorable to their clients is the amount of litigation that those regulations caused in such a short period. Complex regulations and disagreement on interpretation are the heart of an administrative law lawyer's work. The petroleum pricing regulations, however, were supposed to be responsive to a national energy crisis. Instead of helping meet that crisis, the response by firms to the regulatory scheme was to create massive confusion resulting in overcharges,[41] evasion,[42] a burdensome and per-

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at 307:

> The original regulations stated that refiners could, in computing the base price for a covered product, include the amount of increased crude cost which was "attributable" to the product. These regulations were soon replaced by mathematical formulas. These formulas were amended several times prior to April, 1974, when they became critical for the present purposes.

[38] *See, e.g.*, United States v. Exxon Corp., 561 F. Supp. at 824-26.

[39] *See, e.g., In re* Department of Energy Stripper Well Exemption Litigation, 520 F. Supp. at 1272-73.

[40] *See, e.g.*, Sauder v. Department of Energy, 648 F.2d 1341, 1346-47 (Temp. Emer. Ct. App. 1981); *see also* UPG, Inc. v. Edwards, 647 F.2d 147, 150-52 (Temp. Emer. Ct. App. 1981); Standard Oil Co. v. Department of Energy, 596 F.2d 1029, 1040 (Temp. Emer. Ct. App. 1978).

[41] *See, e.g.*, United States v. Exxon, 561 F. Supp. 816 (D.D.C. 1983) (Exxon ordered to pay overcharges of $9 million plus interest into the United States Treasury. This order, now worth over $1.5 billion, is currently on appeal before the Temporary Emergency Court of Appeals).

[42] *See, e.g.*, Rossi v. Mobil Oil Corp., 710 F.2d 821 (Temp. Emer. Ct. App. 1983) (court held that termination of product to retailers to be wrongful); Hydrocarbon Trading and Trans. Co. v. Exxon Corp., 570 F. Supp. 1177 (S.D.N.Y. 1983) (wrongful termination of independent dis-

haps inefficient and inequitable exceptions policy,[43] and a difficult and ineffective enforcement system.[44]

An enforcement problem existed even with the best of lawsuits. When companies pay back some of the overcharges, where does the money go? Too often it does not go back to the people that were overcharged. That is the same problem that is experienced with the Crude Oil Windfall Profits Tax. First, the tax does not yield a true reflection of the profits that were made because of the many exceptions. Second, the overcharged persons are stuck with having transferred payments out of their own income schedule. The overcharges go to the United States Treasury, or to reduced product prices; they do not go directly back to the victims of the overcharge.

There is something to all of this rhetoric—Big Oil is not well managed by Big Government.

IV.

The question then is what to do about breaking out of this *Weltanschuung*. It may be that breaking out is totally undesirable. It may be that people are perfectly willing to acquiesce in allowing firms in the oil industry to maintain their colossal size. Perhaps, then, the only answer for conspiracy-minded souls like Sherrill is to respond by consuming less and hope that there is more price elasticity built into the system than the description of bigness would suggest. That may cause a radical change in lifestyle but it is one response to the ills of bigness.

Sherrill does note a number of attempts to regulate the industry that have been tried and failed. It may be that the way to break out of the mindset is not to concentrate on any single one of those as the palliative for the ills of bigness. The better thing to do may be to move on several fronts and attempt a series of workable projects. I use the term "workable projects" in contradistinction to antitrust

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tributor). The rule of deference and a propensity to grant leeway for business practices allows oil companies to increase prices discriminatorily, see, e.g., Pacific Supply Co-Op. v. Shell Oil Co., 697 F.2d 1084 (Temp. Emer. Ct. App. 1982) (purchaser of refined products sued for overcharges leased on seller's wrongful classification, seller's position upheld due to ambiguity in regulations); see also Eastern Airlines, Inc. v. Mobil Oil Corp., 564 F. Supp. 1131 (S.D. Fla. 1983) (even though Eastern paid more for the same product than did TWA, there was no unlawful price discrimination within the regulatory scheme).

[43] Shuck, *When the Exception Becomes the Rule: Regulatory Equity and the Formulation of Energy Policy Through an Exception Process*, _ DUKE L.J. _ (1984). This paper was prepared for consideration by the Administrative Conference of the United States.

[44] *See, e.g.*, J. TOMAIN & S. HOLLIS, ENERGY DECISION MAKING 133-47 (1983); Sporkin Task Force Report, 207 ENERGY USERS REP. (BNA) 13 (1978); Bloom, *Enforcements Procedure for Price Regulation Audits and Overcharges*, 13 TULSA L.J. 715 (1978).

suits because it is clear that antitrust enforcement does not work. There has not been a successful major antitrust suit against Big Oil in over fifty years.[45]

An attempt in the 1980's to break up the majors will be no more successful than the attempt in the 1950's to break up the Yankees. A broad based antitrust attack against all majors for everything is bound to fail much like the Government's suits against AT&T and IBM failed.[46] The failure of a full-fledged antitrust assault does not preclude movement along a number of different fronts. A movement to revivify an effort at horizontal divestiture ought not to be foresaken. Similarly, vertical divestiture, which should help to reduce the market power of the majors, may break the industry into more competitive segments. That would necessarily require some mechanism guaranteeing that producers pump oil and gas into pipelines for refining, distributing and marketing. That may then require pricing and allocation mechanisms in order to promote such efforts.

Along similar lines, the Government could look at restricting diversification. Tax laws can be structured to disallow oil company purchases of non-industry companies in order to divert income or buy tax benefits for the purpose of reducing corporate taxation. Diversification into businesses that does not require reinvestment of capital into production of oil and gas resources, and at the same time provides beneficial tax consequences, should be restricted.

A serious look at regulating cross-ownership of energy resources is past due. The evidence is as simple as looking at a breakdown in Fortune magazine of who owns what resource to find significant cross-ownership between oil, gas, coal and uranium resources. Federal lands could be developed for the purpose of selling oil and gas to big government purchasers, such as the Department of Defense. That effort, in and of itself, could reduce the power of Big Oil.

It would be simple enough to limit the amount of money that a single oil company could deposit in a single financial institution, thereby hopefully reducing the impact a threat of removing a large amount of money would have on a particular lender. Finally, and certainly not least, a complete restructuring of the tax law vis-à-vis how oil companies are treated needs to be considered. It is nothing less than scandalous to have allowed the percentage depletion allowance that firms previously enjoyed, nor does it make any sense to have

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[45] Arguably the last successful major antitrust suit against Big Oil was Standard Oil Co. v. United States, 221 U.S. 1 (1911). Since then there have been some minor victories. However, significant antitrust actions against the majors have been dropped.

[46] *Supra* note 4.

allowed a tax structure which gave oil companies a dollar for dollar credit for royalty payments to host countries in the Middle East, which, in turn, allowed Middle East governments to purchase military arms with United States taxpayer dollars.

These sometimes grandiose-sounding schemes are mentioned in *Oil Follies* and are catalogued here less as a policy platform for breaking up Big Oil companies than as ways just to begin to think about the consequences that firms the size of the majors have in our economy and in our society.