Spavins and LeGrange agree that there is a need for better and more comparable empirical work to determine who has made how much money and whether or not it is too much. If we can assume that the income and the cash flows reported by various firms in their financial statements can be taken at their face value, the only remaining question is whether the money made by pipeline companies is too much in terms of some fair return standard.

How is that standard to be determined? Spavins and Legrange agree that a return standard should be specified in terms of the total capital invested – that is, whether it is the equity capital or borrowed capital, the amount of money that a firm has made should be determined as a proportion of the total investment of the firm.

In both papers, the return on total capital has been calculated, and Spavins’ results are somewhat higher. The rate of return for the pipeline companies, according to Spavins, is 13 percent, compared with a median of 10.8 percent for other industries. According to Mr. LeGrange, the average rate of return for pipeline companies is 9.5 percent, compared with an overall industry average of 9.9 percent – figures that are much closer together.

On the face of it, one might conclude that there is some discrepancy in the data; fortunately, both papers have been based on the same data, and it is possible to reconcile the two numbers. I do not see any basic differences in these numbers.

The key, of course, is the adjustment for leverage. LeGrange computed his rates of return after taking out the effect of leverage; he added to the net income available to shareholders the interest paid on borrowed capital. That interest payment was adjusted for tax savings, so he has used net income plus after-tax interest, divided by total capital invested as the appropriate rate. This rate has taken out the effect of leverage and reduced all the data of all firms within the pipeline industry and across the industries to a comparable basis after adjusting it for differences in leverage.

Spavins has not carried out that adjustment in his paper. He has chosen to compute the return on total capital without carrying out the leverage adjustment. The effect of the leverage adjustment is not really very important because a comparison of a fair return standard across firms and across industries will need an appropriate adjustment for risk anyway.

There are two main components of risk we have to consider. One part of the risk is the business risk of the company – the nature of the business the firm is in. The second part of the risk is the leverage. If we compare LeGrange’s numbers, we have to worry only about the business risk of the firm because the leverage risk has already been taken out of those numbers. When we compare the numbers prepared by Spavins, we have to consider the total risk of these firms, which combines both the business risk and the leverage risk.