

No. 4979.

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**United States Circuit Court of Appeals**

FOR THE FOURTH CIRCUIT.

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HOPE NATURAL GAS COMPANY,  
*Petitioner,*

vs.

FEDERAL POWER COMMISSION,  
CITY OF CLEVELAND,  
CITY OF AKRON, and  
PENNSYLVANIA PUBLIC UTILITY COMMISSION,  
*Respondents.*

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**SUPPLEMENT TO BRIEF OF PETITIONER.**

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**1. RESPONDENT THE FEDERAL POWER COMMISSION'S "ORDER REDUCING RATES," DATED MAY 26, 1942.**

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UNITED STATES OF AMERICA  
FEDERAL POWER COMMISSION

Commissioners { Leland Olds, Chairman, Claude L. Draper, Basil Manly and Clyde L. Seavey. John W. Scott dissenting in part.

May 26, 1942

City of Cleveland,	Complainant	}	Docket No. G-100
vs.			
Hope Natural Gas Company,	Defendant	}	
City of Akron,	Complainant	}	Docket No. G-101
vs.			
Hope Natural Gas Company,	Defendant	}	
Pennsylvania Public Utility Commission,	Complainant	}	Docket No. G-127
vs.			
Hope Natural Gas Company,	Defendant	}	
In the Matter of		}	Docket No. G-113
Hope Natural Gas Company			

ORDER REDUCING RATES

Upon consideration of the complaints, answers, petitions, and orders previously entered in these proceedings, the evidence of record, the briefs and oral arguments, and the Commission having on this date entered and

issued its Opinion No. 76 which is hereby incorporated by reference and made a part hereof;

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The Commission *finds* that:

- (1) Hope Natural Gas Company (hereinafter designated as the "Company") is a corporation organized and existing under the laws of the State of West Virginia;
- (2) The Company purchases and produces natural gas within the State of West Virginia;
- (3) The Company transports, delivers and sells large quantities of the natural gas referred to in Finding (2) to The East Ohio Gas Company and The River Gas Company at points on and along the interstate boundary between the States of West Virginia and Ohio, which gas is so transported and sold at wholesale for the purpose of resale for ultimate public consumption at points outside the State of West Virginia;
- (4) The Company transports, delivers and sells large quantities of the natural gas referred to in Finding (2) to The Peoples Natural Gas Company and Fayette County Gas Company at points along the interstate boundary between the States of West Virginia and Pennsylvania, which gas is so transported and sold at wholesale for the purpose of resale for ultimate public consumption at points outside the State of West Virginia;
- (5) The Company transports, delivers and sells quantities of the natural gas referred to in Finding (2) to The Manufacturers Light and Heat Company at points within the State of West Virginia, which gas is transported and sold to such purchaser at wholesale for the purpose of resale for ultimate public consumption at points outside the State of West Virginia;
- (6) The transportation and sale by the Company of natural gas at the several points of delivery to the several purchasers and for the purposes stated in Findings (3), (4) and (5) constitute, in each in-



stance, the transportation and sale of natural gas in interstate commerce within the purview of the Natural Gas Act, and the rates charged and collected by the Company for the natural gas so transported and sold are subject to the jurisdiction of the Federal Power Commission;

- (7) The evidence of the reproduction cost new of the Company's property used and useful in the production, transportation, delivery and sale of natural gas to the interstate wholesale purchasers named above (as of December 31, 1938) as presented by the Company in these proceedings, is hypothetical, conjectural and inherently fallacious and cannot be considered as having probative value in the determination of the allowable rate base;

—3—

- (8) The evidence of the trended "original cost" of the Company's property (as of December 31, 1938) as presented by the Company is basically erroneous and cannot be considered as having probative value in the determination of the allowable rate base;
- (9) The Company's restated "original cost" of its property (as of December 31, 1938) erroneously includes items and amounts in excess of the actual legitimate cost thereof as such cost is controlled by fundamental principles of cost determination, and as defined in the Federal Power Commission's Uniform System of Accounts and by decisions of this Commission;
- (10) Equity and justice require the elimination of such erroneously included items and amounts referred to in Finding (9) in determining the rate base upon which the Company is entitled to earn a fair rate of return;
- (11) The actual legitimate cost of the Company's property, exclusive of distribution property, property used to transport coke-oven gas, and unoperated acreage was \$51,957,416 as of December 31, 1940:

- (12) The actual existing depletion and depreciation in the Company's property, exclusive of distribution property, property used to transport coke-oven gas, and unoperated acreage, was \$22,328,016 as of December 31, 1940;
  - (13) The actual legitimate cost of the Company's property, less actual existing depletion and depreciation, exclusive of distribution property, property used to transport coke-oven gas, and unoperated acreage, was \$29,629,400 as of December 31, 1940;
  - (14) The Company's unoperated acreage is useful or imminently useful and is necessary for the continued and efficient production of natural gas and its cost should be included in the rate base;
  - (15) The actual legitimate cost of such unoperated acreage was \$566,105 as of December 31, 1940; and is a reasonable amount to be included in the rate base for fixing future rates;
  - (16) Materials and supplies and cash working capital in the amount of \$2,125,000 are necessary for the continued and efficient operation of the Company's interstate natural gas business and should be allowed in the rate base;
  - (17) The additional capital expenditures (less increases in depletion and depreciation reserves) in the three-year period, 1941-1943, will result in an average increase in net actual legitimate cost for that period of \$1,392,021; and such sum should be allowed in the rate base for the determination of reasonable future rates;
- 4—
- (18) For the purpose of determining just and reasonable rates for the future, the rate base represented by the actual legitimate cost of the Company's property used and useful in the production, transportation and sale of natural gas in interstate commerce (Finding (13)), plus unoperated acreage, working capital and future net capital additions, is \$33,712,526;
  - (19) The fair rate of return for the Company is not more than 6½% per annum; and \$2,191,314 is the

maximum fair annual return which the Company is entitled to earn on the rate base;

- (20) The operations for 1940, as adjusted, are a proper basis for fixing future rates;
- (21) The operating revenues from interstate sales were \$19,296,755 for 1940;
- (22) The proper credit to the Company's operating expenses for the excess profits from the gasoline and butane extracted from its gas by the affiliated Hope Construction & Refining Company is \$185,105 and for steam and boiler fuel furnished the affiliate is \$119,592, or a total of \$304,697 for the determination of future rates;
- (23) Reasonable and proper allowances for operating expenses (including amortization of reclassification and rate case expenses) and after allocation of costs to local West Virginia sales, miscellaneous gas revenues, and the amount of tax required under lawful rates, are as follows:

Operating Expenses	\$16,272,934
Miscellaneous Gas Revenues	(83,275)
Allocation of Costs to Local West Virginia Sales	(2,694,075)

Total Deductions from  
Interstate Revenues \$13,495,584

- (24) The rates charged and received by the Company for the transportation and sale of natural gas in interstate commerce for resale for ultimate public consumption are unjust, unreasonable, and excessive, and therefore unlawful, to the extent of \$3,609,857 annually, determined as follows:

Revenues from Interstate Sales	\$19,296,755
Operating Deductions	13,495,584
Net Operating Income from Interstate Sales	5,801,171
6½% Return on Interstate Rate Base	2,191,314
Excess	\$ 3,609,857

—5—

- (25) The total allowable cost of all interstate services of the Company is \$13,495,584 plus \$2,191,314 for a fair return, or \$15,686,898;
- (26) The average rates and charges per m.c.f. of the Company, after reflecting the reductions herein-after ordered, will be just and reasonable;

Therefore, the Commission *orders* that:

- (A) The rates charged and received for the transportation and sale of natural gas by Hope Natural Gas Company in interstate commerce for resale for ultimate public consumption shall be decreased to reflect a reduction, on an annual basis, of not less than \$3,609,857 in the operating revenues of that Company;
- (B) The following just and reasonable average rates per m.c.f. shall be charged the five customer companies in the future:

	<i>Average Rate Per M.c.f.—Cents</i>
The East Ohio Gas Company	29.5
The Peoples Natural Gas Company	28.5
Fayette County Gas Company	28.5
The Manufacturers Light and Heat Company	28.5
The River Gas Company	35.0

- (C) The Hope Natural Gas Company shall file, on or before July 1, 1942, new schedules of rates and charges for the transportation and sale of natural gas in interstate commerce to its five customer companies for resale for ultimate public consumption, which shall reflect not less than the reduction ordered in paragraph (A) and shall be the average rates per m.c.f. ordered for the respective companies in paragraph (B);
- (D) The new schedules of rates and charges ordered in paragraph (C) shall be effective as to all bills based on meter readings made on or after July 15, 1942;

- (E) On and after the effective date of the new schedules of rates and charges, filed and made effective in accordance with paragraphs (C) and (D), the Hope Natural Gas Company shall cease and desist from making, demanding or receiving any rates and charges other than those ordered in these proceedings until changed by order of this Commission.

By the Commission.

(Signed) LEON M. FUQUAY,  
Secretary.

**2. RESPONDENT THE FEDERAL POWER COMMISSION'S "FINDINGS AS TO LAWFULNESS OF PAST RATES," DATED MAY 26, 1942.**

UNITED STATES OF AMERICA  
FEDERAL POWER COMMISSION

Commissioners { Leland Olds, Chairman, Claude L. Draper, Basil Manly and Clyde L. Seavey. John W. Scott dissenting in part.

May 26, 1942

City of Cleveland,	Complainant	}	Docket No. G-100
vs.			
Hope Natural Gas Company,	Defendant	}	Docket No. G-101
City of Akron,	Complainant		
vs.		}	Docket No. G-127
Hope Natural Gas Company,	Defendant		
Pennsylvania Public Utility Commission,	Complainant	}	Docket No. G-113
vs.			
Hope Natural Gas Company,	Defendant	}	Docket No. G-113
In the Matter of			
Hope Natural Gas Company			

FINDINGS AS TO LAWFULNESS  
OF PAST RATES

Upon consideration of the City of Cleveland's complaint and amendment, the Company's answers, the petitions and orders previously entered in these proceedings,

the evidence of record, the briefs and oral arguments, and the Commission having on this date entered and issued its Opinion No. 76 and order, which Opinion is hereby incorporated by reference and the appropriate portions are made a part hereof;

—2—

The Commission *finds* that:

- (1) The City of Cleveland raised the issue of the lawfulness of the rate charged The East Ohio Gas Company by Hope Natural Gas Company, and requested this Commission to find the just, reasonable and lawful rate from June 30, 1939, to the date of this determination, as an aid to State regulation;
- (2) The Commission has jurisdiction and authority to make such findings which are in the public interest;
- (3) Hope Natural Gas Company is a corporation organized and existing under the laws of the State of West Virginia;
- (4) Hope Natural Gas Company purchases and produces natural gas within the State of West Virginia;
- (5) Hope Natural Gas Company transports, delivers and sells large quantities of the natural gas referred to in Finding (4) to The East Ohio Gas Company at points on and along the interstate boundary between the States of West Virginia and Ohio, which gas is so transported and sold at wholesale for the purpose of resale for ultimate public consumption at points outside the State of West Virginia;
- (6) The transportation and sale of natural gas by Hope Natural Gas Company stated in Finding (5) constitute the transportation and sale of natural gas in interstate commerce within the purview of the Natural Gas Act, and the rates charged and collected by Hope for the gas so transported and sold have been subject to the exclusive jurisdiction of this Commission since June 21, 1938;

- (7) The evidence of reproduction cost new of the Hope Company's property used and useful in the production, transportation, delivery and sale of natural gas to its five interstate wholesale purchasers (as of December 31, 1938), as presented by the Company in these proceedings is hypothetical, conjectural and inherently fallacious and cannot be considered as having probative value in the determination of the allowable rate base;
- (8) The evidence of the trended "original cost" of Hope Company's property (as of December 31, 1938), as presented by the Company, is basically erroneous and cannot be considered as having probative value in the determination of the allowable rate base;
- (9) The Hope Company's restated "original cost" of its property (as of December 31, 1938) erroneously includes items and amounts in excess of the actual legitimate cost thereof as such cost is controlled by fundamental principles of cost determination, and as defined in the Federal Power Commission's Uniform System of Accounts and by decisions of this Commission;

—3—

- (10) Equity and justice require the elimination of such erroneously included items and amounts referred to in Finding (9) in determining the rate base upon which the Company is entitled to earn a fair rate of return;
- (11) The actual legitimate cost of Hope Natural Gas Company's property, excluding distribution property, property used to transport coke-oven gas, and unoperated acreage, was \$51,019,585 for 1939 and \$51,957,416 for 1940;
- (12) The actual existing depletion and depreciation in Hope Natural Gas Company's property was \$21,737,823 for 1939 and \$22,328,016 for 1940, and the resulting actual legitimate cost, less actual existing depletion and depreciation, and excluding distribution property, property used to transport coke-oven gas and unoperated acreage, was \$29,281,762 for 1939 and \$29,629,400 for 1940;



- (13) The unoperated acreage was useful or imminently useful and the actual legitimate cost of such acreage in the amounts of \$567,152 for 1939 and \$566,105 for 1940 should be included in the rate bases;
- (14) Materials and supplies and cash working capital were necessary in the amounts of \$2,100,000 for 1939 and \$2,125,000 for 1940, and should be allowed in the rate bases;
- (15) For the purpose of determining what rates were just, reasonable and lawful since June 30, 1939, the average rate base represented by the actual legitimate cost of Hope Natural Gas Company's property used and useful in rendering interstate service (Finding (12)), plus the cost of unoperated acreage and the necessary working capital, was \$32,326,398 for 1939, \$32,134,710 for 1940, and \$33,712,526 since 1940;
- (16) A rate of return of 6½% was liberal for the period of June 30, 1939, to date;
- (17) The actual operations for 1939 and 1940 are the reasonable and proper bases for determining lawful rates in those years, and 1940 operations, as adjusted, are the reasonable and proper basis for determining lawful rates since 1940;
- (18) The operating revenues from interstate sales were \$14,866,894 for 1939 and \$19,296,755 for 1940;
- (19) The proper credit to Hope Natural Gas Company's operating expenses for the excess profits from the gasoline and butane extracted from its gas by its affiliate, Hope Construction & Refining Company, and for steam and boiler fuel furnished the affiliate, was \$352,516 for 1939, \$304,697 for 1940 and \$304,697 annually since 1940;

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- (20) Reasonable and proper allowances for operating expenses (including amortization of reclassification and rate case expenses) and after allocation of costs to local West Virginia sales, miscellaneous gas revenues and the amount of tax required under lawful rates, are as follows:

## Findings as to Lawfulness of Past Rates

	<u>1939</u>	<u>1940</u>	<u>Since 1940</u>
Operating Expenses	\$14,242,454	\$15,775,195	\$16,272,934
Miscellaneous Gas Revenues	( 68,695)	( 83,275)	( 83,275)
Allocation of Costs to Local West Virginia Sales	( 2,328,110)	( 2,694,075)	( 2,694,075)
Total Deductions from Interstate Revenues	\$11,845,649	\$12,997,845	\$13,495,584

- (21) The rates charged and received by the Company for the transportation and sale of natural gas in interstate commerce for resale for ultimate public consumption were unjust, unreasonable and excessive, and therefore unlawful, to the extent of \$920,029 for the year 1939, \$4,210,154 for the year 1940, and \$3,609,857 since 1940 (on an annual basis), determined as follows:

	<u>1939</u>	<u>1940</u>	<u>Since 1940</u>
Revenues from Interstate Sales	\$14,866,894	\$19,296,755	\$19,296,755
Operating Deductions	11,845,649	12,997,845	13,495,584
Net Operating Income from Interstate Sales	3,021,245	6,298,910	5,801,171
6½% Return on Interstate Rate Base	2,101,216	2,088,756	2,191,314
Excess	\$ 920,029	\$ 4,210,154	\$ 3,609,857

- (22) The total required revenue for all interstate service of the Company was \$13,946,865 for 1939, \$15,086,601 for 1940 and \$15,686,898 annually since 1940;
- (23) Cost, conditions and characteristics of service show that the just, reasonable and lawful rates for natural gas sold by Hope Natural Gas Company in interstate commerce to The East Ohio Gas Company for resale for ultimate public consumption were those required to produce compensation in the amount of \$11,528,608 for 1939, \$11,507,185 for 1940, and \$11,910,947 annually since 1940;

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- (24) The rates charged and received by the Hope Natural Gas Company for the transportation and sale of natural gas in interstate commerce to The

East Ohio Gas Company for resale for ultimate public consumption were unjust, unreasonable, excessive, and therefore unlawful to the extent of \$830,892 during 1939, \$3,219,551 during 1940, and \$2,815,789 on an annual basis since 1940.

By the Commission.

(Signed) LEON M. FUQUAY,  
Secretary.

**3. RESPONDENT THE FEDERAL POWER COMMISSION'S "OPINION NO. 76," TOGETHER WITH CONCURRING OPINION OF COMMISSIONER MANLY AND PARTIALLY DISSENTING OPINION OF COMMISSIONER SCOTT, DATED MAY 26, 1942.**

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UNITED STATES OF AMERICA  
FEDERAL POWER COMMISSION

OPINION NO. 76

City of Cleveland,	Complainant	}	Docket No. G-100
vs.			
Hope Natural Gas Company,	Defendant.	}	
City of Akron,	Complainant	}	Docket No. G-101
vs.			
Hope Natural Gas Company,	Defendant.	}	
Pennsylvania Public Utility Commission,	Complainant	}	Docket No. G-127
vs.			
Hope Natural Gas Company,	Defendant.	}	
In the Matter of		}	Docket No. G-113
Hope Natural Gas Company			

APPEARANCES

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For the State of West Virginia  
and the

Public Service Commission of West Virginia:

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Hon. John J. D. Preston  
Hon. E. B. Pennypacker  
Hon. C. E. Nethken  
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## OPINION

## BY THE COMMISSION :

These proceedings grew out of complaints filed by the cities of Cleveland and Akron, Ohio, and were enlarged by the Commission's Order of October 14, 1938, for an investigation of the reasonableness of all the interstate wholesale rates of Hope Natural Gas Company under the provisions of the Natural Gas Act.<sup>1</sup>

The cities of Cleveland and Akron, Ohio, filed with the Commission complaints alleging that the price charged by Hope Natural Gas Company to East Ohio Gas Company for natural gas was unreasonable and unduly discriminatory. The Pennsylvania Public Utility Commission also filed a complaint asserting that the rates charged by Hope Natural Gas Company to Peoples Natural Gas Company, Fayette County Gas Company and the Manufacturers Light and Heat Company were unlawful.

The three complaint proceedings and the proceeding instituted by the Commission were consolidated for purposes of hearing. Upon petition, the Public Service Commission of West Virginia, the State of West Virginia and the City of Toledo, Ohio, were permitted to become interveners in the consolidated proceedings.

Hearings were held, pursuant to order and notice, at intervals during 1940 at which Hope presented its case-in-

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chief. After written and oral argument the motion of the cities of Cleveland and Akron for an immediate order reducing rates to East Ohio Gas Company was denied for insufficiency of evidence. Additional hearings were conducted during the first half of 1941 and concluded in July. The evidence presented during the 43 days of hearings

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<sup>1</sup> The term "interstate wholesale" when used in this Opinion means the sale of natural gas in interstate commerce for resale for ultimate public consumption for domestic, commercial, industrial, or any other use.

covered all issues and embraced nearly a gross of extensive exhibits and about 7,000 pages of transcript. Each party to these proceedings was cognizant of the issues and was afforded ample opportunity to present evidence. Comprehensive briefs have been filed and the Commission, sitting *en banc*, has heard extensive oral argument.

### JURISDICTION

The jurisdiction of the Commission was not challenged in these proceedings. The facts show and counsel for Hope Natural Gas Company have stipulated that Hope transports and sells natural gas in interstate commerce to five companies for resale for ultimate public consumption.<sup>2</sup> Hope is a natural gas company within the purview of the Natural Gas Act and we may proceed with the determination of the lawfulness of its interstate wholesale rates. See *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*, 314 U. S. 498; *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U. S. ....

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### OPERATIONS OF THE COMPANY

The Hope Natural Gas Company was organized in 1898 in West Virginia and is a subsidiary of Standard Oil Company (N. J.). Its property, composed of approximately 5,000 miles of pipe lines and 3,000 gas wells in West Virginia, is an integral part of the interconnected Standard

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<sup>2</sup> Hope's pipe lines interconnect with those of its five wholesale customers and the gas which it sells to those companies flows in interstate commerce without interruption and is resold in Ohio and Pennsylvania. Hope sells and delivers gas (1) to the East Ohio Gas Company and the River Gas Company at several points along the West Virginia-Ohio state boundary; (2) to the Peoples Natural Gas Company and the Fayette County Gas Company at points on the West Virginia-Pennsylvania state boundary; and (3) to the Manufacturers Light and Heat Company in northern West Virginia, which transports and sells such gas in Pennsylvania for ultimate public consumption.

Oil System which serves the Appalachian area with natural gas. The major customers of Hope are its affiliates, The East Ohio Gas Company and The Peoples Natural Gas Company, which serve a large area including Cleveland, Akron, Youngstown, Massillon, Canton, Pittsburgh and Altoona. Hope also sells gas to its affiliate, The River Gas Company, and to two non-affiliates, Fayette County Gas Company and The Manufacturers Light and Heat Company. Hope produces about one-third of its total annual gas requirements and purchases the remaining two-thirds under more than 300 contracts.<sup>3</sup>

In 1940, Hope handled about 74,000,000 m.c.f. of gas and sold: (1) more than 40,000,000 m.c.f. to East Ohio Gas Company; (2) about 10,000,000 m.c.f. to Peoples Natural Gas Company; (3) more than 2,000,000 m.c.f. to Manufacturers Light and Heat Company; (4) approximately 860,000 m.c.f. to Fayette County Gas Company; (5) nearly 400,000 m.c.f. to River Gas Company; and (6) more than 11,000,000

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m.c.f. to local consumers in West Virginia. The remainder totaling about 9,000,000 m.c.f. was gas lost or used in Company operations.

Hope's natural gas is processed by an affiliate, Hope Construction & Refining Company, for the purpose of extracting the natural gasoline and butane. Another affiliate, the Domestic Coke Corporation, sells its by-product coke-oven gas to Hope for use as boiler fuel in Hope's main compressor station.<sup>4</sup>

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<sup>3</sup> Hope purchases coke-oven gas from the affiliated Domestic Coke Corp. and transports the gas to Hastings for use as compressor station fuel. It is agreed that the property and costs relating to that transaction be eliminated and the equivalent m.c.f. of natural gas be substituted at Hastings compressor station at a cost of 22¢ per m.c.f.

<sup>4</sup> Hope Natural Gas Company in December 1939 merged the former Reserve Gas Company, but by agreement between counsel that property and income have been segregated and excluded for the purposes of these proceedings.



## CORPORATE AND FINANCIAL HISTORY

Hope Natural Gas Company is a large, seasoned and successful utility, and during its corporate history of more than forty years its capital structure has been solely in the form of common stock. Since 1908, it has been a subsidiary of Standard Oil Company (N. J.) and all of its outstanding capital stock, having an aggregate par value of approximately \$28,000,000, is owned by Standard.

During Hope's existence it has paid more than \$108,000,000 in dividends, \$11,000,000 of which were stock dividends. From 1898 to 1941 the average annual cash dividends to stockholders exceeded 20% on the average annual amount of capital stock issued for cash or other assets.

The Company presented its balance sheet as an exhibit, which shows an owner's equity in assets, at the end of 1938, of more than \$33,000,000, comprising \$28,000,000 of

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capital stock and \$5,000,000 of surplus. This equity is represented in assets principally by gas plant in the net amount of \$15,500,000, Government bonds of \$11,000,000, and cash and investments of \$5,500,000. The \$15,500,000 net investment per books in the Company's gas plant, including distribution property, is actually about \$8,000,000, because the Company had previously transferred \$7,500,000 from depletion and depreciation reserves to earned surplus.<sup>5</sup>

<sup>5</sup> Source: Ex. No. 11, pp. 10 and 21; Ex. 61, p. 3.

Plant, Dec. 31, 1938, per books (including Distribution Property of about \$2,795,000)	\$56,213,454
Depreciation and depletion reserve, per books	40,633,562
	<u>15,579,892</u>
Less adjustments in 1934 (\$5,901,000) and in 1908 (\$1,650,000) transferring these amounts from depreciation and depletion reserve to earned surplus	7,551,000
	<u>\$ 8,028,892</u>
Net Investment	

We will now proceed to the pragmatic determination of the lawful rates, within the ambit of our statutory authority.

#### RATE BASE

The Hope Company claimed a rate base of \$66,000,000 and calculated that it was earning a rate of return of about 3% from its interstate business on that base. The claimed rate base was molded from an estimate of the cost to reproduce the property less observed depreciation, plus working capital. The derived rate of return was based upon the Company's presentation of revenues and expenses averaged for 1937, 1938 and 1939.

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#### *The Company's Estimates of Reproduction Cost and Trended "Original Cost"*

The estimate of the Company approximated \$97,000,000 for the cost to reproduce the property. That result was reached by applying unit prices for material and labor to an inventory and adding about 17% to that total for undistributed construction costs.

Many hypotheses were employed for this reproduction-cost estimate and each of them disregards the development and experience of the Hope Company. Quoted prices for pipe and other material, rather than actual current prices, were used and obsolete compressor station equipment was priced by applying quoted prices for modern equipment. The record demonstrates that the quoted price for pipe is not in fact the price that is paid. Actual prices are the result of negotiation. The calculated construction costs exceeded the actual pipe line construction costs experienced by the Hope Company during a recent period. This appraisal of the cost to reproduce the system included \$14,000,000 for undistributed construction costs or overheads which ignored the experience of the Company with

respect to such costs and the fact that Hope has charged all overhead expenditures (with minor exceptions) to operating expenses in the past. It is improper and inequitable to capitalize items formerly charged to operating expenses, and in rate-making the inclusion of such expenses in the rate base would compel the rate payer to reimburse the Company more than once for the same item. We will discuss this point extensively in connection with the Company's claimed "original cost."

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The Company's hypothetical reproduction cost estimate is nearly double the actual legitimate cost of the property, although, as the record shows, the greater part of the property was constructed during the high-price period of 1917-1930.

After full consideration of the estimate of reproduction cost new presented by the Company, we find that it is not predicated upon facts and that it is too conjectural and illusory to be given any weight in these proceedings. See *Railroad Commission v. Pacific Gas & Electric Co.*, 302 U. S. 388, 397; *Re Canadian River Gas Co. et al.*, F. P. C. Op. 73.

The Company also presented a trended "original cost" estimate which exceeded \$105,000,000. The objective of that estimate, according to the witness, was to reflect changes in price levels and to indicate what the original cost of the property would have been if 1938 material and labor prices had prevailed throughout the whole period of the piecemeal construction of the Company's property since 1898. At the outset this estimate includes a multi-million dollar error because the trend factors were applied to an inflated "original cost" claim of the Company, which we will discuss fully under the subject of actual legitimate cost. The evidence discloses fundamental errors in the trending process used. No consideration was given by the Company's witness to the great advances in the science of con-

struction and the improvement in the quality of pipe and equipment in the natural gas industry, during the long history of the Company.

Hope Company's own experience demonstrates that

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man-hour productivity has increased greatly throughout the years during which the Company's property was constructed. Yet the Company's witness gave no consideration to that fact, but utilized high 1938 hourly wage-rates to price the slower obsolete construction methods of the past on a time basis. It is undisputed that service qualities of pipe, including increased tensile strength and reduced weight, have been improved in recent years. Pipe is sold on the basis of weight and the heavier and inferior pipe in the Hope System was priced at 1938 prices for modern pipe, in disregard of the known improvements in the product. Another basic defect in the trending was the adoption of the arithmetical average of the cost per ton of smaller sizes of pipe when 95% of the cost of pipe in the Company's transmission lines represented pipe having greater diameters. That such a pipe trend is not representative is obvious. Furthermore, the 1938 prices upon which the trends were based, being representative of only slightly more than 1% of the total plant, furnished no dependable yardstick.

In the light of the evidence the conclusion is inescapable that the Company's trended "original cost" estimate is not founded in fact, but it is basically erroneous and produces irrational results.

The reproduction cost studies and the so-called trended "original cost" studies were the typical, hypothetical conjectures which have plagued rate regulation for more than forty years. The actual development and experience of the Hope Company were ignored. In addition, assumption upon assumption as to material and labor costs, and magni-

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fied imagination as to overheads were indulged in lavishly. The results have no probative value and accordingly must be condemned.<sup>6</sup>

The estimates of reproduction cost and trended "original cost" lack reliability, so we turn to the evidence of actual cost of Hope's property.

*Actual Legitimate Cost*

The Company and the Commission's Staff submitted exhibits and supplied testimony on the cost of gas plant used in the Company's interstate service. The Company claimed that cost, as of December 31, 1938, amounted to \$69,735,638, the Staff indicated a figure of \$51,984,153, while the books disclosed an investment of approximately \$52,730,666.<sup>7</sup>

Hope's vouchers, books and records are adequate for examination, analysis and audit. Hope kept complete records of its expenditures throughout its existence, so no estimates are required to ascertain the actual cost.

<sup>6</sup> Under the recent decision of the Supreme Court involving the Natural Gas Act in *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U. S. . . ., and the decision of this Commission in *Re Chicago District Electric Generating Corporation*, 39 P. U. R. (N. S.) 263, involving the companion part of the Federal Power Act, such estimates of reproduction cost and trended "original cost" need not have been admitted in evidence.

<sup>7</sup> The book cost of the interstate facilities is derived as follows:

Total Plant Investment per books		\$56,213,454
Less:		
Distribution Property	\$2,795,083	
Unfinished Construction	81,392	
Intangible Plant	30,186	
Property Used to Transport Coke-oven Gas	576,127	3,482,788
		<hr/>
Plant Investment, per books, of Interstate Facilities		<u>\$52,730,666</u>

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Table A appearing on page 11 compares the cost of facilities used in interstate service as claimed by the Company, as shown by the books of account, and according to our findings, as of December 31, 1938.

*The Company's Estimated  
"Original Cost"*

The first step in the Company's determination was the taking of an inventory. The inventory units were then priced at estimated cost, including arbitrary overheads. The amounts shown as plant costs by the books were ignored, except for the purpose of aiding in estimating unit costs. As is shown by Table A, the Company's method resulted in a claimed net increase of \$17,004,972 over the amount recorded as investment in the interstate properties on its books of account. The Company claims, in other words, that its books fail to show the true cost of such properties in that amount. The items of that amount which are identifiable represent expenditures previously charged to expense accounts. Some of the alleged expenditures were not incurred at all. For example, claimed interest during construction of \$632,000 was not actually paid. Obviously, to the extent that the plant costs are understated, if they are, the difference must represent charges to other accounts, particularly expense accounts, in the books.

The claimed additional costs are divisible into two groups—one relating to properties constructed by the Company, and the other relating to property acquired from other utilities. Table B on page 12 shows the general nature of the \$17,004,972.

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TABLE A

Account	Cost of Plant as of December 31, 1938		
	Claimed by Company	Amt. Shown by Books*	Allowed
<b>Natural Gas Production Plant</b>			
Natural Gas Producing Lands .....	\$ 2,370	\$ 3,320	\$ 3,320
Natural Gas Producing Leaseholds.	1,684,636	1,331,101	1,599,005
Rights of Way .....	701,556	529,400	645,391
Other Land and Land Rights .....	22,126	24,602	21,008
Field Measuring and Regulating Station Structures .....	40,773	28,617	21,139
Other Prod. System Structures ....	291,872	213,164	191,189
Gas Wells: Construction .....	17,783,637	4,366,934	4,089,478
Equipment .....	8,168,192	7,885,581	7,610,510
Field Lines: Construction .....	4,056,915	3,028,847	3,622,489
Equipment .....	8,244,966	7,929,927	7,674,252
Field Meas. and Reg. Station Equip- ment .....	267,099	249,842	184,385
Drilling and Cleaning Equipment ..	604,936	543,740	595,693
Other Production Equipment .....	89,102	45,031	75,532
<b>Total Production Plant .....</b>	<b>41,958,180</b>	<b>26,180,106</b>	<b>26,333,391</b>
<b>Transmission Plant</b>			
Land .....	164,105	158,122	162,912
Rights of Way .....	442,394	491,784	391,243
Compressor Station Structures ....	1,725,945	1,661,573	1,441,882
Trans. Meas. and Reg. Station struc- tures .....	11,988	11,399	8,207
Other Transmission System Struc- tures .....	11,509	7,348	6,776
Mains .....	15,180,596	14,413,516	14,132,075
Compressor Station Equipment ....	8,313,531	7,979,316	7,683,672
Trans. System Meas. and Reg. Equip- ment .....	26,713	29,463	17,616
Other Transmission System Equip.	23,042	15,188	21,016
<b>Total Transmission Plant ...</b>	<b>25,899,823</b>	<b>24,767,709</b>	<b>23,865,399</b>
<b>General Plant</b>			
Land and Land Rights .....	98,188	126,678	96,981
Structures and Improvements ....	247,427	237,323	225,888
Office Furniture and Equipment ...	195,911	239,989	178,683
Transportation Equipment .....	148,540	161,431	142,315
Stores Equipment .....	9,466	3,321	5,107
Shop Equipment .....	114,706	63,169	104,185
Laboratory Equipment .....	1,070	1,003	1,003
Tools and Work Equipment .....	4,634	200,761	4,545
Communication Equipment .....	347,639	249,121	248,976
Miscellaneous Equipment .....	1,172	20,484	1,148
<b>Total General Plant .....</b>	<b>1,195,753</b>	<b>1,303,280</b>	<b>1,008,831</b>
<b>Gas Plant for Interstate Service ....</b>	<b>69,053,756</b>	<b>52,251,095</b>	<b>51,207,621</b>
Unoperated Acreage .....	681,882	479,571	584,382
Wells and Field Lines not in Service			192,150
<b>Total Gas Plant (Exclusive of Dis- tribution Plant and Property used to transport Coke-oven Gas) .....</b>	<b>\$69,735,638</b>	<b>\$52,730,666</b>	<b>\$51,984,153</b>

\* For comparative purposes the amounts in this column have been classified (without change in the total) in accordance with our Uniform System of Accounts for Natural Gas Companies. The Company's study is on this basis also.

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TABLE B

<i>Constructed Property</i>	
Inventory, Transfer and Correcting Adjustments	\$(1,821,581) <sup>s</sup>
Direct Material and Labor Costs not Capitalized	13,580,814
Unloading, Hauling and Warehouse Handling Costs	383,454
Indirect Field Costs	396,141
Overhead Costs	2,866,414
Total Claimed Adjustments to Constructed Property	\$15,405,242
Claimed Adjustments to Properties Purchased from Other Utilities	1,599,730
Total	\$17,004,972

The Company's cost study was made by an engineering firm. The witness for the Company, a valuation engineer, indicated clearly that he was not concerned with the Company's past practices in determining costs and in determining expenses. To him it was of no concern whether an item had been charged to expense and the cost thereof recouped in rates, or even whether an item represented an expense under the wide discretion of management allowed by accepted principles of accounting. The realities as to past practices and determinations received no consideration. Evidently the object of the study was to determine the maximum cost which could be assigned to the properties under any theory or principle of cost determination, regardless of the fact that the Hope Natural Gas Company had been in business more than forty years and had made determinations in its regular course of business as to which of its expenditures constituted investment in plant and which constituted operating expenses.

The first proposed adjustments to book cost (\$1,821,581), reflecting inventory, transfer and correcting adjust-

<sup>s</sup> Parentheses indicate decrease.



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ments, will be discussed hereinafter.

The second adjustment (\$13,580,814) represents items previously charged to expense and not capitalized in the books or items which cannot be identified in the books and records and, therefore, may not have been incurred at all. The amount of \$13,580,814 may be subdivided as follows:

Well Drilling	\$11,279,554
Other Direct Material and Labor Cost	996,543
Labor Costs in Laying Mains, Constructing Compressor Stations, etc., During Years 1918 to 1922, Inclusive	1,295,953
Leasehold Cost	8,764
	\$13,580,814
Total	\$13,580,814

The largest item of claimed additional cost relates to labor and drilling equipment used in drilling wells. The additional amount claimed (\$11,279,554) is associated with 2,633 wells. It is the Company's contention that these expenditures, which were charged to operating expenses when incurred, should now be included in the rate base.

It was the consistent practice of the Hope Company up to 1923 to charge the cost of drilling wells to operating expense. This likewise was the general practice of the natural gas industry. It followed the well-established practice of extractive industries of charging items to expense which in less venturesome enterprises were ordinarily charged to the plant account.<sup>9</sup> The theory underlying the practice was that additional wells were constantly needed to keep

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the Company in business, hence the cost incurred was not for the purpose of adding to the property but rather for the purpose of maintaining the business. The evidence

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<sup>9</sup> *Re Hope Natural Gas Co.*, 1921 E 418, 439-440; *United States v. Roden Coal Co.*, 39 Fed. (2d) 425; *Marsh Fork Coal Co. v. Lucas*, 42 Fed. (2d) 83; *Commissioner of Internal Revenue v. Brier Hill Collieries*, 50 Fed. (2d) 777.

shows that the Natural Gas Association of America opposed a provision in the first uniform system of accounts for natural gas companies issued by a State commission which required capitalization of well drilling expenditures. That Association took the view that such expenditures were necessary operating expenses. In fact, Hope did not change its practice in this respect until it was required to do so by the provisions of the system of accounts for natural gas companies promulgated by the Public Service Commission of West Virginia, effective in 1923. It is significant that West Virginia's system of accounts did not require and evidently did not permit the Hope Company to re-account for its past expenditures, but merely required a change as to treatment of well drilling expenditures beginning with its effective date.

The Company's practice of charging well drilling expenditures to operating expenses, therefore, conformed to the principles and practices of the time. One of the obvious purposes of keeping books of account is to inform management so that proper managerial decisions may be made. One of the first functions of management, of course, is to endeavor to fix prices so that revenues will cover operating expenses and yield a profit. Where it is the general practice of the industry to treat certain expenditures as operating expenses, it is manifest that such expenditures will be considered as expenses in its rate negotiations and determinations.

If there were any doubt about this matter, it would be

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dispelled by the action of the Hope Company itself. In 1921 the Hope Company was involved in a rate proceeding before the Public Service Commission of West Virginia. It was a proceeding in which Hope sought to increase its rates. In that proceeding the Company claimed well drilling and other expenditures now sought to be included in the rate base, as operating expenses. They were allowed

as such by the Public Service Commission of West Virginia.<sup>10</sup> No further proof is needed to show that Hope considered the expenditures in question as operating rather than plant items, in its efforts to recover full operating costs plus a profit in the conduct of its business.

No greater injustice to consumers could be done than to allow items as operating expenses and at a later date include them in the rate base, thereby placing multiple charges upon the consumers.

The other direct material and labor costs of \$996,543 appear, to the extent they can be identified, to have been charged in the past to maintenance and repairs.

The adjustments for cost of labor in laying mains, constructing compressor stations and other property totaling \$1,295,953, and the adjustment of \$8,764 to the cost of leases are treated later.

In addition to well drilling expenditures, other items now sought to be included in the plant accounts which were previously included in expenses, if they were incurred at all (the Company's method makes it impossible to determine whether or not certain of the expenditures were incurred), are as follows:

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Unloading, Hauling and Warehouse	
Handling Costs	\$ 383,454
Indirect Field Costs	396,141
Other Overhead Costs	2,866,414

As to these items, here again the Company followed a consistent practice, and the practice of the industry, in charging such expenditures to expense accounts. It was not customary for the natural gas industry or other extractive industries to load the plant accounts with overhead items, such as shown above. Even under the relatively definite requirements of the Commission's present Uniform System of Accounts, considerable discretion and latitude

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<sup>10</sup> *Re Hope Natural Gas Co.*, P. U. R. 1921 E 418, 433, 439-440.

are allowed management in accounting for overhead expenditures. Accordingly, the allowance of the items mentioned would not represent the correction of past errors, but merely the substitution of present judgment for the judgment exercised at the time the expenditures were incurred, which covered a period of forty years. The important rule is that once discretion has been exercised, subsequent action must be consistent with the decisions previously reached. There is no settled principle controlling the determination of the exact amount of overheads, if any, which should be applied to the cost of plant items.

Besides claiming large additional costs for property constructed by the Company, Hope claims a net sum of \$1,599,730 representing alleged additional original cost of property acquired from other utilities. These properties, acquired chiefly from affiliated utilities, were accounted for by Hope at the cost to it, which was the cost to the predecessors. Hope now claims that the costs accounted for as

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plant by the predecessors were in error in that the predecessors followed the same allegedly erroneous practices that Hope followed. It, therefore, claims that well drilling costs in the amount of \$1,364,087, other direct material and labor costs of \$286,173, unloading, hauling and warehouse handling costs of \$18,557, indirect field costs of \$38,519, other overhead costs of \$122,043, and leasehold costs of \$6,388, all of which, if incurred at all, the predecessors had charged to expense, should be added to its plant investment figure and included in the rate base.<sup>11</sup> Since these predecessor companies kept their books and records exactly as did Hope, in accordance with the general practice of the industry, the proposed adjustments, except for leasehold

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<sup>11</sup> There were also inventory, transfer and correcting adjustments which decrease the book cost by \$236,037, and they are discussed hereinafter.

costs, are in the same category as the items which Hope now attempts to restate in its plant accounts.

In the course of its study, the Hope Company determined that considerable property which was recorded in its plant accounts, was no longer in existence. In other words, there were unrecorded retirements. Offsetting the unrecorded retirements were certain items of existing property for which the Company found no costs in its plant accounts. More than likely, certain of the latter merely represented the failure to identify items which were determined to be unrecorded retirements. The net effect is a substantial adjustment (\$1,821,581 for constructed property, and \$232,930 and \$3,107 for acquired property) for unrecorded retirements and miscellaneous corrections. The adjustment is not controverted and should be made.

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*Impropriety Of Including In Rate Base  
Items Previously Charged To Expense*

It has been shown that the Company's claim of additional plant cost over and above what is recorded on its books as plant investment represents largely expenditures previously charged to expense in accordance with the discretion of management. The Company, in other words, now impeaches its books and its former financial statements to regulatory bodies, tax authorities, investors, and others. It impeaches the decisions of management made at the time the expenditures were incurred. It does this in spite of the fact that its past decisions conformed to its own consistent practices, until required to change them by a regulatory agency, and to the general practice of the natural gas industry, as well as the extractive industry. The adjustments proposed, therefore, do not reflect the correction of errors in the past. Errors as to these items were not made.

The past determinations of the items constituting plant investment were deliberate, conscious acts on the part of

management at the time of the transactions. A decision obviously must be made when an expenditure occurs as to whether it represents an investment in plant or an expense. There must also be some finality to these decisions.<sup>12</sup> If

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they are treated as expenses at one time and as plant investment subsequently, chaos in rate-making and in corporate finance will prevail. It is no answer that many of the expenditures in question were incurred prior to the effective date of a prescribed uniform system of accounts. The Company kept plant and expense accounts throughout its history and conformed to the general business practices of the industry and like business institutions. It was evidently thoroughly convinced as to the propriety of its decisions, as witness its claim before the West Virginia Commission in 1921, that the very expenditures in question were operating expenses. The Company is now estopped from re-accounting for those expenditures.

With the decline in favor of the doctrine of "fair value" as the only mode of public utility rate regulation, its keystone, reproduction cost, crumbles. Bona fide investment figures now become all important in the regulation of rates. Immediately, however, we find an effort to tamper with these. There is in progress an attempt to make the reproduction cost *process* survive in the determination of actual cost of or investment in plant. Thus, in this case an inventory was taken and then units were priced at the estimated "actual cost." The method should be condemned at

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<sup>12</sup> Costs of exploration for and development of future gas reserves are considered current operating costs by the industry and Hope has included such costs in its current operating expenses. If retroactive accounting were allowed then the Company might restate these costs as capital investment in the future productive acreage. The Commission will allow \$600,000 in annual operating expenses for exploration and development costs in fixing rates. If this item were permitted to be restated in plant cost ten years from now \$6,000,000 would be added to the rate base resulting in multiple charges to consumers.

the threshold. For in addition to being permeated with conjectural estimates, it gives no heed to the realities of past events. Consistent treatment of expenses and plant investment costs is indispensable to the successful operation of the regulatory system.

This is not to say that genuine errors in the investment accounts should not be corrected and the true figures

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given recognition in the rate base. Where real errors are made, they probably should be corrected. A distinction must be made, however, between genuine errors and a change in point of view, whereby past, deliberate decisions within the scope of an accepted principle are sought to be impeached to the pecuniary benefit of the Company.

The courts and commissions which have considered this matter have generally refused to include in the rate base amounts previously charged to expense in accordance with discretion of management. In the instant case, large parts of the claimed additions to book costs relate to well drilling expenditures and alleged overheads. The very question at issue has been passed upon twice by the Supreme Court of Appeals of West Virginia. In the first case in 1924, the Natural Gas Company of West Virginia sought to include such expenditures in the rate base after they had been charged to expense. The Public Service Commission of West Virginia refused to allow them. The Supreme Court of Appeals sustained the Commission.<sup>13</sup> The question was raised again in 1934 by the Natural Gas Company of West Virginia. The Public Service Commission of West Virginia then concluded that the inclusion of such expenditures in the rate base was required as a matter of law. The City of Wheeling, West Virginia, appealed the Commission's decision. The Court reversed the Commission and

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<sup>13</sup> *Natural Gas Company v. Public Service Commission*, 95 W. Va., 557, 121 S. E. 716, 720, P. U. R. 1924 D 346, 361.

again held that items previously charged to operating expenses should not be included in the rate base.<sup>14</sup>

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Thus, by far the weight of authority in court and commission decisions sustains the principle, sound in equity and justice, that items previously charged to operating expenses under the allowable discretion of management should not later be included in the base on which customers are required to pay a return and depletion and depreciation allowances.<sup>15</sup>

The Hope Company's earnings over the years have been ample to provide for all operating expenses, including the \$17,800,000 which it attempts to add to actual cost, an excessive reserve for depletion and depreciation, taxes, and large returns to investors. During the period 1898 to 1923 for which the Company seeks to re-account and expand its recorded plant costs by approximately \$12,600,000 for well drilling costs alone, the average rate of earnings on the annual average invested capital (capital stock and surplus) was more than 15%.

*Actual Legitimate Cost Or  
Gross Plant Investment*

Accordingly, we begin with the book cost in the determination of the actual legitimate cost or investment in the facilities used in the Company's interstate business. We

<sup>14</sup> *Wheeling v. Natural Gas Company*, 115 W. Va. 149, 175 S. E. 339, 343-4, 5 P. U. R. (N. S.) 471, 479, app. dis. 296 U. S. 659.

<sup>15</sup> *Re Los Angeles Gas & Electric Corp.*, P. U. R. 1931 A, 132, 143-4, aff. 58 Fed. (2d) 256, 261, 267, 289 U. S. 287; *Re Peoples Gas Light & Coke Co.*, 19 P. U. R. (N. S.) 177, 196-8, aff. 373 Ill. 31, 25 N. E. (2d) 482, 493, 31 P. U. R. (N. S.) 193, 207, app. dis. 309 U. S. 634; *Re West Virginia Central Gas Co.*, P. U. R. 1918 C, 453, 464-6; *Re Mondovi Telephone Co.*, P. U. R. 1933 B, 319, 321-3; See *Re Northwestern Electric Co.*, 36 P. U. R. (N. S.) 202, 208-213, aff. 125 Fed. (2d) 882; *Re Canadian River Gas Co., et al.*, F. P. C. Op. 73; cf. *Chicago & N. W. R. Co. v. Com'r. Int. Rev.*, 114 Fed. (2d) 882, 886, cert. den. 312 U. S. 692.



have already found that such book cost at the end of 1938 amounted to \$52,730,666. There must be deducted from the

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book cost the unrecorded retirements, or inventory adjustments in the amount of \$2,057,618. There is added to the book cost the amount of \$15,152 (\$8,764 for constructed property and \$6,388 for acquired property) representing adjustments due to errors in stating the cost of leases, and an amount of \$1,295,953, representing plant costs properly capitalized and then arbitrarily charged off to operating expenses.

There is considerable question as to whether the latter amount should be restored to book cost in determining the rate base. The amount arises as follows. From 1918 to 1923 Hope followed the peculiar practice of capitalizing the cost of direct labor incurred in laying pipe lines, constructing compressor stations and in installing equipment, but at the end of each year, arbitrarily charged off the amount thus capitalized during the year. This practice was peculiar to the Hope Company and was not a general practice of the industry. It did not conform to sound accounting principles. Hope followed the correct practice during all of its existence except for the few years mentioned. Under the circumstances, the amount is restored to the investment figure and is allowed in the rate base. The allowance in this instance, however, is not to be construed as a precedent.

As of December 31, 1938, the cost of unoperated acreage (\$584,382) and the cost of certain wells and field lines (\$192,150) then not in service were contained in the accounts. These items are eliminated from gas plant in service as of December 31, 1938, and appropriate adjustments for the use of such property and facilities are made subsequently.

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After considering the evidence based upon the vouchers, books and records of the Company, and as a result of

the application of fundamental principles of accounting, cost determination and equity, the Commission finds, in the words of Section 6(a) of the Act, the actual legitimate cost as of December 31, 1938 in plant used in the interstate business was \$51,207,621, composed as follows:

Book Cost 12/31/38	\$52,730,666
Less Inventory adjustments (unrecorded retirements)	2,057,618
Less Wells and Field Lines Not in Service	192,150
Less Unoperated Acreage	584,382
	<hr/>
Sub-total	49,896,516
Plus Correction to Cost of Leases	15,152
Plus Capitalized Costs Charged Off in Error	1,295,953
	<hr/>
Actual Legitimate Cost of Plant in Interstate Service	\$51,207,621

There were more retirements than additions in 1939, so the actual legitimate cost was \$51,099,024 at the end of 1939. The record shows net additions of \$965,533 in 1940 to produce a total actual legitimate cost of \$52,064,557. Certain inactive wells with the connected field lines became active in 1940 and the cost of this property is \$110,316. We find that the actual legitimate cost, including such currently used property, aggregates \$52,174,873 as of December 31, 1940.

This actual legitimate cost is predicated upon facts and it is the best evidence in these proceedings, so we will employ it for determining the proper and allowable rate base.

#### *Depletion and Depreciation*

In determining the allowable rate base in these proceedings the actual existing depletion and depreciation should be deducted from the actual legitimate cost of the property devoted to the interstate service. See *Los Angeles Gas & Electric Corp. v. R. R. Comm.*, 289 U. S. 287,

312. Actual existing depletion and depreciation is the extent to which the service life, that is the economic life, of the property has been consumed due to such forces as exhaustion of the natural gas supply, wear, inadequacy, and obsolescence.<sup>16</sup> Annual depletion and depreciation measure the economic service life consumed in one year, actual existing depletion and depreciation are the accrued consumption of the utility's economic service life on a certain date; the annual allowance for depletion and depreciation must, therefore, be correlated with the actual existing amount to avoid injustice to the utility or rate payer. *Re Canadian River Gas Co., et al.*, F. P. C. Op. 73; *Re Chicago District Electric Generating Corp.*, 39 P. U. R. (N. S.) 263, 275; *Re Interstate Power Co.*, 32 P. U. R. (N. S.) 1, 10.

The Company presented inconsistent claims in this respect. It alleged a relatively small amount of accrued or existing depletion and depreciation to be deducted in fixing the rate base, but claimed large annual amounts for future operating expenses.

The Company contends that the accrued depletion and depreciation in its property equaled approximately 35%

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of the reproduction cost at the end of 1938. We have weighed the estimate of reproduction cost and found it wanting. In addition, it is inequitable to predicate depletion and depreciation upon the delusive reproduction cost. The integrity of the investment will be maintained by basing depletion and depreciation upon actual legitimate cost and the Supreme Court has approved that method.<sup>17</sup>

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<sup>16</sup> *Lindheimer v. Illinois Bell Tel. Co.*, 292 U. S. 151, 167; *Re Canadian River Gas Co., et al.*, F. P. C. Op. 73; cf. *Depreciation Charges of Telephone and Steam Railroad Companies*, 177 I. C. C. 351, 408, 422.

<sup>17</sup> *Lindheimer v. Illinois Bell Tel. Co.*, 292 U. S. 151, 167-9, 176; *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U. S. . . . .

The Company determined accrued depreciation primarily by the observation process and obtained what is called a "per cent condition" of the property. For annual expense purposes, it weighted the observed depreciation with retirement of property up to the date of the study. The fallacy of the "per cent condition" theory of accrued depreciation is plain here. To illustrate, under the hypothesis of the Company's witness, in determining the "per cent condition" of certain compressor station equipment, the property would be found to have depreciated only 25% throughout its life or be in 75 "per cent condition," and then suffer a precipitous loss in the brief final stage of service. Such a theory is opposed by reason and facts. *Los Angeles v. Southern California Telephone Co.*, 14 P. U. R. (N. S.) 252, 273-4. The Company's estimate of existing depreciation was based primarily upon a sporadic visual inspection of physical deterioration. Most of Hope's production and transmission property is not visible and the extent to which the service life has been consumed can not be determined from observation alone. Also, the functional

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causes of the retirement of property are given little consideration by the Company's visual method which samples physical causes. *Re Rochester Gas & Electric Corp.*, 33 P. U. R. (N. S.) 393, 468-490. The Commission concludes that the so-called accrued depletion and depreciation claimed by the Company does not give full or proper consideration to all factors contributing to the retirement of property, and that it does not reflect the actual existing depletion and depreciation or diminished service life of the property in service.

*The Required Reserve For  
Depletion and Depreciation*

The same factors that cause annual depletion and depreciation cause the actual existing depletion and depreciation to be deducted from the property in fixing the rate base. In our opinion, where reasonable and proper depletion and depreciation accounting practices have been observed by a natural gas company, the resulting reserve is the best measure of the depletion and depreciation existing in the property, i.e., the accumulated cost of property which has been consumed in service.

It is well known that many electric and gas utilities have not observed sound depreciation and depletion practices. The Hope Company is in this category. For many years most of Hope's business was not under regulation. Its practices as to depreciation and depletion, like the practices of many other utilities, were inconsistent and haphazard. Its book reserve does not measure the actual existing depreciation and depletion.

This Company has actually accumulated an excessive reserve. We are confronted, therefore, with the question

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as to whether that excessive reserve, or the reserve requirement (actual existing depreciation and depletion), should be deducted in determining the rate base.<sup>18</sup> We have formerly indicated that public utilities ought to set up proper depreciation (and depletion) expense and that the resulting reserve should be deducted from the gross cost in the rate base determination.<sup>19</sup> We reiterate that view.

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<sup>18</sup> There are those who argue that excessive reserves should be deducted. *Pennsylvania Public Utility Comm. v. The Peoples Natural Gas Co.*, Nos. 11380, 12683 (1942), Buchanan, dissenting; See *Chesapeake & Potomac Tel. Co. v. Whitman*, 3 Fed. (2d) 938, 951-953; *New York Telephone Co. v. Prendergast*, 36 Fed. (2d) 54, 66.

<sup>19</sup> *Re Interstate Power Co.*, 32 P. U. R. (N. S.) 1, 10; *Re Chicago District Electric Generating Corp.*, 39 P. U. R. (N. S.) 263, 275.

We believe, however, that under such circumstances as exist in this case, where a large part of the Company's business is brought under regulation for the first time and where incorrect depreciation and depletion practices have prevailed, the best procedure is to deduct the reserve requirement in computing the rate base. This procedure will permit us to be consistent in those cases where utilities have deliberately failed to observe sound practices and as a result have deficient reserves. Thus, in the Interstate Power Company case, where the company had been negligent in accounting for depreciation and had a deficient reserve, we deducted the higher reserve requirement, as the measure of actual existing depreciation.

It should be borne in mind, however, that the deduction of the reserve requirement, rather than the actual book reserve, is for the purpose of getting a sound basis for

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future regulation and control of rates. Hereafter, the Company, in accordance with this Opinion and under our System of Accounts, is required to record proper depreciation and depletion expense. Hence, the books of this Company, as well as the books of others subject to our jurisdiction, after once having the reserve requirement determined, should reflect in substantial degree the proper depreciation and depletion. Use of the reserve requirement in this case will produce a proper starting figure so that the book reserve can be deducted hereafter as the proper measure of the actual depreciation and depletion. This treatment will then be consistent with the view that the book reserve is the proper deduction from the gross cost in determining the rate base.

It becomes necessary, therefore, to ascertain the best measure of the reserve requirement. The purpose of depletion and depreciation accounting is to offset diminution

in service value<sup>20</sup> of property being used in service, and to determine as accurately as possible another element of the cost of service for a particular period. All of Hope's physical property, except certain land, will be depleted or depreciated completely when it reaches the end of its useful or economic life. Physical and functional forces, whether their effects are visible or not, are constantly reducing the service life of the Company's property. Service life is the equivalent of economic life or the utility of the property.

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Hope incurs plant costs to provide for future service and to make production possible. As natural gas service is rendered the economic value of property is gradually consumed, and the property is finally retired at the end of its service life. The cost of the property consumed annually in rendering that service should be charged to operating expenses to reflect the depletion and depreciation incurred.

The Commission's Staff presented a depletion and depreciation reserve requirement study in these proceedings. Estimates were made of the over-all service lives of the properties by classes; those average service lives were converted into depreciation rates, and then applied to the cost of properties to determine the portion of the cost which had expired, that is, which related to the consumed service lives. The study covers the operations of the Company from its beginning in 1898 to December 31, 1940. It shows annual amounts for each group of property from the date installed to the date of retirement, and it concurrently provides the necessary reserves for property retired and for the ultimate retirement of existing property. The fundamental principle that annual expense for depletion and depreciation must be harmonized with accrued depletion and depre-

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<sup>20</sup> "Service value" is the difference between original cost and the net salvage value of gas plant. Depletion and depreciation signify the consumption of service life of property and when that is translated into dollars it shows the loss in service value.

ciation has been applied here. The straight-line service life method was used to compute the reserve requirement for all of the material, equipment and structures of the Company, and the unit-of-production method was applied to plant costs which are associated with the gas supply, i.e., gas producing lands and leases, field line and gas well con-

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struction, rights-of-way, and costs of abandoning gas wells.<sup>21</sup> The service life study was made by a properly qualified Staff engineer who analyzed Hope's past experience, including the retirement of property over the years. He gave consideration to relevant service life data on other pipe lines. He also considered the functional and physical aspects of depreciation. As an aid in the determination of service lives he made a field inspection of the Company's physical properties. The unit-of-production method used by the Staff was related to the gas reserves of the active wells of the Company. This case is free from the usual complexities involved in the estimate of gas reserves because the geologists for the Company and the Commission presented estimates of the remaining recoverable gas reserves which were about one per cent apart. The permeability and porosity characteristics of the region cause isolated pools of natural gas, and the Company's gas production properties are intermingled with non-productive areas and other companies' properties. This situation necessitated the segregation of Hope's property into gas producing areas for the depletion and depreciation reserve requirement study. Gas rights, well construction and connected field line construction costs are consumed in service proportionately with the depletion of the associated gas supply. Well equipment and field pipe line material are recovered and used again when the various sources of gas supply are exhausted. These facts of operation have been

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<sup>21</sup> As defined in the Uniform System of Accounts.



recognized in the ascertainment of the required reserve for depletion and depreciation.

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The Staff recommended the depletion and depreciation reserve requirement for Hope's production, transmission and general plant in the amount of \$23,520,561 as of December 31, 1940.<sup>22</sup> After a careful analysis of the evidence we have accepted certain adjustments advocated by the Company and find that the depreciation and depletion reserve should be not less than \$22,328,016 as of December 31, 1940. These adjustments are as follows: (1) Due to the plant inventory adjustment made by the Company, as of December 31, 1938, and accepted by all parties, a net reduction in the plant accounts was made which represents property retired prior to December 31, 1938, but not so recorded on the books. The Company contends that 10 years is a fair approximation of the average period by which these retirements have been accumulating, hence the depreciation provisions should be reduced for the 10-year period. Had the retirements been made on the books as soon as the property was retired the depreciation base would be reduced and the annual provisions would be less. It is impossible to determine the actual dates the property was retired and we accept the 10-year period as a reasonable estimate of the average time from the date the property was retired to December 31, 1938. This adjustment results in a reduction of \$31,106 in annual depreciation expense for each year and

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a reduction of \$311,060 in the reserve requirement as of December 31, 1938. (2) In the case of lines lifted, Hope has

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<sup>22</sup> That recommended required reserve is after a deduction of \$1,162,710 for cost of abandoning property. The depreciation rates used in the reserve requirement study make proper provisions for the inevitable cost of abandoning property. But during the period 1898-1931 Hope charged the cost of abandoning property to maintenance expense, rather than to the depreciation reserve as a part of the net salvage.

usually retired labor cost and charged it to the depreciation reserve. But in the case of pipe retired in connection with a replacement the original labor was not always retired and the renewal labor was charged to operating expense. The depreciation rates applied by the Staff include provisions for the retirement of all labor and materials, hence its reserve requirement computation includes accruals for construction labor cost on the main pipe lines which has been retired and not charged to the depreciation reserve. The Company has estimated an amount of \$272,693 representing the additional retirements of labor cost which we will allow as a reduction in the reserve requirement. (3) The group depreciation rate of 2.5% employed by the Staff in its study should be reduced to 2.22% for gas well equipment. As revised the rate for gas well material is the same as for field line material, although the evidence indicates that a somewhat shorter average life has been experienced for gas well material than for field line material. At the rate of 2.22% the annual depreciation expense will be reduced \$21,110 for 1939 and \$20,911 for 1940. Consistent with the reduction in the annual depreciation expense the reserve requirement at the end of 1938, 1939 and 1940 will be reduced \$566,771,<sup>23</sup> \$587,881, and \$608,792, respectively.

The first two of the above-mentioned adjustments are the result of certain accounting practices of Hope prior to

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December 31, 1938 and do not affect depreciation expense for the years subsequent to that date. The reserve requirement which the Commission finds to be reasonable and proper is summarized as follows:

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<sup>23</sup> Total provisions from 1898 to 1938, inclusive, amount to \$5,060,456 at a 2.5% depreciation rate and \$4,493,685 at a 2.22% depreciation rate for gas well equipment.

*Depletion and Depreciation Reserve Requirement*

	Dec. 31, 1938	Dec. 31, 1939	Dec. 31, 1940
Amount Computed by Staff	\$23,501,356	\$24,072,167	\$24,683,271
Less Staff Adjustment for Cost of Abandoning Property	1,162,710	1,162,710	1,162,710
Amount Recommended by Staff	22,338,646	22,909,457	23,520,561
Less: Unrecorded Retirements	311,060	311,060	311,060
Unretired Labor on Trans- mission Line Replace- ments	272,693	272,693	272,693
Change in Depreciation Rate for Gas Well Equipment	566,771	587,881	608,792
Total Adjustments	1,150,524	1,171,634	1,192,545
Required Depreciation and Deple- tion Reserve	\$21,188,122	\$21,737,823	\$22,328,016

The required depletion and depreciation reserve, as we have determined it upon the record, is the best evidence of the measure of actual existing depletion and depreciation, and it will be deducted from the actual legitimate cost of the Company's property for rate-making.<sup>24</sup> The reserve requirement on any selected date is the total of the annual provisions for depletion and depreciation less the actual retirements of property. The method used here determines the amount required annually to reimburse the Company for property consumed in service, and it results in a cor-

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relation of the annual expense and the accumulated reserve. The method is just and consistent for each operating period because the costs utilized are matched with the revenues produced by the property in service.

<sup>24</sup> See *Re Long Island Lighting Co.*, 18 P. U. R. (N. S.) 65, 146-151, 189-191; aff. 249 App. Div. 918, 292 N. Y. S. 807, 809, 18 P. U. R. (N. S.) 225, 226; *Re Rochester Gas & Electric Corp.*, 33 P. U. R. (N. S.) 393, 489, 502-3; National Association of Railroad and Utilities Commissioners, Proceedings of Fiftieth Annual Convention (1938) pp. 473-4.

As we have noted, the Company has built up an excessive reserve by charging large annual allowances for depletion and depreciation to operating expenses in the past.

The book reserve for interstate plant at the end of 1938 amounted to about \$39,000,000 which is \$18,000,000 in excess of the amount we determined as the reserve requirement. In addition, twice in the past the Company has transferred amounts aggregating \$7,500,000 from the depreciation and depletion reserve to surplus. When these latter adjustments are taken into account, the excess becomes \$25,500,000, which has been exacted from the rate payers over and above the amount required to cover the consumption of property in the service rendered and thus to keep the investment unimpaired. *Lindheimer v. Illinois Bell Tel. Co.*, 292 U. S. 151, 169, 174.

*Estimated Additional Fixed Capital Expenditures*

To make the rate base figures current, the Company presented an estimate of \$8,956,500 in "capital expenditures" which it planned for production, transmission and general plant during 1941, 1942 and 1943. Obviously these proposed gross additions should increase the allowable rate base only to the extent that net actual legitimate cost will be increased. Also, \$1,270,000 was estimated for 1943 additions to meet the demands of new or increased business.

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The Commission has not given direct effect to those expected 1943 additional revenues in the forecast of revenues for rate-making, so that \$1,270,000 will not be included in the rate base. The determination of the estimated increase in net plant cost requires the consideration of additions and retirements of plant and the effect on the depletion and depreciation reserve of future accruals and retirements. Giving due weight to all these factors the increased

net actual legitimate cost, averaged for the period 1941-1943, is \$1,392,021.<sup>25</sup>

The Company presented a general plan which it has for the construction of a pipe line from West Virginia to Louisiana to supplement its present source of supply of gas and to meet predictable increased demands for natural gas. Due mainly to the shortage of materials caused by this war, the status of that proposed line is so uncertain that it need not be considered in these proceedings. When the proposed line is constructed and definite information is presented concerning its effect on the rate base and net income, the Commission will give the matter timely and

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appropriate consideration.

#### *Other Used and Useful Property*

The Company's geologist grouped the unoperated acreage<sup>26</sup> into three classes: (1) protective acreage within a mile of producing wells comprised 64%; (2) prospective

<sup>25</sup> Estimated Fixed Capital Expenditures 1941-1943		\$8,956,500
Less: Expenditures in Expectation of New or Increased Business	\$1,270,000	
Gross Property Retirements	2,700,000	3,970,000
		<hr/>
Estimated Net Change in Plant		4,986,500
Deduct: Estimated Net Change in Depletion and Depreciation Reserve—Depletion and Depreciation Accruals 1941, 1942, 1943	4,362,500	
Less: Retirement Losses Chargeable against Reserve	2,160,042	2,202,458
		<hr/>
Estimated Increase in Net Actual Legitimate Cost		\$2,784,042
Average for the period ( $\$2,784,042 \div 2$ )		\$1,392,021

<sup>26</sup> Operated gas acreage is any acreage that is being drained by producing gas wells and all other acreage is considered as unoperated. Hope has held less than two unoperated acres to one operated acre during the last ten years.

acreage for shallow-sand production within three miles of producing wells comprised 14% ; and (3) prospective acreage for deep-sand production within three miles of producing wells comprised the remaining 22%. The total unoperated acreage as of December 31, 1940, was 539,285 acres. The Company has undertaken an extensive drilling program, including deep-test wells, and it is a reasonable expectation that within a few years nearly all of this unoperated acreage will become productive, or will be proved unproductive and cancelled. There is no evidence that Hope has acquired large blocks of unoperated acreage to obtain a monopoly on the source of supply, and there is evidence that all of its unoperated acreage is necessary and useful, or imminently useful, in rendering gas service. The cost of unoperated acreage will be included in the rate base. The Commission finds that the actual legitimate cost of unoperated acreage was \$584,382 as of December 31, 1938, \$567,152 for the end of 1939, and \$566,105 as of December 31, 1940.

*Materials and Supplies Plus Cash Working Capital*

There is no controversy over the amount of materials

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and supplies required by the Company. The monthly average of materials and supplies on hand is the most accurate measure of the Company's requirements. The Commission finds that \$1,228,599 is the necessary average amount for materials and supplies in 1939, 1940 and the future. This is sufficient, on the average, to meet requirements for more than a year.

A witness for the Company used a period of 45 days as the lag in the receipt of revenues. He stated that 45 days of operating expenses, including gas purchased, would measure the cash working capital required by the Company on a practical operating basis and he computed the amount to be \$1,754,008.

A period of 45 days is ample to measure the amount of cash required for payment of operating expenses. Cost of gas purchased must be excluded from the computation because revenues from gas sales are received before the payment for purchased gas is due. The Company has approximately \$500,000 on hand at all times representing taxes which are not paid until many months after they are accrued and these tax funds are available for bank balances and working capital requirements. The Commission will allow cash working capital in the amount of \$871,407 for 1939 and \$896,401 for 1940. This is the maximum allowable amount computed on 45 days of operating expenses, excluding cost of gas purchased, and allowing prepaid expenses in full.

The Commission finds that \$2,100,000 was required for materials and supplies and cash working capital in 1939, and that \$2,125,000 was necessary for 1940 and will be ade-

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quate for the future.

#### *Conclusions With Respect to the Rate Base*

There is a further matter with respect to plant investment which the Commission will consider before making the final determination of the rate base. Prior to January 1, 1939, the Company charged all administrative and general costs to operating expense. Beginning January 1, 1939, the Company tentatively adopted the practice of capitalizing a portion of its administrative and general expenses. This discretion by the management is permissible under the Commission's Uniform System of Accounts. This tentative capitalization of administrative and general expenses was reconsidered by the Company and it has informed the Commission that it wishes to resume the regular practice of including all general and administrative costs in operating expenses. This change in the tentative accounting policy is reflected in the verified annual report for

1941 filed with this Commission. The amounts of \$79,439 for 1939 and \$138,018 for 1940 are removed from plant costs and included in operating expense for the respective years. Theoretically, adjustments to annual depreciation expense and to the reserve requirement should be made on account of the foregoing, but the amounts are so insignificant in a case of this magnitude that no inequity will result from not making them.

The analysis of the evidence which we have discussed with respect to the components of the rate base and our conclusions may be summarized thus:

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	Dec. 31, 1938	Dec. 31, 1939	Dec. 31, 1940	Future
Gross Investment in Gas Plant in Service (Exclusive of Distribution Plant, and Property Used to Transport Coke-oven Gas)	\$51,207,621	\$51,019,585	\$51,957,416	\$51,957,416
Less: Actual Existing Depletion and Depreciation	21,188,122	21,737,823	22,328,016	22,328,016
Net Investment	30,019,499	29,281,762	29,629,400	29,623,400
Add: Net Capital Additions 1941, 1942, 1943				1,392,021
Useful Unoperated Acreage	584,382	567,152	566,105	566,105
Working Capital	2,100,000	2,100,000	2,125,000	2,125,000
Interstate Rate Base	\$32,703,881	\$31,948,914	\$32,320,505	\$33,712,526

The Commission, therefore, adopts the foregoing amounts as the interstate rate base for the dates indicated, for the Company's property assembled as a whole and doing business as part of an integrated system. The Commission finds that the rate base for 1939 was the average of the rate base amounts at the beginning and the end of that year or \$32,326,398, that the rate base for 1940 was the average of the rate base amounts at the beginning and the end of that year or \$32,134,710, and that the rate base for fixing future rates is \$33,712,526.



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## OPERATING REVENUES AND EXPENSES

For rate-making purposes the Commission has given consideration to the actual operating revenues and expenses of the Company for 1937-1940, inclusive, and has also considered the income statements since 1898. In testing the reasonableness of existing rates the latest experience of the Company, as disclosed by the record, is the closest reflection of the present and future operations.

*Interstate Gas Service Revenues*

There is no controversy over the volume of gas sold or the revenues received by Hope. The Commission finds that during the years 1939 and 1940 the interstate gas sales to the five customer companies were as follows:

	1939		1940	
	M.c.f. billed	Revenues	M.c.f. billed	Revenues
East Ohio Gas Company	33,907,672	\$12,359,500	40,376,091	\$14,726,736
Peoples Natural Gas Company	3,864,104	1,371,757	9,738,612	3,457,207
River Gas Company	237,640	83,174	388,750	136,063
Fayette County Gas Company	840,398	264,725	859,106	270,618
Manufacturers Light and Heat Company	2,500,755	787,738	2,241,684	706,131
	41,350,569	\$14,866,894	53,604,243	\$19,296,755

*Interstate Operating Expenses*

The Commission has considered the Company's operating expenses as recorded on its books, as claimed for rate-case purposes, and as recommended by the Staff. The subsequently discussed adjustments to the Company's operating expenses are made to the amounts as actually recorded

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on its books for the years 1939 and 1940.

*Depletion and Depreciation Expenses*

The annual allowance for depletion and depreciation included in operating expenses is determined by the same

rates and methods used to determine the depletion and depreciation actually existing in plant.

The Commission finds that \$392,500 for 1939 and \$624,440 for 1940 is the proper allowance for depletion expense. The present and prospective demands upon the production system indicate that production for the year 1940 is the proper guide for future depletion expense and we will allow \$624,440 as the average cost of depletion in our determination of the cost of service. (Depletion expense is computed on the unit-of-production, hence it varies with the actual production of gas.)

The record shows that Hope Company's annual depreciation expense has remained relatively stable, the proper amounts for 1939 and 1940 being as follows:<sup>27</sup>

	1939	1940
Production Plant	\$351,811	\$349,676
Transmission Plant	460,267	460,245
General Plant	25,725	25,676
Total Depreciation Expense	\$837,803	\$835,597

<sup>27</sup> Determined by applying the following straight-line depreciation rates to the average depreciable investment for the year:

<i>Production Plant:</i>		<i>Rate</i>
Structures		4.17%
Field Line Material, Meas. & Reg.		
Station Equipment		2.22%
Gas Well Equipment		2.22%
<i>Transmission Plant:</i>		
Main Lines, Rights-of-Way and Meas. & Reg. Station Equipment		1.56%
Structures		2.50%
Compressor Station Equipment		2.56%
<i>General Plant:</i>		
Structures		2.17%
Office Furniture & Equip.		4.00%
Other Equipment		3.57%
Communication Equipment		3.85%

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The Commission finds that the annual depletion and depreciation allowance required for future operating expenses is \$1,460,037.

*Exploration and Development Costs*

Section 14(b) of the Natural Gas Act authorizes the Commission to determine the “propriety and reasonableness of the inclusion in operating expenses, capital, or surplus of all delay rentals or other forms of rental or compensation for unoperated lands and leases.” Delay rentals paid periodically on natural gas lands to reserve the gas rights for a future supply of gas are included in exploration and development costs. The other costs included are those associated with the drilling of non-productive wells, the abandonment of non-productive leases and the abandonment of projects on which preliminary expenditures were made to determine the gas prospects of available acreage.

The Hope Company, like other companies in the natural gas industry, has followed the conservative practice of charging all exploration and development costs to operating expenses. Exploration and development costs are necessary to replenish the Company’s gas supply in order to maintain continued gas service. The Commission has included Hope’s gas producing acreage and its useful unoperated acreage at cost in the rate base. The annual depletion allowance is based upon the actual legitimate cost of gas producing leases so there is no margin in that annual allowance to cover exploration and development costs. In fairness to the investors and the rate payers the Commission will make an allowance for delay rentals related to the unoperated acreage and the other exploration and development costs in operating expenses. Hope incorrectly stated the cost of abandoned and surrendered leases in 1939 and

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1940 and we find that the cost of leases abandoned should be included in exploration and development costs in the respective amounts of \$45,164 for 1939 and \$12,422 for 1940. The Company's exploration and development costs were \$500,344 in 1939 and \$407,920 in 1940. In view of the Company's extensive program for drilling wells in the next few years and its recent experience with respect to exploration and development costs, the Commission finds that the proper and reasonable future annual allowance for such costs is \$600,000 for rate-making purposes.

*Reclassification and Rate Case Expenses*

The Hope Company presented evidence to show that it has spent \$675,000 in making reclassification studies in order to comply with the recent Systems of Accounts prescribed by the West Virginia Commission and the Federal Power Commission. The Company also showed expenditures totaling \$825,000 as its expenses in this rate case. A contention is made by the Company that it should be allowed an interest rate of 8% on the "unamortized balance" of its reclassification and rate case expenses. In fact, however, the Company has charged all these costs to operating expenses as they were incurred during the years 1938-1941 and the rate payers have already paid enough to reimburse the Company. The Company's interstate wholesale rates have been excessive for several years and the unusually large amount of rate case expenses would ordinarily prompt the Commission to disallow any such expenses to be amortized in the future under the rates the Commission will prescribe because it results in a duplica-

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tion of charges. But in view of the Supreme Court's statement that even where rates in effect are excessive the utility should be allowed its reasonable expenses for presenting its side to the Commission, the Commission con-

cludes that the rate case expenses and the reclassification expenses, totaling \$1,500,000 should be spread over a 10-year period beginning January 1, 1939, by the inclusion of \$150,000 annually in operating expenses.<sup>28</sup> The Company has charged rate case and property reclassification expenses to operating expenses as incurred in the amounts of \$543,121 for 1939 and \$624,041 for 1940. Those amounts will be eliminated from operating expenses for rate-making, and the allowance of \$150,000 annually for ten years will be made instead.

*Affiliate's Excess Profits From  
Processing Hope Company's Gas*

Hope Construction & Refining Company, an affiliate, extracts gasoline and other by-products from the natural gas of Hope Natural Gas Company. The extraction of gasoline and butane is profitable and is necessary to make the natural gas marketable and transportable. The process of extracting gasoline and butane reduces the heating value of the natural gas and consumes a certain volume of Hope's natural gas, thus imposing a burden upon the gas business.<sup>29</sup> Much of the gasoline extracted from Hope's natural gas has been sold to the Standard Oil Company at about one-half the price received from sales to others. It is sig-

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nificant that the Hope Natural Gas Company processed its own gas before 1920. The natural gas customers are entitled to be credited with a share of the profit from the processing of Hope's gas, even as they would pay the deficit if that essential processing were not profitable. It is agreed that it is proper to make a credit for a portion of the profits realized by Hope Construction & Refining Com-

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<sup>28</sup> *Driscoll v. Edison Light & Power Co.*, 307 U. S. 104, 120-121.

<sup>29</sup> *Re Hope Natural Gas Co.*, P. U. R. 1921E 418, 428-430.

pany from the processing of Hope's gas, but there is a dispute over the amount of the credit. The Commission concludes that the credit proposed by the Company, being a royalty of  $\frac{1}{4}$  of the gross earnings from the gasoline and butane extracted, is not supported by sufficient evidence. The excess profits of the affiliated company above the cost of processing Hope's gas and a fair rate of return on its investment is the proper credit to Hope Natural Gas Company. See *United Fuel Gas Co. v. Comm'n*, 278 U. S. 300, 319-321; *Dayton Power & Light Co. v. Comm'n*, 292 U. S. 290, 295. The cost of processing Hope's gas includes all of the affiliated company's related operating expenses, including depreciation expense, taxes, and a liberal  $6\frac{1}{2}\%$  rate of return on the net investment, plus working capital, devoted to the processing function. The affiliated company's extraction plants are usually located near Hope's compressor stations. The Commission finds that Hope should have received payments of \$117,641 in 1939 and \$119,592 in 1940 for the steam and boiler fuel which it furnished its affiliate at the extraction plants, and that the gas vapors which are returned to Hope after processing belong to Hope as part of its natural gas. From the record we

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find that Hope Construction & Refining Company had the following average net investment and required working capital devoted to processing Hope's natural gas:

	1939	1940
Gross Investment	\$1,716,145	\$1,696,510
Depreciation Reserve Requirement	1,208,739	1,260,312
Net Investment	507,406	436,198
Working Capital	80,000	80,000
Average Net Investment	\$ 587,406	\$ 516,198

The Commission finds that Hope's affiliate has earnings from the processing of gas in excess of a fair return and that these excess profits are applicable as reductions

of Hope's operating expenses. For 1939 and 1940 these excess profits are determined as follows:

	<u>1939</u>	<u>1940</u>
Gasoline and Butane Revenues	\$791,451	\$770,028
Related Operating Expenses	518,394	551,370
Net Processing Income	273,057	218,658
Return at 6½% on Net Investment Plus Working Capital	38,181	33,553
Excess Profits	<u>\$234,876</u>	<u>\$185,105</u>

In prescribing future rates the affiliate's excess profits for 1940 will be employed as a conservative measure of Hope's portion of the profits from the gasoline and butane extracted from its gas.

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#### *Other Adjustments to Operating Expenses*

Hope furnishes management services to several affiliated companies at cost, and credits the proceeds to miscellaneous gas revenues thereby permitting the cost of those services to others to remain in its operating expenses. The Commission, therefore, finds that operating expenses should be reduced \$192,415 for 1939 and \$109,194 for 1940 for the cost of services billed to others in order to reflect actual net operating expenses.

Hope furnishes natural gas to Hope Construction & Refining Company for use in repressuring oil wells. The gas is returned to Hope's system at reduced pressures. An amount of 2½¢ per m.c.f. is regarded as the cost of recompressing the natural gas returned to the Hope Company. Hope records these transactions as sales and purchases of natural gas and that practice overstates both revenues and expenses. The Commission finds that operating expenses and revenues should be reduced \$72,388 for 1939 and \$73,644 for 1940 to eliminate duplication of cost in production and transmission expenses.

The Company has eliminated the property and expenses relating to the transportation of coke-oven gas used as fuel at its Hastings Compressor Station and in its figures has substituted the cost of an equivalent amount of natural gas priced at 22¢ per m.c.f. The Commission agrees with the Company and finds that \$295,158 for 1939 and \$333,036 for 1940 should be eliminated from operating expenses, and that \$107,758 for 1939 and \$126,000 for 1940 should be included in operating expenses to reflect the

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equivalent cost of natural gas for the quantity of coke-oven gas used as fuel in the Hastings Station.

Hope furnishes steam from its compressor stations without charge to Hope Construction & Refining Company for use in the extraction plants, with the exception of the steam furnished from Goff Compressor Station, and does not record this transaction on its books. The necessary adjustment for this free steam has been made by the Commission. The Company credits revenue instead of expenses with the value of steam furnished by its Goff Station, thereby overstating both gas service revenues and the cost of compressing natural gas. The Commission, therefore, finds that operating expenses should be reduced \$4,404 for 1939 and \$6,000 for 1940 to state the actual cost of operation.

Hope bills the Peoples Natural Gas Company at the rate of 38.5¢ per m.c.f. for the natural gas sold and includes the gross amount of the billings in revenues. The Peoples Company must compress that gas to transport it to market, so Hope refunds 3¢ per m.c.f. to Peoples under the provision of the sales contract and includes this amount in its operating expenses as a cost of compressing gas. This accounting practice followed by Hope overstates the actual revenues and overstates the actual operating expenses. The Commission finds that the cost of compressing gas has been stated incorrectly and that operating expenses should be reduced \$115,923 for 1939 and \$292,158 for 1940.



Certain donations were included by the Company in Administrative and General Expenses. The Commission finds that donations amounting to \$5,183 for 1939 and \$3,496

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for 1940 are not allowable costs for purposes of rate-making and should be deducted from operating expenses.

The Company has included \$10,926 for the settlement of a claim for damages and \$16,318 to meet a deficiency in its insurance plan for employees in general expenses for the year 1939. These expenses are applicable to prior years' operations and therefore not allowable for 1939.

Hope recorded the salvage received from an experimental liquefying gas plant as revenues in the amount of \$23,896. That amount should have been applied as a reduction of the cost of the experiment, which cost was charged to 1940 operating expenses. Therefore, the Commission finds that 1940 operating expenses should be reduced \$23,896.

#### *State and Miscellaneous Federal Taxes*

The Company has included in taxes for the years 1939 and 1940 certain amounts which should not have been included, and has failed to include certain other amounts which should have been included. The following table shows the amounts:

	<u>1939</u>	<u>1940</u>
<b>Taxes Not Applicable</b>		
Taxes applicable to prior years	\$23,349	\$17,099
W. Va. taxes billed others	10,768	41,334
Taxes not applicable to gas operations	2,741	3,218
	<u>36,858</u>	<u>61,651</u>
<b>Taxes Applicable</b>		
Underaccrual of taxes	16,548	313
Net Tax Adjustment	<u>\$20,310</u>	<u>\$61,338</u>

The Company has over-accrued Federal Income taxes on its books and the Commission has made a deduction of

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\$33,479 for 1939 and \$16,480 for 1940 to reflect the taxes actually paid which were \$191,521 for 1939 and tentatively reported to be \$912,313 for 1940.

*Specific Distribution Expenses*

The Commission finds that certain amounts included in depreciation, administrative and general expenses, and taxes are specific distribution costs, as follows:

	<u>1939</u>	<u>1940</u>
Depreciation	\$ 82,000	\$ 89,345
Taxes	126,981	141,640
Administrative and General	17,237	13,231
Total	<u>\$226,218</u>	<u>\$244,216</u>

*Operating Expenses Summary*

The total of the Commission's adjustments to operating expenses per books results in a reduction of \$1,186,002 for the year 1939 and a reduction of \$1,199,958 for the year 1940, and they are summarized as follows:

	<u>1939</u>	<u>1940</u>
<b>Decreases in Operating Expenses:</b>		
Excess Profits on Gasoline and Butane	\$ 234,876	\$ 185,103
Steam Furnished H. C. & R. Co.	117,640	119,592
“ “ “ —Goff Station	4,404	6,000
Refund to the Peoples Nat. Gas Co. for compressing gas	115,923	292,158
Gas used in repressuring oil wells	72,388	73,644
Management Fees and Expenses	192,415	109,194
Excess Cost of Coke-oven gas	187,400	207,036
Donations	5,183	3,496
Salvage from Liquefying Gas Experiment	—	23,896
Taxes	20,310	61,338
Income Tax	33,479	16,480
Reclassification and Rate Case Expenses	543,121	624,041
Expenses applicable to Reserve Gas Co.	125	—
Expenses applicable to prior years	27,244	—
Total Decreases	<u>1,554,508</u>	<u>1,721,978</u>

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	<u>1939</u>	<u>1940</u>
<b>Increases in Operating Expenses:</b>		
Abandoned Leases	\$ 45,164	\$ 12,422
Adm. & General Expenses capitalized in error	79,439	138,018
Depletion and Depreciation	93,903	221,580
Reclassification and Rate Case Expenses	150,000	150,000
<b>Total Increases</b>	<u>368,506</u>	<u>522,020</u>
<b>Total Adjustments</b>	<u>\$1,186,002</u>	<u>\$1,199,958</u>

The functional classification of operating expenses per books and after the application of the foregoing adjustments follows:

Operating Expenses	<u>1939</u>		<u>1940</u>	
	<u>Per Books</u>	<u>Allowed</u>	<u>Per Books</u>	<u>Allowed</u>
<b>Interstate Operating Expenses:</b>				
Natural Gas Production	\$ 1,439,971	\$ 1,186,578	\$ 1,427,594	\$ 1,227,930
Gas Purchased	7,746,854	7,675,105	8,605,981	8,533,779
Transmission Expenses	1,906,993	1,481,833	2,437,381	1,818,335
Administrative and General Expense	1,593,814	1,069,090	1,653,623	1,187,336
Depletion	18,400	392,500	18,384	624,440
Depreciation	1,200,000	837,803	1,309,418	835,597
Amortization (other)	6,369	6,369	5,996	5,996
Exploration and Development Costs	455,179	500,343	395,498	407,920
Taxes: State and Miscl. Federal	1,211,732	1,053,117	1,348,005	1,133,862
Federal Income Tax (before tax saving)	225,000	191,521	928,793	912,313
<b>Total Interstate</b>	<u>15,804,312</u>	<u>14,394,259</u>	<u>18,130,673</u>	<u>16,687,508</u>
<b>Specific Distribution Expenses:</b>				
Distribution	201,929	201,775	215,128	215,128
Customers' Acctg., Coll. and Sales Exp.	166,180	164,167	161,917	160,908
Administrative and General		17,237		13,231
Depreciation		82,000		89,345
Taxes		126,981		141,640
<b>Total Distribution</b>	<u>368,109</u>	<u>592,160</u>	<u>377,045</u>	<u>620,252</u>
<b>Total Operating Expenses</b>	<u>\$16,172,421</u>	<u>\$14,986,419</u>	<u>\$18,507,718</u>	<u>\$17,307,760</u>

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*Future Operating Expenses*

The operating expenses as determined for the purpose of estimating the future cost of interstate service are based primarily on the actual operating cost for the year 1940, the latest available data in the record. That year reflects an increase of \$2,300,000 over the operating expenses of 1939 and is the best guide to present and future costs.

The Commission finds that the following adjustments to 1940 costs are reasonable and proper for the purpose of estimating future operating expenses for rate fixing:

Increase in wages not reflected in 1940 operating costs	\$202,172
Increase in West Virginia property taxes not reflected in 1940 operating costs	81,751
Decrease due to the following non-recurring costs which were included in administrative and general expenses for 1940:	
Cost of moving Company office from Pittsburgh, Pa. to Clarksburg, W. Va.	\$41,750
Experimental liquefying gas plant	8,492
Pennsylvania State income tax	4,601
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Decrease	54,843
Increase in Exploration and Development costs to allow an average amount of \$600,000 annually in the future costs	192,080
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Total net increase over 1940 operating expenses	\$421,160

*Federal Income Tax*

In accord with practice, Hope's income tax return for 1940 was prepared on a tentative basis. The evidence in the record shows that the net taxable income was approximately \$3,801,304 for 1940 and was \$1,160,733 for 1939, that the tax rate was 24% for 1940 and 16.5% for 1939, and that the income tax was approximately \$912,313 for 1940 and was \$191,524 for 1939.

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The Company does not report operating revenue deductions for tax purposes the same as it records them on its books.<sup>30</sup> Adjustments for rate-making and accounting purposes do not affect operating expenses for tax purposes, because that amount is determined by the administration of the federal Revenue Acts. The complete effect of all Commission adjustments is shown by any increase or decrease in revenues which results from a rate order. In order to determine a reasonable allowance for income taxes it is necessary only to apply the proper tax rate to the net taxable income applicable to the test year and to give effect to any tax saving or increase by reason of a change in revenue due to a rate order.

A combined normal and surtax rate of 40% is being discussed in Congress. We will use that rate for the purpose of computing the future income tax allowance. Based on 1940 net taxable income of \$3,801,304 the income tax would be \$1,520,522 at a 40% tax rate.

Each dollar of the indicated reduction in gross revenues will result in a reduction of forty cents in income taxes. The following computation shows the indicated reduction in rates and the amount of income taxes by applying the rate of return found to be fair and which is discussed in the subsequent section:

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<sup>30</sup> The net income per books in 1940 was \$5,234,175 after book income taxes of \$928,793 or \$6,162,968 before income taxes. The net taxable income for that year was \$3,801,304 showing that Hope claimed \$2,361,664 for tax deductions not reflected in operating expenses on its books.

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	<u>Before Income Tax Saving</u>	<u>After Income Tax Saving</u>
Operating Revenues from Interstate Sales	\$19,296,755	\$15,686,898
Deductions:		
Interstate Operating Expenses (Excluding income taxes)	16,196,355	16,196,355
Other Gas Revenues	( 83,275)	( 83,275)
Allocation of costs to local West Va. Sales <sup>31</sup>	( 2,694,075)	( 2,694,075)
Federal Income Tax at 40%	1,520,522	76,579
Net Operating Revenue from Interstate Sales	\$ 4,357,228	<u>\$ 2,191,314</u>
Return at 6½% on Interstate Rate Base of \$33,712,526	2,191,314	
Excess Earnings before Income Tax Saving	2,165,914	
Income Tax Saving	1,443,943	
Excess Earnings after Income Tax Saving	<u>\$ 3,609,857</u>	

The Commission finds that the amount of \$76,579 is an adequate allowance for Federal Income taxes for the future.<sup>32</sup>

<sup>31</sup> Computed as follows:

West Virginia Operating Revenues		\$3,435,675
Specific Distribution Expenses	\$ 620,252	
Return at 6½% on Distribution Property	121,348	741,600
Allocation of costs to W. Va. Sales		<u>\$2,694,075</u>

<sup>32</sup> Computed as follows:

Net Taxable income for 1940	\$3,801,304
Reduction in revenues	3,609,857
Revised Net taxable income	<u>191,447</u>
Tax Rate	40%
Allowance for Income Tax	\$ 76,579

The operating expenses allowed for the future are shown by the functional classification in the following tabulation:

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	1940	Adjustments For Future Operating Changes	As Adjusted For Future
<b>Interstate Operating Expenses:</b>			
Natural Gas Production	\$ 1,227,930	\$ 202,172	\$ 1,430,102
Gas Purchased	8,533,779		8,533,779
Transmission Expenses	1,818,335		1,818,335
Administrative and General Expense	1,187,336	( 50,242)	1,137,094
Depletion	624,440		624,440
Depreciation	835,597		835,597
Amortization (other)	5,996		5,996
Exploration and Development Costs	407,920	192,080	600,000
Taxes—State and Misc. Federal	1,133,862	77,150	1,211,012
Federal Income Tax	912,313	(835,734)	76,579
<b>Total Interstate</b>	<b>16,687,508</b>	<b>(414,574)</b>	<b>16,272,934</b>
<b>Specific Distribution Expenses:</b>			
Distribution	215,128		215,128
Customers' Acctg., Coll. & Sales			
Promotion	160,908		160,908
Adm. and Gen. Expense	13,231		13,231
Depreciation	89,345		89,345
Taxes	141,640		141,640
<b>Total Distribution</b>	<b>620,252</b>		<b>620,252</b>
<b>Total Operating Expenses</b>	<b>\$17,307,760</b>	<b>\$(414,574)</b>	<b>\$16,893,186</b>

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### RATE OF RETURN

Many factors enter into the determination of what constitutes a fair rate of return in each rate case. The Supreme Court has stated the principal factors in *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm.*, 262 U. S. 679, 692-3. They are that the return of a public utility shall be equal to that generally being made at the same time and in the same region on investments in other enterprises attended by corresponding risks and, that the return should be sufficient to assure confidence in the finan-

cial soundness of the utility and to maintain its credit and enable it to attract the capital necessary for the proper discharge of its public duties.

The record contains an abundance of evidence on the subject of rate of return. The information includes investors' appraisal of the natural gas industry, comparative risk rata, interest rates and yields on securities of natural gas and electric utilities, statistics showing the growth and stability of the natural gas industry, the trend of the cost of money and its current cost, commodity price indices, industrial production, employment, and payroll indices, federal reserve bank rediscount rates, national income payments and other economic data, idle money statistics, the financial history of the Hope Company and the facts about recent financing by its parent Standard Oil Company. That evidence reveals unmistakably that, compared to industrial and railroad enterprises, the utility business has relatively greater stability. Moreover, it shows also that interest rates generally are now lower than

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they have ever been in this century; it discloses that the yields on better issues of natural gas company bonds sold in the last year or two are close to 3%.

The Company's contention that it should be allowed a rate of return not less than 8% is unreasonable. The record shows that the Hope Company is a seasoned enterprise whose risks have been minimized by (1) ample past and present provisions for depletion and depreciation with concurrent high profits; (2) protected established markets, through affiliated distribution companies, in populous and industrialized areas; and (3) available supplies of gas locally to meet requirements, except on certain peak days in the winter, which it is feasible to supplement in the future with gas from other sources. During the forty-two years of its history, to 1941, Hope has earned on its owners' equity an annual average profit of 12% and, in addition,



has built up through annual provisions charged to expense, depletion and depreciation reserves far in excess of requirements. Hope faces no hardship with respect to increased taxes, operating expenses, and inflation, greater than those faced by similar enterprises. The Company's efficient management, established markets, financial record, affiliations, and its prospective business place it in a strong position to attract capital upon favorable terms when it is required.

In making the findings on rate of return, the national and international situations have commanded our attention and entered our deliberations. The Commission is aware of the increased demands made upon Hope for gas due to

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the war program. Considering these matters, the underlying factors, and all of the evidence in the record, the Commission finds that 6½% is the fair rate of return for the Hope Natural Gas Company. This rate of return being for the future, has been set only after endeavoring to weigh all known and predictable elements; in setting it we have made allowance for presently unforeseeable contingencies. Our views on the subject of rate of return are consonant with recent decisions by the Supreme Court and other courts and commissions involving natural gas companies.<sup>33</sup>

#### LAWFULNESS OF PAST RATES

In 1938 the Cities of Cleveland and Akron, Ohio, filed complaints with the Federal Power Commission alleging that the rate which Hope charged East Ohio Gas Company

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<sup>33</sup> *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U. S. . . .; *Peoples Gas Light & Coke Co. v. Slattery*, 373 Ill. 31, 25 N. E. (2d) 482, 500-501, 31 P. U. R. (N. S.) 193, 217-218, App. Div. 309 U. S. 634; *East Ohio Gas Co. v. Cleveland*, 27 P. U. R. (N. S.) 387, 412, Aff. 137 O. S. 225, 28 N. E. (2d) 599, 612, 35 P. U. R. (N. S.) 158, 174-175; *Re Montana-Dakota Utilities Co.*, 32 P. U. R. (N. S.) 121, 128; See *Re Canadian River Gas Co. et al.*, F. P. C. Op. 73.

was unjust, unreasonable and unlawful. These complaints were registered before Hope filed its five interstate wholesale rate schedules which are involved in these proceedings. The acceptance of a rate schedule for filing does not mean that the Commission approves it, and does not establish the justness or reasonableness of the rate. *Re Home Gas Co.*, 39 P. U. R. (N. S.) 102, 109. On October 14, 1938, this Commission instituted an investigation of the reasonableness of all of Hope's interstate rates. If it had been possible to adduce the volume of evidence required for the disposition of such a complex matter within a few months,

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the Commission would have prescribed the reasonable interstate wholesale rates for 1939 and subsequent years. The City of Cleveland raised the issue of the lawfulness of the rate charged by Hope to the East Ohio Gas Company and asked this Commission, as an aid to State regulation, to make a separate determination of the reasonable rates since June 30, 1939. Originally the City of Cleveland requested this Commission to find the lawful Hope-East Ohio rates since June 21, 1938, but it now represents that the subject is idle for rates prior to June 30, 1939, because those rates which Cleveland consumers were obligated to pay East Ohio have been settled. The Commission does not have the authority to fix rates for the past and to award reparations. But Congress did empower and instruct the Commission in Section 5(a) of the Natural Gas Act to fix future rates, and as a step in that process we must necessarily consider the reasonableness of past and existing rates. When the issue is raised and the public interest will be served, we consider as a necessary part of that duty the power to examine the entire rate problem involved and to determine what rates were lawful in the past. Also, Section 14(a) of the Act authorizes the Commission to investigate any facts which it finds necessary in order to determine whether Hope has violated any provision of the Natural Gas Act. Furthermore, the Commis-

sion has power to perform any act, pursuant to Section 16, which is necessary or appropriate to carry out the provisions of the Act. Under Section 4(a) of the Act any interstate wholesale rate that is not just and reasonable is unlawful. *Federal Power Commission v. Natural Gas Pipe-*

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*line Co.*, 315 U. S. .... Hope's rate collected from East Ohio Gas Company was lawful after June 21, 1938, the effective date of the Act, only to the extent that it was just and reasonable. The City of Cleveland states that the Ohio Commission is investigating the reasonableness of the East Ohio Gas Company's bonded retail rates in Cleveland for the period since June 30, 1939, and that the lawfulness of Hope's rate is an important factor in the case. Since the enactment of the 1938 Natural Gas Act this Commission has had exclusive jurisdiction to determine the lawfulness of the interstate wholesale rates charged by Hope and other natural gas companies.<sup>34</sup>

In response to the request of the City of Cleveland, the Commission will make the appropriate findings of fact as to the lawfulness of the rates charged East Ohio by Hope since June 30, 1939. The Interstate Commerce Commission has furnished precedents for the performance of this public duty.<sup>35</sup> Congress intended that this Commission cooperate with State Commissions and municipalities, and the provisions of Sections 5(b) and 17 are special evidence of such intent.

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<sup>34</sup> Sections 1, 2, 4 and 5(a). See *Missouri v. Kansas Natural Gas Co.*, 265 U. S. 298, 308; *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*, 314 U. S. 498, 506; *Kentucky Nat. Gas Corp. v. P. S. C.*, 28 F. Supp. 509, 513, aff. 119 Fed. (2d) 417.

<sup>35</sup> *W. A. Barrows Porcelain Enamel Co. v. Cushman Motor Delivery Co.*, 11 M. C. C. 365, 366; *Dixie Mercerizing Co. v. ET & WNC Motor Transp. Co.*, 21 M. C. C. 491, 492. See: *United States v. Morgan*, 307 U. S. 183, 313 U. S. 409; *Lima Tel. Co. v. P. U. C.*, 98 O. S. 110, 120 N. E. 330.

REASONABLE EARNINGS AND RATES  
FOR THE FUTURE

Future reasonable earnings and rates must be fixed with consideration of a forecast of operating revenues and

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expenses. The most recent experience of the Company is the best guide for prognostications. The President of the Company predicted a great increase in sales for 1941 over 1940. Comparative income figures for the first quarters of 1940 and 1941 show an increase of \$592,000 in net operating income or about 20%. The increasing demands for natural gas in the industrialized areas of Hope's markets are common knowledge. It seems certain that 1940 will be the lowest year, on an earnings basis, of the 1940-1944 period. Upon a consideration of all the relevant facts in the record and the future prospects, the Commission finds that 1940 is a conservative "average" year and should be used in rate-making in these proceedings. This is a conservative basis because allowance will be made for all probable future increases in the rate base and operating expenses while the operating revenues for the relatively low year of 1940 are employed as the test in fixing rates for the future.

Applying the 6½% rate of return to the rate base for the future of \$33,712,526, produces \$2,191,314 as the amount of annual return which the Company is entitled to earn in the future. Hope's income available for return is not less than \$5,801,171, so the excess of \$3,609,857 is the sum by which existing revenues must be reduced.

Hope's gas sales revenues are classified between intrastate sales and interstate sales for purposes of determining the sales and rates subject to the jurisdiction of this Commission.

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Hope's entire properties are located within the State of West Virginia and production, transmission, compressing and general facilities are used jointly for intrastate or

local sales and interstate or export sales. Therefore, a classification or allocation is necessary to determine operating expenses and return applicable to the interstate business. Certain direct costs pertaining to distribution property and sales in West Virginia are easily segregated from the joint costs. The allocation of the remaining joint costs is made in accordance with the following facts and principles which are undisputed in the record and accepted by all parties to these proceedings.

The Company's local retail business in West Virginia is incidental to its major business of exporting gas from West Virginia. In determining the allocation of joint expenses to the local West Virginia business, this fact was given consideration, with the result that a smaller amount of expenses was allocated to that business than would have resulted by the application of one of the customary allocation methods. Briefly, the amount of joint expenses (including return) allocated to the local business was that amount which, together with the specific local expenses, would give the Company a 6½% return on the net investment in property used exclusively in the local business. As indicated above, a more orthodox allocation probably would have resulted in assigning a larger share of the joint costs to the West Virginia sales and a greater amount of the excess profit, although the amount would not be material, to the interstate sales. The method used was

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proposed by representatives of the Company and was not controverted.

The following schedule (Col. (c)) shows the excess of future net operating revenue over 6½% return on the interstate rate base, and Columns (d) and (e) show the prescribed rates and revenues after giving effect to the rate reduction:

**Net Operating Income Available For Return**

Rate Base for Interstate Sales \$33,712,526

	<u>M.c.f.</u>	<u>Before</u>	<u>After Reduction</u>	
		<u>Reduction</u>	<u>Prescribed</u>	
			<u>M.c.f.—cents</u>	<u>Amount</u>
(a)	(b)	(c)	(d)	(e)
<b>Operating Revenues from Interstate Sales:</b>				
East Ohio Gas Company	40,376,091	\$14,726,736	29.50	\$11,910,947
Peoples Natural Gas Company	9,738,612	3,457,207	28.50	2,775,504
River Gas Company	388,750	136,063	35.00	136,063
Fayette County Gas Company	859,106	270,618	28.50	244,845
Manufacturers Light and Heat Company	2,241,684	706,131	28.50	638,880
<b>Total Interstate Revenues</b>	<b>53,604,243</b>	<b>\$19,296,755</b>		<b>\$15,706,239</b>
<b>Deductions:</b>				
Operating Expenses		16,272,934		16,272,934
Other Gas Revenues		(83,275)		(83,275)
Allocation of Costs to Local West Virginia Sales		(2,694,075)		(2,694,075)
<b>Total Deductions from Interstate Revenues</b>		<b>13,495,584</b>		<b>13,495,584</b>
<b>Net Operating Income from Interstate Sales</b>		<b>5,801,171</b>		<b>2,210,655</b>
<b>6½% Return on Interstate Rate Base</b>		<b>2,191,314</b>		<b>2,191,314</b>
<b>Excess of Future Net Operating Income over 6½% Return on Interstate Rate Base</b>		<b>\$ 3,609,857</b>		<b>\$ 19,341<sup>36</sup></b>

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The Company's intrastate rates are under the jurisdiction of the Public Service Commission of West Virginia. The West Virginia Commission and the State of West Virginia are intervenors in these proceedings and no objection was made by them to the method used herein for the allocation of cost to local operations in West Virginia.

The evidence on the cost of service allocated among the five customer companies and the conditions of service for the respective companies disclose that no reduction in rates

<sup>36</sup> It is not considered necessary to refine average rates per m.c.f. more than the prescribed rates shown above and the result is the margin of \$19,341.

is applicable to the affiliated River Gas Company. Among other reasons for this determination, is the fact that the River Gas Company is a small company and has a poor load factor. Accordingly, the total amount of the reduction in interstate rates is applicable to the East Ohio Gas Company, Peoples Natural Gas Company, Fayette County Gas Company and the Manufacturers Light and Heat Company. The present average rates per m.c.f. are 36.5¢ for East Ohio Gas Company, 35.5¢ for the Peoples Natural Gas Company, 35¢ for the River Gas Company, and 31.5¢ for Fayette County Gas Company and the Manufacturers Light and Heat Company.

The conditions and characteristics of service, required by the contracts, are similar for the East Ohio Gas Company and the Peoples Natural Gas Company with respect to obligations and priorities by classes of consumers, but there is a great difference with regard to delivery pressures. Hope Company delivers gas to the East Ohio Company at sufficiently high pressures so that no additional compression is required by the East Ohio Company for de-

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livery of the gas to the ultimate consumers. On the other hand, Hope delivers gas to the Peoples Natural Gas Company, at various pressures, into that company's Brave Compressor Station and the Peoples Company must compress the gas for transportation to the ultimate consumers. From the evidence we conclude that the differential of one cent between the average price per m.c.f. for gas sold to the East Ohio and the Peoples Companies is reasonable, and it reflects the difference in the cost, conditions and characteristics of service.

Considering the cost of rendering service to the Fayette County Gas Company and the Manufacturers Light and Heat Company, and the conditions and characteristics of service to those companies, the fact that Hope knows precisely what deliveries it must make to them from day

to day and the fact that those two companies buy less than 6% of the total gas sold by Hope, the Commission finds that the rate for these companies should not be different from the rate paid by the Peoples Natural Gas Company. In the absence of compelling reasons to the contrary, it is good and desirable practice to fix rates that are uniform. Applying this principle in these proceedings the Commission will prescribe uniform rates for the Peoples Natural Gas Company, Fayette County Gas Company and the Manufacturers Light and Heat Company.

After considering all the evidence with respect to Hope's interstate wholesale rates and the proper average rates per m.c.f. for the five customer companies at the respective points of delivery, the Commission finds the fol-

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lowing rates to be just and reasonable :

	<u>Average Rate</u> <u>Per. M.c.f.—Cents</u>
East Ohio Gas Company	29.5
Peoples Natural Gas Company	28.5
Fayette County Gas Company	28.5
Manufacturers Light and Heat Company	28.5
River Gas Company	35.0

In passing, it might be noted that the over-all rate of return for 1940 would have been 8% if the new rates had been in effect that year and if the earnings from the distribution property had remained unchanged. This rate of return is reduced to 6½%, because of estimated increase in expenses and increase in rate base which we have allowed for the future.



Appropriate findings and order will be entered in accordance with this Opinion.

(Signed) LELAND OLDS,  
*Chairman,*

(Signed) CLAUDE L. DRAPER,  
*Commissioner,*

(Signed) BASIL MANLY,  
*Commissioner,*

(Signed) CLYDE L. SEAVEY,  
*Commissioner.*

Dated at Washington, D. C.  
this 26th day of May, 1942.

(Signed) LEON M. FUQUAY,  
*Secretary.*

City of Cleveland	Complainant	}	Docket No. G-100
v.			
Hope Natural Gas Company	Defendant	}	
City of Akron	Complainant	}	Docket No. G-101
v.			
Hope Natural Gas Company	Defendant	}	
Pennsylvania Public Utility Commission	Complainant	}	Docket No. G-127
v.			
Hope Natural Gas Company	Defendant	}	
In the Matter of		}	Docket No. G-113
Hope Natural Gas Company			

MANLY, Commissioner, concurring:

I have joined in the majority opinion of the Commission in this case, with respect to the deduction of the "depreciation reserve requirement" in preference to the depreciation reserves carried on the books of the company, because such action seems to be required by the precedent established by the unanimous decision of the Commission in the Interstate Power case.<sup>1</sup>

In that case the depreciation reserves carried on the books of the Interstate Power Company were obviously deficient, as a result of "unsatisfactory" and "haphazard" accounting practices. They amounted to only about 2½ per cent of the electric plant account. If these utterly de-

<sup>1</sup> *Re Interstate Power Co.*, 32 P. U. R. (N. S.) 1, 10.

ficient book reserves had been accepted as the proper deduction for depreciation in arriving at the rate base, it would have given the company an advantage to which it was not entitled and would have resulted in imposing an unfair burden on the consuming public.

—2—

The Commission therefore, in that case as in the present case, determined on the record what the proper "depreciation reserve requirement" should be and deducted that amount in arriving at the rate base. In the Interstate case such requirement was found to be approximately 28 per cent of the electric plant account, or more than ten times the proportion carried on the company's books. In the instant case the reserves carried on the books are in excess of what the Commission has determined to be a proper reserve requirement, but the principle is exactly the same. We cannot, without discrimination, apply one principle in cases where the reserves are deficient and another where they are excessive. To do so would undermine the very foundation of utility regulation.

It may be noted also that, while many of the natural gas companies have built up excessive depreciation reserves, largely because they had no sound basis for determining the probable service life of their properties, this is not true in the electric utility industry. There it is probable, although no exact determination has been made, that a majority of the companies have established inadequate depreciation reserves. To apply the principle of deducting book reserves to the electric utility industry would therefore be grossly unfair to a large part of the consuming public.

Attention should also be directed to the fact that, until the passage of the Federal Power Act in 1935 and the Natural Gas Act in 1938, the depreciation policies of both

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the electric utilities and the natural gas companies, as regards their interstate operations, were not subject to regulation. Under such conditions, while it is true that the amounts set up on the books as depreciation reserves were derived from revenues collected from customers, they did not, as under regulation, play a determining part in fixing the level of rates and the consequent amount of the revenues. Without regulation, the good old rule of "What the traffic will bear" is controlling and depreciation policies are an afterthought, determined by the management and board of directors. It follows therefore that, during the pre-regulatory period, the customers would not have contributed any more or less to the company's revenues, regardless of what depreciation program was pursued.

Finally, it may be noted that if the Hope company in the instant case had been improvident and dissipated its earnings to such an extent that its depreciation reserves should now be grossly deficient, the utmost that the Commission could do would be to direct the deduction of a proper "depreciation reserve requirement." It is difficult, therefore, to understand how it can be argued that, because it has prudently set aside for depreciation an amount greater than such requirement, it should now be penalized in fixing its rate base. Such a policy, it seems would place a premium on improvident and wasteful management because, until the Commission has made its official determination of the reserve requirement, no one can say with assur-

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ance what it should be.

If the Commission, in the years that lie ahead, consistently requires proper reserve requirements to be set up on the books of interstate electric utilities and natural gas companies, and proper annual depreciation to be set aside, the time will soon come when all such companies will be on a uniform basis and the book reserves may properly be de-

ducted in arriving at the correct rate base. If such consistent policies are not followed, regulation will inevitably collapse under the unequal strains which have been imposed.

(Signed) BASIL MANLY,  
*Commissioner.*

Washington, D. C.,  
May 26, 1942.

City of Cleveland	Complainant	}	Docket No. G-100
v.			
Hope Natural Gas Company	Defendant	}	
City of Akron	Complainant	}	Docket No. G-101
v.			
Hope Natural Gas Company	Defendant	}	
Pennsylvania Public Utility Commission	Complainant	}	Docket No. G-127
v.			
Hope Natural Gas Company	Defendant	}	
In the Matter of		}	Docket No. G-113
Hope Natural Gas Company			

SCOTT, Commissioner, dissenting, in part:

This proceeding poses such a basic problem of regulation that I am constrained to dissent in part.

The majority has found a rate base in the amount of approximately \$33,712,526, and has predicated the rates which it has prescribed upon the bases of allowing the Hope Company a return of 6½% upon that base.

Upon the record in this proceeding, I believe that the rate base for Hope Natural Gas Company can be reasonably determined not to exceed the sum of \$17,662,792.<sup>1</sup> Using this figure as a predicate, a further reduction of some \$1,040,000 in net revenue to Hope is clearly indicated.

<sup>1</sup> It might even be set at a lower amount; see discussion on page two hereof.

It seems to me that this case is an appropriate one in which to establish the concept that true prudent investment in property of the utility dedicated to the public service, is a fair and proper rate base. In this regard, the recent decision of the Supreme Court in the *Natural Gas*

—2—

*Pipeline Company of America* case<sup>2</sup> affords ample authority for the use of prudent investment. The problem, then, is to determine what is the amount prudently invested by the Hope Company in the properties now devoted to public service. This problem does not appear too difficult.

The total cost of plant used and useful in the public service has been found by the Commission to be approximately \$52,000,000.

The depreciation and depletion reserves, as of December 31, 1940, as shown on Hope's books, attributable to this property was approximately \$38,377,750.<sup>3</sup> In addition, it should be noted that Hope has in the past transferred \$7,552,919 from depreciation and depletion reserves to

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earned surplus.<sup>4</sup> It is unquestioned that every single dol-

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<sup>2</sup> *Federal Power Commission, et al. vs. Natural Gas Pipeline Company of America, et al.*, 315 U. S. . . . ; 62 S. Ct. 736.

<sup>3</sup> The depreciation and depletion reserve per books at December 31, 1940, totals \$46,654,691. \$4,819,640 of this amount is attributable to the property of the Reserve Gas Company merged into Hope in 1939, but, as is pointed out by the majority in a footnote, the property and income of Reserve have been segregated and excluded for purposes of these proceedings. \$1,866,887 of the reserve is applicable to distribution property with which we, of course, are not here concerned. \$1,590,414 represents charges to the reserve by reason of adjustments made in plant accounts at December 31, 1938, but not recorded on the books. The book reserve, therefore, applicable to Hope's property with which we are concerned is thus \$38,377,750. The deduction of this reserve from \$51,957,416, cost as found by the majority, leaves \$13,579,666, to which is added (per the majority opinion) \$4,083,126 for net capital additions 1941, 1942 and 1943, useful unoperated acreage and working capital, making a total of \$17,662,792.

<sup>4</sup> If correction be made for this transfer, the rate base would not exceed \$10,109,873.

lar in the depreciation and depletion reserves (as well as the \$7,552,919 transferred from those reserves to surplus) has been taken from gross operating revenues whose only source was the amounts charged customers in the past for natural gas. It is, therefore, a fact that *the depreciation and depletion reserves have been contributed by the customers* and do not represent any investment by Hope. Indeed, J. C. Chisler, Vice President and Treasurer of Hope, testified that it had been the company policy to retain revenues obtained through the medium of depreciation to finance and to develop its property.

The funds accumulated by such charges to operating expenses, the net total of which is represented by the amount in these reserves, have been used to build property now in service.

As was pointed out in the *Lindheimer case*:<sup>5</sup>

“\* \* \* According to the practice of the Company, the depreciation reserve is not held as a separate fund but is invested in plant and equipment. As the allowances for depreciation, credited to the depreciation reserve account, are charged to operating expenses, the depreciation reserve invested in the property thus represents, at a given time, the amount of the investment which has been made out of the proceeds of telephone rates for the ostensible purpose of replacing capital consumed. \* \* \*”

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It is proper, of course, that depreciation and depletion reserves should be accumulated from consumer payments for service to assure that the capital embarked in the enterprise by the utility owner shall remain unimpaired. But it is an equitable corollary of the duty which rests upon the consumer that he shall not be required to pay a return on amounts which, in fact, *he, rather than the owner of the utility, has contributed.*

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<sup>5</sup> *Lindheimer v. Illinois Bell Telephone Company*, 292 U. S. 151, 168.



The majority has very properly pointed out that property which has been constructed by past charges to operating expense, such as well drilling and overhead charges, should not be permitted to be capitalized for ratemaking—or for any other—purposes. This is based on the simple equitable principle that the customer should not be required to pay more than once. With this position of the majority, I am, of course, entirely in accord. Moreover, I can see no distinction between property which has been constructed by the company through charges upon the consumers by operating expenses labelled, for example, “well drilling expense” and property which has been constructed by the company through charges upon the consumers by operating expenses labelled “depreciation and depletion expense.” In the latter case, equally with the former, the only amount *invested by the utility owner* in the business is the amount over and above the amount of property whose construction was paid for by operating expense charges. Consequently,

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if we are setting as the rate base the prudent investment by the owner in the property, we should not permit the owner a return on something which quite patently he has not invested in the property.<sup>6</sup>

This principle is eminently fair in practice and is certainly not new in utility regulation. For example, in the case of *Re Mondovi Telephone Company*, P. U. R. 1933B, 319, the Wisconsin Commission concluded that:

“\* \* \* Customers who have unwittingly been financing property additions in the manner shown [by charges to operating expenses made by the company for capital additions] should not be expected to pay

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<sup>6</sup> The same principle, of course, would apply to a so-called fair value rate base. In that case the only amount to be “valued” would also be the amount invested by the owner and not that amount contributed by the consumer.

rates which will allow a return on the property so paid for.’<sup>7</sup>

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Whether customer contributions be made directly for the purpose of building specific additions to plant or whether they be made somewhat indirectly but are likewise used for the construction of plant, there is no reason in either case why the customers, having contributed the funds to build the plant, should be required to pay to the utility company a return on the amount they have contributed.

In the *Mondovi* case the precise problem of deduction of the full depreciation reserve was also directly involved. The depreciation reserve was admittedly in excess of the existing depreciation in the property, i.e., the used-up service capacity of the property. But the Wisconsin Commission said:

“\* \* \* The question now arises whether the entire [depreciation] reserve should be deducted from the property and plant account to arrive at a proper rate

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<sup>7</sup> The exact facts as set out by the Commission were as follows:

“\* \* \* year after year certain items of capital expenditure, notably wages of labor used in making additions to plant, were charged to operating expenses. The revenues received from subscribers, through the rates charged for service, more than covered these operating expenses, including items of expenditures for plant additions erroneously included in maintenance expense. In other words, the rates paid by subscribers were sufficient not only to pay running expenses but also to pay labor used in adding to the property. In addition, these rates provided a return enabling the company to pay dividends in every year except one during the past eighteen years, these dividends averaging just under 8 per cent on the stock outstanding during the 18-year period. The effect of including in the appraisals property so paid for and then using these appraisals in determining a rate base is to require customers to pay twice. Year after year, through these erroneous charges to operating expense, subscribers have been paying for plant additions, and now, if the appraisal values are used as a rate base, subscribers will be forced to pay a return on property already paid for by them.

“Such a result, in our opinion, would be grossly unfair.  
\* \* \*”

base. Because of the fact that any excess in the reserve over and above an amount representing the used-up service capacity of the property is made up of 'involuntary' contributions on the part of the subscribers, we do not believe that the company is entitled to earn a return on property financed by such contributions.  
\* \* \* ,'

The majority itself has pointed out that with respect to cost of property the Supreme Court of Appeals of West

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Virginia has taken a position on consumer contributions to capital in the form of overheads which is identical with this one.<sup>8</sup>

Certainly the fact that not only the overheads but the direct cost, as well, of the property financed by the depreciation and depletion reserves have been contributed by the customers should emphasize the lack of equity in requiring the public to keep on paying a return on that which it has contributed to the property. There is neither fairness nor economic necessity in such a requirement.

Nor are we without specific authority of the United States Supreme Court on this exact point. In the case of *Louisiana R. R. Comm. v. Cumberland Tel. Co.*, 212 U. S. 414, the Court pointed out (p. 424):

“\* \* \* It was obligatory upon the complainant to show that no part of the money raised to pay for depreciation was added to capital, upon which a return was to be made to stockholders in the way of dividends for the future. It cannot be left to conjecture, but the burden rests with the complainant to show it. It certainly was not proper for the complainant to take the money, or any portion of it, which it received as a result of the rates under which it was operating, and

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<sup>8</sup> *City of Wheeling v. Natural Gas Co. of W. Va.*, 115 W. Va. 149, 175 S. E. 399, 5 P. U. R. (N. S.) 471; *Natural Gas Company of West Virginia v. Public Service Commission*, 95 W. Va. 557, 121 S. E. 716, P. U. R. 1924D, 346. See also *Re Reedsburg Telephone Company*, 7 P. U. R. (N. S.) 389, 395.

so to use it, or any part of it, as to permit the company to add it to its capital account, upon which it was pay-

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ing dividends to shareholders. If that were allowable, it would be collecting money to pay for depreciation of the property, and, having collected it, to use it in another way, upon which the complainant would obtain a return and distribute it to its stockholders. That it was right to raise more money to pay for depreciation than was actually disbursed for the particular year there can be no doubt, for a reserve is necessary in any business of this kind, and so it might accumulate, but to raise more than money enough for the purpose and place the balance to the credit of capital upon which to pay dividends cannot be proper treatment.  
\* \* \*”

What the Court there condemned is what Hope claims here.

The majority has found that \$22,328,016 is money enough for the purpose of a reserve for depreciation. It also appears from the record that Hope has accumulated \$16,049,734 more than enough for this purpose, or \$23,602,653 more than enough if adjustment be made for the transfers from depreciation and depletion reserves to surplus. This balance of approximately \$23,600,000 the majority permits Hope to place to the credit of capital upon which dividends may be paid—a result which the Supreme Court in the *Cumberland Telephone Company Case, supra*, unequivocally states “cannot be proper treatment.” Certainly it cannot be gainsaid that Hope has taken this portion of the depreciation and depletion money which it received as a result of the rates under which it was operating and has so used it “as to permit the company to add to its capital account upon which it was paying dividends to shareholders.” Hope has done this for practically its

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entire history. It seems to me that simple justice to the consumers demands that we follow the injunction of the

Supreme Court and call a halt to this unjustified exploitation of the public.<sup>9</sup>

The Supreme Court, in the *Lindheimer case, supra*, appears clearly to support my conclusions when it said at page 169:

“\* \* \* But if the amounts charged to operating expenses and credited to the account for depreciation reserve are excessive, to that extent subscribers for the telephone service are required to provide, in effect, capital contributions, not to make good losses incurred by the utility in the service rendered and thus to keep its investment unimpaired, but to secure additional plant and equipment upon which the utility expects a return.”

I can find no justification whatever for permitting Hope to continue to make profits upon capital which it has required the public to contribute to its business. We, certainly, are under no constitutional compulsion or requirement to permit Hope longer to take such profits. For, as Chief Justice Stone stated in the *Natural Gas Pipeline Co. of America* case:

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“\* \* \* The Constitution does not require that the owner who embarks in a wasting asset business of limited life shall receive at the end more than he has put into it. \* \* \*”

Obviously, the fictional character of the company's claim of *property* permeates any suggestion of confiscation. There can be no confiscation of *property* when the prop-

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<sup>9</sup> The case of *Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U. S. 23, is in no way contrary to this position. As was pointed out by the West Virginia Supreme Court of Appeals in *Wheeling v. Natural Gas Co.*, *supra*: “An examination of that case shows that the board of commissioners had directed the company to make up current losses out of reserves accumulated in the past. No question was raised there in regard to including property in the rate base which had theretofore been paid for out of operating expenses.”

erty claimed taken is made up of "involuntary" contributions on the part of consumers.

Over its entire history, the investors in Hope have earned extraordinarily generous returns upon their invested capital.<sup>10</sup> The entire investment in Hope, as pointed out in the majority opinion, is represented by capital stock. From its very inception through 1940 the investors have received in cash dividends an annual average of 20% on the average amount of capital stock issued for cash or other assets.

Part of the stock of Hope now outstanding represents common stock dividends issued from time to time, and it appears that Hope has paid over its entire history average annual cash dividends of approximately 13 to 14% on all its common stock, including not only stock issued for cash or assets but also stock issued as dividends. Its depreciation and depletion reserve has been built up *after* such earnings were paid out. Obviously, a utility company

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which has existed for 43 years—through several major economic crises in the country—with such an extraordinary rate of earnings can hardly claim in any good conscience to be entitled to continue to make additional returns upon sums patently *contributed by its customers*.

The prudent investment doctrine as classically expounded by Mr. Justice Brandeis in the *Southwestern Bell case*<sup>11</sup> was designed to afford the utility investor assurance that he would always receive a fair return upon his investment and to save the consumer from being required to pay a return upon any increment above that investment. It was never intended to serve as a method by which the utility investor was to be permitted to earn a return upon funds or property contributed by someone other than himself.

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<sup>10</sup> During period 1908-1940, \$97,273,640 in cash dividends have been paid by the Hope Company.

<sup>11</sup> 262 U. S. 276, 289.

Mr. Justice Brandeis pointed out almost at the very outset of his opinion that:

“\* \* \* The thing devoted *by the investor* to the public use is not specific property, tangible and intangible, but capital embarked in the enterprise. \* \* \*

“The investor agrees, by embarking capital in a utility, that its charges to the public shall be reasonable. \* \* \*”

The basic theme of the entire opinion is that the amount upon which the investor is entitled to earn is *his* investment in the utility and no more. This is so patently fair to all concerned that it should require no further comment.

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This case may seem like a hard one in which to apply this very fundamental and sound principle because of the fact that its application would result in the reduction of the rate base to a comparatively low figure. But there is no injustice in limiting the company to a return on *its investment*, while there is, on the other hand, great inequity in requiring, as does the majority, the consumers to pay a return on some sixteen to over twenty-three and a half millions of dollars which they have contributed to the building of the Hope system.

For these reasons I believe that the rate base should here be the cost of property used and useful in furnishing service, less the actual depreciation and depletion reserves attributable to such property.

(Signed) JOHN W. SCOTT,

*Commissioner.*

Washington, D. C.,  
May 26, 1942.

**4. COMPLETE LIST OF EXHIBITS BY ABBREVIATED TITLES  
CLASSIFIED BY SUBJECT MATTER.**

<u>Exhibit Number</u>	<u>Offered By Company</u>	<u>Exhibit Number</u>	<u>Offered By F. P. C. Staff</u>
<b>I. THE COMPANY'S PROPERTIES AND OPERATIONS.</b>			
<b>(A) Maps.</b>			
1	Tonkin: Map of Hope, East Ohio, Peoples and River systems	41	Hayne: Map of Hope's system
1-A	Tonkin: Reduced scale copy of Ex. 1	41-A	Hayne: Statement explaining Ex. 41
3	Tonkin: Interval maps showing development of Hope's properties	72	Hayne: Gas flow maps
3-A	Tonkin: Reduced scale copies of Ex. 3	72-A	Hayne: Statement explaining Ex. 72
<b>(B) Export Sales Contracts.</b>			
5	With East Ohio	47	Shattuck: Specified conditions of service in Hope's filed rate schedules
6	With Peoples		
7	With River		
8	With Fayette		
9	With Manufacturers		
<b>(C) History of Operations.</b>			
4	Tonkin: Hope's properties, markets, sources of gas supply and development of its properties: Explanation of Exs. 1, 2 and 3 (Printed at page 103 below)		
<b>(D) Gas Sales and Other Statistics.</b>			
2	Tonkin: Hope's properties, markets and sources of gas supply, 1898-1938	48	Shattuck: West Virginia sales of 12 utilities, 1937-1939
2-A	Tonkin: Vendors' wells supplying gas to Hope	49	Shattuck: West Virginia gas purchase prices



<u>Exhibit Number</u>	<u>Offered By Company</u>	<u>Exhibit Number</u>	<u>Offered By F. P. C. Staff</u>
2-B	Tonkin: 1939-1940 statistics supplementary to Ex. 2	69	Lyon: Gas handled annually, 1899-1939
2-C	Tonkin: Hope, East Ohio and Peoples' domestic and industrial sales, 1937-1941	69-A	Lyon: Gas handled, 1940
120	Moorhead: Errors in Ex. 69	70	Lyon: Annual and monthly sales, 1934-1939
120-A	Moorhead: Table 1 of Ex. 69 corrected	70-A	Lyon: Peak day sales, 1934-1939
		70-B	Lyon: 1940 supplement to Exs. 70 and 70-A
		71	Lyon: Graph of Hope's daily deliveries, 1933-1941

**(E) Gas Reserves and Methods of Gas Exploration.**

15	Tollefson: Remaining gas reserves of operated acreage as of Dec. 31, 1938	10	Definition of operated and unoperated acreage
15-A to 15-Q	Tollefson: Sand area maps	41	Hayne: Map of Hope's system showing "pool areas"
23	Tollefson: Methods of gas exploration	41-A	Hayne: Statement explaining Ex. 41
26	Rhodes: Leasehold costs of gas produced	43 43-A 43-B	Ross: Remaining gas reserves of operated acreage as of Dec. 31, 1938 and past production
44	Ross: Sand pool maps from Ross' working papers	51	Ross: Remaining gas reserves of operated acreage as of Dec. 31, 1939 and past production
45	Tollefson: Maps showing certain new wells drilled since 1938	51-A	Ross: Corrections to Ex. 51
46	Ross: List of dead wells on dead leases from Ross' working papers	64	Whitney-Dunn: Exploration and development costs, 1898-1939
52	Tollefson: Map showing certain 1939 drilling	80	Ross: Analysis of unoperated acreage

<u>Exhibit Number</u>	<u>Offered By Company</u>	<u>Exhibit Number</u>	<u>Offered By F. P. C. Staff</u>
53	Ross: Differences between Ross' 1938 and 1939 total recoverable gas reserve estimates for certain pool areas		
54	Ross: Differences between Ross' 1938 and 1939 individual well total recoverable gas reserve estimates		
55	Ross: Working papers supporting Ex. 51		

**(F) Miscellaneous.**

25	U. S. Dept. of Labor report on residential rates for gas in 50 cities, 1935-1939	34	West Virginia Commission letter to F. P. C. on leakage
42	Hayne: Changes in Company wells in 1939 not reflected on map Ex. 41	40	Stipulation that Hope is a natural-gas company under the Natural Gas Act
42-A	Hayne: Corrections to Ex. 41-A	50	Ryan: Typical monthly bills for domestic gas service in cities of population of fifty thousand and more
93	Tollefson: New wells drilled, purchased and drilled deeper, 1939-1941		
118	Tonkin: Future capital expenditures, 1941-1943	81	Nichols-Dunn: Corporate history

**II. RATE BASE.****(A) Original Cost and Adjusted Book Cost.**

11	Chisler: Balance sheet and income account, 1929-1938	20-A	Antonelli: Summary of general overheads included in original cost
20	Antonelli: Original cost of Company's properties (Printed at page 167 below)	Oral	Smith: Construction of F. P. C. code of accounts, R. 2702-2755 (Printed at page 225 below)
28*	Antonelli: Amounts originally expensed which are included in original cost	Oral	Smith: Principles of depreciation, R. 2826-2834 (Printed at page 373 below)

\* Offered by Cleveland in connection with its cross-examination (R. 1434).

<u>Exhibit Number</u>	<u>Offered By Company</u>	<u>Exhibit Number</u>	<u>Offered By F. P. C. Staff</u>
59	Antonelli: Comparison of original cost with F.P.C. adjusted book cost (Printed at page 347 below)	57 & 57-A	Pace-Dunn: Original cost (adjusted book cost) (Printed at page 209 below)
60	Antonelli: Inventory of direct material and labor costs excluded in F. P. C. examiners' adjusted book cost	61	Dunn: Depreciation and depletion of gas plant at Dec. 31, 1938
89	Dunn: Estimated abandonment costs not charged to depreciation reserves	68	Nichols-Dunn: 1938 balance sheet per books and as adjusted
98	Antonelli: Principal property purchases, 1898-1938, and method of recording on books	75	Pace-Dunn: Reconciliation of original cost per Company and per F.P.C. examiners
99	Antonelli: Data furnished F.P.C. at its request showing for major accounts costs expensed and included in the original cost	76	Dunn: 1939 additions and retirements
131*	Sullivan: Figures presented by Cleveland as to original cost less depreciation	78	Dunn: Operations data for 1940
137	Kennedy: Necessary adjustments to F.P.C. examiners' computed depreciation reserves as of Dec. 31, 1938		
138	Kennedy: Necessary adjustments to F.P.C. examiners' computed depreciation reserves as of Dec. 31, 1939		

**(B) Original Cost Trended to Present Prices.**

20	Antonelli: Original cost trended to 1938 prices (printed at page 167 below)	74	Gough: Report on original cost trended to 1938 prices
		74-A	Gough: Chart on price trends

\* Offered by Cleveland in connection with its cross-examination (R. 6616).

<u>Exhibit Number</u>	<u>Offered By Company</u>	<u>Exhibit Number</u>	<u>Offered By F. P. C. Staff</u>
<b>(C) Reproduction Cost New and Less Depreciation.</b>			
16 Parts A to I	Rhodes: Inventory and reproduction cost new of physical properties as of Dec. 31, 1938 (Printed at page 143 below)	39	Rhodes: Segregation of reproduction cost new between direct and other costs
17	Rhodes: Pipe line construction unit costs	73	Bodner: 1939 pipe prices
18	Rhodes: Gas well construction unit costs	73-A	Bodner: Comparison of pipe installation cost per books with Ex. 16 installation cost
21	Rhodes: Reproduction cost new less depreciation of physical properties as of Dec. 31, 1938 (Printed at page 355 below)	123-A to D	Rhodes: Inspection sheets for four gas engines at Hastings Station
22	Rhodes: Summary of data as to accrued depreciation	140	French: 1940 pipe purchases by Manufacturers Light and Heat Co.
38	Rhodes: Corrections to Exs. 21 and 22		
115	Rhodes: Analysis of pipe prices shown in Ex. 73		
116	Rhodes: Analysis of installation costs shown in Ex. 73-A		
121	East Ohio - Cleveland 1931 stipulations on Hope reproduction cost new and less depreciation (not admitted)		
122	East Ohio-Akron 1932 stipulations on Hope reproduction cost new and less depreciation (not admitted)		
<b>(D) Working Capital.</b>			
36	Chisler: Required working capital	62	Nichols-Dunn: Working capital
105	Chisler: Delay rentals paid and time of payment	90	Dunn: Rate of return earned on original cost base, 1937-1940