A. Of course, I might rescind the entire answer and say that to get more gas reserves you might require considerably more expense, and it might change the entire set-up. I don't know how it would affect that. In each particular change in pools, there is a change three ways, there is a change in cost both by additions and retirements, a change in production, and a change in the ultimate recovery or the remaining reserves, and all of those would affect the answer.

Q. Well, on the case we were assuming, Mr. Dunn, what are all these additional costs, and so on; isn't it a fact that we
3097 have assumed you have got the same pool area and the same wells that you had in 1938 except that you have now gotten some additional gas reserves in 1939 and 1940? We don't change any of the figures back of 1938 in our assumption.

A. My understanding of this method is that in order to get additional reserves, you must drill more wells or acquire more acreage. That would represent a change in cost.

Q. Well, did you understand my question, Mr. Dunn, that I was asking you whether, if you redetermined these figures for this pool area that we have been talking about, whether your reserve as of December 31, 1938, would not be different than if you had computed it on your method only up to December 31, 1938?

Mr. Springer. I object again to the question and answer. It is the same question over and over again, and he has already answered that question.

Trial Examiner. Read the question, please.

(The question was read by the reporter.)

Mr. Springer. He has already answered that, Mr. Examiner.

Trial Examiner. I am not sure that I understand the question, so I don't know whether he has answered it before or not. The objection is overruled.

The Witness. Due to the fact that all the underlying conditions might change, I do not know what the result would be.

By Mr. Milde:

3098 Q. Now, Mr. Dunn, in the case of your depletion computation for gas well construction, you charged against your hypothetical depreciation reserve, as you were calculating it, the wells that had been retired, did you not, in the year in which they were retired?

A. That is correct.

Q. And you did that by individual pool areas?

A. Yes.

Q. That is, you analyzed what had happened actually as shown by the books for these various areas which you have labeled "pool areas"?

A. Production areas.

Q. Now you didn't do this in the case of retirements of field lines, did you?

A. I did not. My answer might be misunderstood. I did charge all the loss on retirements of field lines to the accumulated reserve, but I did not assign them to pool areas.

Q. Now will you point to the page in your Exhibit 61 where you worked that out?

A. What page?

Q. I am asking you what page it is.

A. Where I worked it out or where I set it out?

Q. Set it out, referring to lines—isn't that on page 29?

A. That is correct.

3099 Q. And isn't it shown under your heading "Property Retired"?

A. That is correct.

Q. Now is that a correct statement of what you did, Mr. Dunn, you took field line and right-of-way retirements which had occurred in the past all over the company's system, and found that they were $695,000 as shown in your last figure on column (ff)?

A. That is correct.

Q. Now actually, those retirements occurred in various ones of your production areas, did they not?

A. At least the large part of them must have.

Q. Well, didn't all of them?

A. There might be lines to individual wells outside of production areas, there are many purposes of field lines.

Q. Now isn't it a fact that if you had charged these retirements against your depletion reserves for your individual pool areas, that you would have had a lower adjusted depletion reserve as of December 31, 1938, than you have now?

A. I believe the tendency would, in that case, have been to lower the reserve, and also lower the expense in those particular years, lower the expense and likewise lower the reserve somewhat. Of course, it is utterly impractical to do such a thing, there are about 12,000 of these lines.

Q. And because it was impractical, you say you didn't
3100 do it?

A. That is right.

Q. Although it would have resulted in a lower depletion reserve than what you show?

A. Possibly a slightly lower one.

Q. Well, now, what caused that impracticality, Mr. Dunn?

A. The great number of field lines involved.

* * *

3101 Q. As I understand the situation, if you had charged retirements in the past against the pool areas in the case of field line construction and rights-of-way, as you did wells, you would have arrived at a somewhat lower depletion reserve as of December 31, 1938?

3102 A. I would have arrived at a somewhat lower annual expense and a somewhat lower depletion reserve, somewhat.

Q. You mean an annual expense all the way back to 1898?

A. Including the years under consideration now and all prior years.

* * *

Trial Examiner. Did you testify that you would have gotten a more correct answer had you broken it down into pool areas?

The Witness. I believe a little bit more correct answer.

Trial Examiner. And the reason you didn't do that is because it wasn't practical?

The Witness. Yes; I gave very careful consideration to
3103 the problem of breaking it down by pool areas, and in view of the actual conditions it would have required a great amount of time. This is a very small amount of money involved in relation to the total here, and the amount of time involved would have been entirely disproportionate to any answer that would be possibly changed. It is an utterly minor point.

* * *

Q. Referring to page 28 of your exhibit, I notice that you lump your depletion figures prior to 1913 all in one group, isn't that so?

A. That is correct; we did that.

Q. And isn't it a fact that what you did was to take the capitalized costs that existed in 1913 for Rights-of-Way and Field Line Construction, and applied to that the ratio of withdrawals from 1898 up to 1913 in one lump figure as applied to the reserves for that period?

A. Yes; we treated the period 1913 back to 1898 just as if it were one year, instead of many years.

Q. Now, that method of treatment necessarily assumes, does it not, that the property in existence in 1913 had helped carry gas from various production areas right from 1898 on,
3104 or whenever the first production began in each area?

A. Well, I wouldn't say that, because this is strictly on a unit of production, and has little reference to years, back in those early days especially.

Q. Well, suppose a line was installed, a field line, in 1912; you apply something like a 90 percent depletion factor to that line, don't you, in your 1913 figures?

A. If it happened to be in a production area of which there was one that in 1913, 90 percent of the gas had been withdrawn, 90 percent of the cost was written off in 1913.

Q. So that line which I have been talking about, installed in 1912, you would write down on the assumption, would you not, that it had helped carry gas right from the beginning of the gas producing operations of the particular area?

A. It was on a unit-of-production method, and it so happens that it covered a period of 13 years, and possibly you could draw such an inference. I don't know that I had to assume that. I mean, if that much gas had been drawn in one year, I would have gotten exactly the same answer as if it had been drawn in 13 years.

Q. Well, Mr. Dunn, it isn't very accurate, really, is it, to lump all the years from 1898 to 1913?

A. I wouldn't have done it if I could have avoided it, but that is one of the characteristics of this company, that no gas
3105 was metered or calculated, prior to 1913, as far as I know.

Q. That is as far as you know?

A. Yes.

Q. You made no investigation to ascertain, I assume, whether or not the right-of-way and field line costs which you started with in 1913 had actually been installed right from the beginning of the gas-producing activities, did you?

A. Oh, we actually had the figures before us by years from the inception of the company, so I knew exactly when all costs were incurred.

Q. So that you do know that a substantial portion of the right-of-way and field line investment was not made in 1898 when production activities first occurred, but was scattered throughout the years right up to 1913, don't you?

A. They were scattered, that is correct.

Q. Let me ask you, Mr. Dunn, if, in your computation also, you didn't use the costs as you set them up for January 1 of each year, to apply a depletion rate?

A. That is merely a mathematical computation. On depreciation we use average costs. Here it would be absolutely incorrect to use that, because we take the remaining costs over the remaining reserves, and we take the costs at December 31, less the amount accumulated, before any provision is made during the current year, and apply it. That is mathematically correct—any other method would be wrong.

3106 Q. Well, isn't it a fact that you assume, in that method, that property installed at any time during the year has helped carry gas from the first of the year?

A. Time doesn't play much of a part in this, as such; it is the amount of production that is really important.

Q. I am asking you whether that isn't an assumption inherent in your method?

A. If I was getting cost by months, for instance, I would take the amount that I computed at the end of the year, and divide it by 12, and I would get the amount of depletion expense each month.

Q. Can't you answer my question, Mr. Dunn?

Trial Examiner. Just what did you do here?

The Witness. Oh, I took the balance of the investment account at the end of the year, less the accumulated reserve as at the end of the year, but before current provisions were made, and that is the amount I applied the rate to.

By Mr. Milde:

Q. And that includes, does it not, moneys that the company has spent in the summer and fall when it was building lines?

A. That includes both additions and retirements during the year.

3107 Q. Now I notice that on your table here on page 28, in line 34, you have an item of "Reserves Acquired" in the amount of $136,000.

A. Yes, sir.

Q. Now as I understand it, what you have done on these accounts is to compute what I would call a hypothetical depletion reserve of $2,992,000, and then you add to that the reserves acquired; is that right?

A. The $2,992,000 is the sum of the annual provisions to expense, that is what would be charged to expenses, and there is an amount of $136,000 which is reserves acquired, as you have stated, added to that.

Q. Well, now, that increased your depletion reserve by $136,000 over your other calculations; isn't that so?

A. That is correct.

Q. Now that is the reserves that the Hope Company acquired or put on its books, is it not, in connection with the rights-of-way and field lines purchased by it from other companies?

A. Yes; the one company, the Clarksburg Light & Heat.

Q. And by adding it to your reserves, you have assumed, have you not, that the reserves that the Clarksburg Light & Heat Company had set up, and which Hope in turn set up on its books, correctly measured the depletion in those acquired lines as of the date of the purchase?

A. Yes; I think that that is a very correct figure as to the depletion existing in those lines as at that date.

3108 Q. Well, did you make any investigation of that, Mr. Dunn?

A. You mean recomputing the reserves set up by Clarksburg Light & Heat?

Q. I am asking whether you made any investigation as to whether that inherited depletion reserve correctly measured the depletion on your theory, of the properties acquired by the Hope Company from Clarksburg Light & Heat.

A. There was no investigation required on my part; I knew it did.

Q. Your theory is whatever the Clarksburg Light & Heat Company set up on its books for a reserve in connection with field lines and was transferred to the Hope's reserves, correctly measured the depletion of the properties purchased by Hope, is that right?

A. Yes; this is entirely a cost transaction as of 1929.

Q. What you do in effect there, Mr. Dunn, is to put into your accounts here, merely the purchase price which Hope paid for those properties?

A. Yes, sir; Hope's plant cost and reserves are stated on a cost basis.

Q. So that for field lines and rights of way purchased by Hope from Clarksburg Light & Heat Company and in
3109 existence at December 31, 1938, you have the purchase price less any depletion figures in respect to that purchase price

which might be included in your figures from 1929, on; is that not so?

* * *

A. I do not have anything less than the purchase price. I have the original cost less reserves, which equals the purchase price.

Q. You have depleted that property since then in your figures from the time when the Hope Company took over these properties, have you not?

A. That is right. All of those figures equal the purchase price in 1929, and subsequent to that I have depleted them the same as any other property of Hope.

Q. So what you have finally is the depleted purchase price in your final figure?

A. That is correct.

Q. I notice on this table which we have been referring to, subschedule No. 2–b, on page 29, that you deal with what you call individual wells and marketing lines and purchasing lines in columns CC, DD, and EE. What is the fact as to your treatment of individual wells?

A. That means lines to individual wells and there is not
3110 a terrific amount of cost involved here, and rather than
deplete each one of them separately on the basis of the estimated gas reserves for each individual well, I have grouped them and depleted them on the basis of the total gas reserves of these individual wells and the total production of these individual wells.

Q. How many individual wells are there?

A. There are quite a few. I believe there are 75 or 80, and maybe there are more than that.

Q. There are well over 100 of them, are there not?

A. That is probably true. It may be there are as many as 175.

Q. And you added up the reserves and production figures for all of those individual wells and considered them as a whole?

A. Yes.

Q. And they are scattered all over West Virginia, are they not?

A. I believe they are.

Q. And you could have done that same thing for all of the 772 wells, could you not?

A. No; I did not have the individual reserves computed for each well, unless they were just labeled individual wells.

Q. But if someone furnished you that information you
3111 could have handled all of the 772 in that same way, could you not?

A. I could have: yes.

Q. What is your treatment of marketing lines, and just what are they?

A. That is a figure that was furnished me by the engineering division, and I believe they could answer what they are better than I could.

Q. Do you know what that phrase means?

A. They tell me they are lines used to market gas locally, little sales lines right out in the field.

Q. But apart from what they may have said about it, you do not know what they are or where they are?

A. No.

Q. Or what use they are put to?

A. No. I just have their word for it.

Q. How did you handle that particular classification, Mr. Dunn?

A. That small amount of cost is written off over all gas produced and all reserves from present existing wells as of December 31, 1938.

Q. And that method assumes, does it not, Mr. Dunn, that the company will not develop any additional reserves by additional drilling or purchases after December 31, 1938, in order to put gas through these marketing lines?

A. No; I do not believe it assumes that.

3112 Q. Well, in your calculation, you base it on the probable total recovery of gas for the company's whole system, merely up to its gas development activities as they were made prior to December 31, 1938, have you not?

A. Yes, sir. I might say I would have the choice of either using the December 31, 1938, figure or the total recoverable gas, we will say, from deeper drilling, and on an operated acreage, and all of the other figures, but in the interest of conservative accounting, inasmuch as this gas may never be recovered or it may be deemed not worth while to get it, I wrote it off over the costs known to be incurred and the reserves known to be subject to recovery. It would be stretching your imagination a little bit to include all of the other costs.

Q. Your theory is that just as a matter of conservative accounting the company ought to write off its property rapidly, I take it?

A. If there is any choice between conservative and nonconservative figures, I would certainly pick the conservative figure.

Q. Actually, Mr. Dunn, this depletion reserve for marketing lines and so on, does not purport to measure the exhaustion of the service life of those marketing lines, does it?

A. I think it measures it very closely. The chances
3113 are, I am informed by the engineers and geologists, that
when all of the gas has gone out of West Virginia, or even out of the present existing wells, there will be little, if any, use for these local marketing lines. The amount is insignificant. I do not know what would happen if we used some other method.

Q. And if the engineers are wrong about that, of course you are wrong?

A. Yes; I would change it if I had any better information.

Q. And what you have just said now is all of the gas in West Virginia—you did not use the ratio of Hope's production to all of the gas in West Virginia or even all of the gas that Hope will recover in West Virginia, in working your depletion of these lines, did you?

A. I understand that a ratio does not necessarily have to be higher or lower by using all of the gas in West Virginia. This is a ratio and is not necessarily higher or lower by reason of some change.

Q. Mr. Dunn, you can answer my question. Will you read it, Mr. Reporter?

(Question read.)

A. No; I did not use all of the gas in West Virginia.

Q. Now, your next item is purchasing lines; what are they?
3114 A. They were set up by the bureau of engineering; I
did not select them at all.

Q. You do not know what they are?

A. I have been told what they are; do you want me to state that?

Q. Yes.

A. These are little local lines running out to the various purchase gas contract lines.

Q. That is what you understood when you put that phrase down?

A. That is what I was informed.

Q. How did you handle purchasing lines?

A. In exactly the same manner as marketing lines.

Q. You assumed then, did you not, Mr. Dunn, in handling them in that way, that the gas reserves of the company's 340 contract vendors, collectively or individually, were being depleted in the same ratio that Hope's 1938 gas reserves were being depleted?

A. I was informed by the engineers that that was substantially true.

Q. And who informed you of that, Mr. Dunn?

A. I believe several of the engineering staff informed me.

Q. Will you state their names, please?

A. I am sure I consulted with Mr. French on it.

3115 Q. Mr. French told you that the gas reserves of the company's contract vendors, their over-all gas reserves, were being depleted in the ratio of Hope's production to Hope's 1938 reserves?

A. Not in exact ratio, but there is a relationship there.

Q. But you have used this relationship on Mr. French's statement to you?

A. Yes.

Q. You assumed it was the same?

A. I would assume it would make no material difference because there is only a very little amount of money involved.

Q. You think every time there is a little amount of money involved it does not make much difference whether your figures are accurate or inaccurate?

A. There is always the problem to consider whether an enormous amount of work is justified by the results obtained from it.

Q. That means you used a good many short-cuts here to get your final figures, I assume?

A. It looks like about three short-cuts in this case involving not over $400,000 over a period of many years.

Q. You mean $400,000 in depletion reserves?

3116 A. In plant cost.

Q. Which you deduct in your depletion reserve?

A. Gross.

Q. Now, Mr. Dunn, refer back to your schedule No. 2 on page 25 with which you started.

Trial Examiner. Off the record.

(Discussion off the record.)

By Mr. Milde:

Q. You show in your column headed "C," operated acreage.

A. What page?

Q. 25.

A. Yes.

Q. Did you use the same methods we have discussed in connection with field lines and rights-of-way in working out your figures for operated acreage?

A. Yes; the same rates were used.

Q. The same methods?

A. Yes.

Q. You have an adjusted book cost of about $1,600,000 in line 5, and that is the consideration paid for the leases; is it not?

A. Yes; that is the original cost as of December 31, 1938.

Q. That is the dollar or two an acre which was paid
3117 to land owners?

A. In some cases it is considerably more than that.

Q. Is it not also true in working out your figures on operated acreage you also used your pool area method?

A. That is true.

Q. In connection with retirements of leases, you did not charge them by pool areas; did you?

A. No; that is true; I did not.

Q. You handled those just like the retirements we talked about in connection with field lines and rights-of-way?

A. That is true.

Q. And your same general statements as to the reasons and the effect of that method as applied to field lines and rights-of-way costs would apply here; would they not?

A. That is true.

Q. In addition to your adjusted depletion reserves, you develop in this exhibit the depletion allowances for 1937 and 1938, which appear in the income accounts as presented in other exhibits?

A. Yes; they are directly related.

Q. And the amounts of money you have set out in schedule No. 1 on page 23, for example, for 1937 and 1938, are the result of the application of these rates to the cost in each of those years; is that not so?

3118 A. Yes.

Q. And those are the same rates which you used to develop the depletion reserve?

A. Yes, sir.

Q. And all of the assumptions we have talked about in connection with your determination of depletion reserves and other matters apply to your determination of depletion rates; they are one and the same thing, being correlative?

A. That is true. If we lower the reserve, we lower the annual expense, and if we raise the reserve we automatically raise the annual expense.

Q. And these annual depletion rates are all based on this information which was supplied to you in connection with determining depletion reserves, the information supplied you by engineers, and so on; it is the same subject, is it not?

A. Yes.

* * *

3123 Cross-examination by Mr. REEDER:

Q. Mr. Dunn, I believe you testified that in your opinion if you had used the method suggested by Mr. Milde, it would have been generally unfavorable to the company for rate-making purposes: is that right?

* * *

The WITNESS. I do not believe I could state it in the exact dollars and cents, but I do believe that it would have created a higher reserve which would tend to be unfavorable in rate-making
3124 proceedings, leaving less net book cost.

By Mr. REEDER:

Q. It would have resulted in a higher or lower annual allowance for depletion?

A. I believe it would have resulted in a lower annual allowance for depletion.

Mr. REEDER. That is all.

* * *

3621 Cross-examination (continued) by Mr. MILDE:

Q. Mr. Dunn, isn't it a fact that on December 31, 1938, the Company had, according to your figures, 3,262 active gas wells in service?

A. I believe that is the figure. Do you want me to check it exactly?

Q. Yes; if you will.

A. Yes; I have the figure of 3,261, I believe. I got that by adding up the number of wells in which well equipment was capitalized.

Q. 3,261?

A. Yes, sir.

Q. Isn't it a fact that of these wells, there were some drilled each year back from 1938 all the way to 1891?

A. That is correct.

Q. And of the wells drilled prior to 1903, that are now in service, those were wells purchased by the Hope Company after they had been drilled by other parties; isn't that so?

A. Well, I would have to check on that particular point, I don't recall.

Q. Well, you know that the Hope Company first began to drill wells itself in 1903, don't you?

3622 A. No; I never have made any particular study of that, of when.

Q. You didn't determine that that was so in connection with your analysis of original cost data?

A. Oh, yes; it is in the work papers, the date every well was drilled is in there.

Q. And you just don't recollect that now?

A. That is right.

Q. Do you know when the Hope Company first began to abandon wells?

A. That was also included in the work papers.

Q. Can you determine it readily from your working papers?

A. I think so; yes.

Q. Suppose you tell us?

A. Oh, not that readily. It would require maybe several hours.

Q. Well, isn't it a fact, Mr. Dunn, that right from the beginning of the Company's operations to the end of 1922, the Company charged the cost of abandoning wells to operating expenses as the wells were abandoned?

A. Yes; I think that is absolutely a fact.

Q. They were charged to an account called Field Lines and Wells, Account 17, Operating Wells and Field Lines; isn't that so?

A. I would have to check on the exact account; I don't
3623 recall.

Q. Now, isn't it a further fact that under the 1921 West Virginia Public Service Commission Uniform Classification of Accounts, that became applicable to the Company in 1923, the cost of abandoning wells was required to be charged to operating expenses?

A. I believe they have an account in there.

Q. And that in accordance with this Classification, the Company continued to charge well abandoning costs to operating expenses as wells were abandoned?

A. Yes, sir.

Q. And that is true as a direct charge to operating expenses up through 1931; is it not?

A. That is right.

Q. And then in 1932, the Company made a charge in effect to operating expenses directly, did it not, by setting up a reserve each year for the anticipated abandoning costs, and then when the actual costs were known, charging that to the reserve and wiping out this year by year accrual?

A. That is right, the reserve is in effect a charge to operating expenses.

Q. So that, right from the beginning up until 1938, the Company has charged the cost of abandoning wells, as they were abondoned, to operating expenses?

A. Yes, sir.

3624 Q. And that was recognized as good accounting practice in the industry, was it not?

A. Certainly. It might still be recognized as good accounting practice; in other words, if there is no provision in the reserve for cost of removal, cost of removal is an expense.

Q. Now will you turn to your Schedule No. 2 on page 25 of Exhibit No. 61? You recall, do you not, Mr. Dunn, that at the last session we discussed columns (c), (d), and (e) on Schedule No. 2, which were the columns that showed the results of your depletion provisions for Operated Acreage, Field Line Right-of-Way and Construction Cost, and Gas Well Construction?

A. I do.

Q. And we had not reached Column (f), which is entitled "Cost of Abandoning Gas Wells." And there you show, do you not, at the bottom of your column, in line 33, total annual accruals to December 31, 1938, of $2,100,000?

A. That is correct.

Q. Now isn't it a fact, Mr. Dunn, that the details for this determination are shown on your Schedule No. 2D, at pages 32 and 33?

A. That subschedule shows the details of cost of abandoning gas wells by production areas.

Q. And the column (b), as it appears on page 32, is the one that you subsequently transferred to column (f) on

3625 Schedule No. 2 at page 25, isn't that so?

A. Yes, sir; that is correct.

Q. Now referring to page 32, your first line is, or your first group of lines appear under the heading "Cost Subject to Depletion," do they not?

A. Yes, sir.

Q. And here they are shown as blank?

A. That is correct.

Q. And the fact is that you aren't depleting any costs at all in this instance, are you?

A. We are not depleting any invested cost.

Q. You are not depleting any costs, are you?

A. This is strictly a provision for cost of abandoning in the future, and is not incurred today.

Q. That is right, this isn't really a depletion allowance at all, is it?

A. In the terms of depletion being applied to invested capital; no, it is not.

Q. Or applied to any amount of money; you have nothing to deplete here, have you?

A. No; as I explained, it is exactly what it is labeled, the cost of abandoning gas wells in the future.

Q. There is an accrual, or a hypothetical accrual, of a fund to take care of future operating costs or abandoning costs; isn't that so?

3626 A. Well, I believe I just said it was an accrual to take care of the future cost of abandoning gas well, determined as explained under column (a).

Q. Now as you worked that out, Mr. Dunn, you find under line 5 that the expense for the cost of abandoning gas wells, computed for each active gas well at December 31, 1938, at $1,007 per well, will be $3,285,131; isn't that so, as shown in column B?

A. Yes.

Q. And that is your estimate, or the estimate of yourself and Mr. French, of what it will cost the Company to abandon the 3,261 active gas wells that were in existence at December 31, 1938, and which you classified as then in service?

A. That is right.

Q. Now the fact is, is it not, Mr. Dunn, that in the past the Company has not set aside any funds for these future abandonment costs of these existing wells, but has, on the contrary, followed the practice of charging well-abandonment costs to operating expenses as wells were abandoned?

A. That is correct. The first part of your sentence—I might add, there are no funds earmarked for this specific purpose. I won't go so far as to say that they have not set aside funds for this purpose.

Q. You didn't find any set aside on the books, did you, by way of any reserve?

3627 A. No; I didn't find any specific reserve for this particular point; no.

Q. Now this set-up of yours, Mr. Dunn, reflects a shift, does it not, in accounting policy or procedure or requirement?

A. Well, it represents a change, I suppose, in the method of handling cost of abandoning gas wells, certainly.

Q. Heretofore, the cost of abandoning wells has been charged to operating expenses as wells were abandoned?

A. Yes.

Q. And you recognize, do you not, that if that practice is followed consistently, that that produces a fair and equitable result?

A. Yes; it produces a fair result. It may produce a very distorted picture of operating expenses in the future, however; if you start having an abandonment cost of over $3,000,000 that should be charged into operating expenses, it might produce a pretty heavy charge against operating expenses in the future. It should be provided for now.

Q. It hasn't had that effect in the last 40 years, has it, Mr. Dunn?

A. No; there have not been great numbers of gas wells abandoned during the past 40 years.

Q. Why, Mr. Dunn, you know, do you not, that there have been over 2,000, or close to 3,000 gas wells abandoned by the Company?

3628 A. Well, over a period of 40 years; yes.

Q. And what you say about some distorted result is just on the assumption that the history in the future will not be the same as the history of the Company in the past?

A. Well, it is based on the fact that these wells will probably be abandoned more frequently in the future than they have been in the past. That is one assumption.

Q. Well, a well is abandoned only once, isn't it, Mr. Dunn?

A. Certainly.

Q. And the fact is, you don't know what the result will be in the future unless you can predict the history of the Company's production system and predict that it will be different in the future than it has been in the past?

A. Well, I think certain future predictions have been made of the Company's future production, and they are in the record, and the geologists estimate the future gas reserves.

Q. Well, all I want to get perfectly clear, Mr. Dunn, is that here the Company, right up until 1938, has been following one system of taking care of this cost, which is to charge well abandoning costs to operating expenses as the wells are actually abandoned. That is true, is it not?

A. Yes; although they probably, at 1932, foresaw the need of some kind of a reserve accounting.

Q. And what you have done here is to set up an accrual
3629 on a different theory, isn't that so?

A. Yes; absolutely.

Q. A completely different theory. Your theory is here that the Company should have accrued a reserve in the past to take care of the abandoning costs of the present existing wells?

A. That is correct.

Q. And it is a sort of a hypothetical accrual, is it not, Mr. Dunn, which you have developed by taking the production of all of the Company's wells in the past, plus the reserves of the existing wells, and you have determined on the ratio of this production to these total reserves, that the Company should have set up a total of $2,107,000, isn't that approximately what you did?

A. Well, when you say "sort of hypothetical," I think this is a very real cost. As I understand the law in West Virginia, you are required to spend about $107,000 as an average cost per well in the future when you abandon that well. I think it is a very real cost and expense.

Mr. Slaff. Did you mean $1,007 in your last answer? You said $107,000.

The Witness. Yes; $1,007.

By Mr. Milde:

Q. Of course this is a very real cost, and we both agree that in the future the Company will have to spend about
3630 $3,285,000 of cash to abandon its present existing wells?

A. I fully expect that they will; yes.

Q. And there isn't any doubt about it that that is coming right out of the Company's pockets, isn't that so?

A. Any estimate in the future might be in some slight doubt, but this seemed to be about as real a figure as we could develop.

Q. It represents real dollars the Company has to spend?

A. I think so.

Q. That isn't what I asked you before, Mr. Dunn. I asked you whether it wasn't a fact that you have got a hypothetical accrual, which assumes that in the past the Company has set aside $2,107,000 towards this future cost?

Mr. Slaff. That was answered, Mr. Examiner. I object to the question, because it has been answered just previously.

Trial Examiner. Well, he stated that he didn't consider it a hypothetical matter.

Mr. Slaff. That is right, he answered it completely.

Mr. Milde. Well, you don't understand it. May I have the question read again?

(The question was read by the reporter.)

Trial Examiner. Go ahead and answer the question.

The Witness. I don't understand the difference between accrual and hypothetical accrual, but I will answer in terms of ac-
3631 crual in the past, which I will say, as I already said once,
that the Company did not provide a specific reserve in the past earmarked for this particular purpose. However, the Company in the past has provided a great deal of reserve which is available for any purpose, and not earmarked for any particular item.

By Mr. Milde:

Q. This isn't any sort of a depreciation allowance, is it, Mr. Dunn; this is something different; this is merely an accrual for future operating expenses?

A. It operates exactly the same as a depreciation allowance.

Q. And you haven't found anywhere that the Company at any time set aside any funds for the cost of abandoning property in the future?

A. They have a great deal of reserve available for that purpose.

Q. That isn't what I asked you.

Mr. Slaff. The question has been asked three times and answered three times by the witness.

Trial Examiner. Yes; I think he has already stated that a couple of times.

By Mr. Milde:

Q. What have you already stated?

Mr. Slaff. I object to that. If counsel wants to know what has been stated, he can have the reporter read back the
3632 record to him, and I am willing to have him do that.

TRIAL EXAMINER. He stated that he didn't find any funds earmarked for that purpose.

Mr. MILDE. That is what I understood, and I thought he was trying to modify that answer, and I want it perfectly clear that there was no modification of that.

By Mr. MILDE:

Q. Now, actually, Mr. Dunn, it would have been completely impossible for the Company to have set aside an accrual for these future abandoning costs in the amounts that you have shown here, would it not?

A. By no means would it have been impossible.

Q. Well, in the first place, Mr. Dunn, the Company would have had to know, back in 1898 or thereabouts, that in 1938, or the end of 1938, there was going to be a different accounting system which shifted the theory of handling well abandonment costs, wouldn't it?

A. Well, this isn't particularly a different accounting theory, this is done quite often. I understand that the Company was very familiar with depreciation accounting and depletion accounting back in 1898. There are many letters on file to show that they understood it practically as well then as they do today.

Mr. MILDE. Will you please read the last question, Mr. Reporter?

3633 (The question was read by the reporter.)

By Mr. MILDE:

Q. Now, can you answer that question?

Mr. SLAFF. Let's have the answer read, too.

TRIAL EXAMINER. Read the answer.

(The answer was read by the reporter.)

Mr. SLAFF. It is perfectly answered. He said there is nothing different about it.

TRIAL EXAMINER. You mean that a new system has not been instituted as suggested by the question?

Mr. SLAFF. That is my understanding of the answer, yes; no new principle. What he is saying is that the assumption that counsel is making in his question just doesn't exist as a matter of fact, that is all.

TRIAL EXAMINER. Is that what you mean to say?

The WITNESS. Well, yes; if I understand his question, he assumed that by some action of possibly a regulatory body or some new theory of accounting, that a condition exists today that didn't exist then in accounting, and I say not.

By Mr. Milde:

Q. Well, Mr. Dunn, the question I started with is this, and I think you agreed with me—if not, you can so state: that as a matter of practice, the Company couldn't possibly have set aside in the past this hypothetical accrual of yours in the total amount of $2,100,000; isn't that so?

3634 A. It couldn't possibly have set it aside?

Q. In the amount that you there show.

Mr. Springer. I object to that. The Company has shown a depreciation accrual that is excessive here, of $40,000,000, on its books to cover all possible losses.

* * *

The Witness. Well, I think probably this would happen as a practical matter: if the Company had been setting aside a reserve for abandoning based on production, it would be approximately this amount, maybe not to the dollar.

By Mr. Milde:

Q. Well, Mr. Dunn, the fact of the matter is that the Company couldn't have set it aside, the Company couldn't have set aside an accrual for abandoning wells that it would have in 1938, and also continue what was then the accepted and required accounting practice of charging well-abandoning costs to operating
3635 expenses as the abandoning costs were incurred; isn't that so?

A. Oh, well, you have presented me with two alternatives, they either do one or the other.

Q. And they followed the alternative of charging well-abandoning costs to operating expenses as they occurred?

A. That is what they actually did; yes.

Q. That is right. And following that alternative, they couldn't possibly, as a practical matter, have also accrue a sum of money to take care of future abandoning costs on the theory that that should be provided for by accruals rather than as a current charge, could they?

Mr. Springer. The question isn't clear. The sum of money refers to what? May we have that read?

(The question was read by the reporter.)

Mr. Springer. Is that sum of money a reserve or a fund that you are talking about?

Mr. Milde. Are you asking me?

Mr. Springer. Yes, sir; it isn't clear, Mr. Milde.

Mr. Milde. Well, the question is whether it is clear to the witness.

Trial Examiner. Do you understand the question?

Mr. Slaff. We have a right to have it made clear to counsel, too, so that we can know whether to object to the question. It is a perfectly proper inquiry by us as to what is meant by the use of that term.

3636 Trial Examiner. All right.

Mr. Slaff. If counsel knows what he means.

Trial Examiner. Just what do you mean by the use of that phrase, that language?

Mr. Milde. Well, let me rephrase the question.

By Mr. Milde:

Q. It is perfectly clear, is it not, Mr. Dunn, that as a matter of practical accounting, starting from the beginning of the Company's operations, that it could not have handled well abandoning costs on two theories at the same time?

A. I think that is perfectly clear; yes, sir.

Q. And having adopted the practice, and being required to adopt the practice, under the subsequent West Virginia Commission Code of Accounts, of charging well abandoning costs to operating expenses as they occurred, they could not, the Company could not, as a practical matter, have also handled them on this accrual theory?

A. Well, you have got a statement in there to the effect that the West Virginia Commission required them to do this. Now I am not sure that if they had applied to the West Virginia Commission and asked for permission to create a reserve, that they wouldn't have given it to them. So I would like not to answer that part as to the requirements of the West Virginia Commission, because I don't know what they would have ordered in that case.

3637 But I will say this, that had they provided a reserve for well abandonment costs, the costs of abandoning should be charged to it; and if they didn't have a reserve, naturally they would charge it to operating expenses.

Q. Now, Mr. Dunn, the question I asked you is this, and I think you can answer it—and this time I will leave out the West Virginia Commission if it will please you any—that following the practice, right from the beginning, of charging well abandoning costs to operating expenses as they occurred, the Company could not, as a matter of practical accounting, have also accrued a reserve for future abandoning costs on the theory that is presented in your exhibit?

A. I don't believe they could have done that exact method. Of course, what would have happened is that they would have arrived at approximately the same result, as I have already testified.

Q. Well, we are perfectly clear, are we not, that they couldn't, as a matter of practical accounting, have done it both ways?

Trial Examiner. At the same time?

Mr. Milde. At the same time.

The Witness. No; because of the fact that at that time they didn't know exactly what these present existing wells at 1938 were.

By Mr. Milde:

3638 Q. Well, that is one reason, and the other reason is that you wouldn't possibly handle an operating expense on two different accounting theories which are different, at the same time, would you; that is, you wouldn't follow two theories simultaneously, would you?

A. No, indeed.

Q. And as you pointed out, the Company couldn't possibly have known in its past history, commencing in 1898, that on December 31, 1938, it would have approximately 3,261 wells, could it?

A. No; it wouldn't have known that.

Q. And they wouldn't have known in 1898 that at present price levels it would cost $1,007 to abandon those wells, would they?

A. They might have come to a figure approximating that, I wouldn't say that they couldn't have known that; no.

Q. They couldn't have estimated, back in 1910 or 1911, that the price level by 1938 would be substantially higher, could they?

A. Well, after all, they could very well estimate a cost which might come close to this, and it might even be higher, I don't know.

Q. By the way, do you think that when a company is setting aside reserves, it should include in its consideration the fact that the price levels may change in the future?

3639 A. No; the reserves are for the purpose of writing off the original cost of the property over its useful service life.

Q. Let me ask you one other thing about this $1,007, Mr. Dunn. The fact is that that is cost based on 1939 prices for abandoning, is that not so?

A. I got the cost from the engineering division.

Q. And didn't they advise you that that was based on 1939 prices?

A. No; they did not. I don't recall if they did, they may have.

Q. Now also, Mr. Dunn, it wouldn't have been possible, would it, for the Company to have known, in 1898, for any year right up to 1939, that its production property would be segregated into these pool areas, as testified to by Mr. Ross?

A. Well, had they made a similar study, they might have arrived at the same result.

Q. Well, they couldn't possibly have known that in 1941 Mr. Ross would come along and find certain pool areas in the Company's production property, could they?

A. Well, they probably didn't know that Mr. Ross would do it; no.

Q. Or that anybody would do it?

A. Well, they might have well expected that somebody might investigate their system at some time or another.

Mr. Slaff. That was a reasonable expectation, you mean?

3640 The Witness. Yes, sir.

By Mr. Milde:

Q. And also you think it is a reasonable expectation that the Company should have had, that this future geologist would divide its production up into these particular pool areas; do you think that that was a reasonable expectation?

A. From what I have learned, or from what I have heard the geologists say in the time I spent in the gas business, it is quite usual to divide production up into pool areas if it is at all possible.

Q. Well, the fact is that you have used these pool areas to arrive at your $2,107,000 accrual figure, haven't you?

A. Oh, yes; I have used them.

Q. And isn't it a fact that these accruals which you make for future cost of abandoning the present wells aren't based on the production and reserves of these particular wells?

A. It is my recollection that they are, but I would have to check to see the figure I used.

Q. I think that is rather important, Mr. Dunn. Will you check it, please?

A. I will have to go upstairs to get my work papers, I didn't bring the depletion work papers down.

Q. We have some copies of your work papers here. Can

3641 you use those?

A. Yes; I believe so.

(After a pause.)

The Witness. Will you read the question, please?

(The question was read by the reporter.)

The WITNESS. These wells are included in those production figures; yes.

By Mr. MILDE:

Q. I think you know what my question means, Mr. Dunn. Will you try to answer it more fully? Are they or are they not—and when I refer to "they," I mean these accruals of yours—based upon the production and the reserves of these particular 3,261 wells?

A. You mean—and no other wells—is that what you mean?

Q. That is what I asked you.

A. Yes; I will say, then, that these wells are included in those figures, and also all other production of the Company is included for any well that they had prior to 1938.

Q. That is right. These accruals for the cost of abandoning these 3,261 wells that the Company had on December 31, 1938, are based on the production and the reserves for all the wells the Company ever had, right down to December 31, 1938; isn't that so?

3642 A. That is correct.

Q. And the answer to my question as to whether or not these accruals for the future costs of abandoning these present wells are based on the production and the reserves of only those wells, is that they are not; isn't that so?

A. Well, if you would ask a direct question as to what they are based on, I could answer it directly. But if I answered it any other way, it might leave the impression that they were not included, which they are.

Q. Well, they are included with all the other wells the Company ever had, that is all you are saying?

A. That is right.

Q. And if I ask you again whether or not these accruals are based solely upon the reserves and the production of the particular 3,261 wells for which you develop these future accruals, the answer to that is what?

A. The answer is that they are not based solely on these 3,261 wells, but the word "solely" you did not use before.

Q. Do you know how many wells, Mr. Dunn, are included, or the production of how many wells is included, in the figures which you added to the production and reserves of these existing wells?

A. No; I didn't count them. It was the wells the Company had in the past, whatever wells it produced gas from in

3643 the past entered into this calculation.

Q. It is a matter of thousands, isn't it?

A. Yes.

Q. And it includes wells for which you have not allowed drilling costs in the adjusted book costs of the Company's properties, and the wells for which you have allowed some costs in the adjusted book costs?

Mr. SPRINGER. That is hardly properly phrased. What does he mean by "have not allowed drilling costs"? Is he talking about the costs that were expensed by the company in the past?

TRIAL EXAMINER. I don't know what he means.

Mr. MILDE. Well, Mr. Examiner, I think we have developed here, rather frequently, that in the adjusted book costs the Power Commission's accountants, including Mr. Dunn, have not included any drilling costs in their adjusted book costs for some 2,300 of the Company's existing wells. What I am now asking Mr. Dunn is, when he prepared this hypothetical accrual for these future abandoning costs, if he hasn't considered the production for both wells for which he has allowed drilling costs in the adjusted book costs, and those for which he hasn't.

Mr. SLAFF. Then I object to any question being put to him on the basis of a hypothetical accrual, when Mr. Dunn has testified that it is not a hypothetical accrual.

TRIAL EXAMINER. Well, that word wasn't used in the question, I believe.

3644. Mr. SLAFF. Well, as I understood it, it was explanatory of what was intended by the question.

TRIAL EXAMINER. I think that should be stricken out, if the explanation is to be considered part of the question.

Mr. MILDE. I think there is no question but that it is hypothetical——

TRIAL EXAMINER (interposing). Maybe you might use the term "so-called," or something like that.

By Mr. MILDE:

Q. Let me use the term "computed reserve." I think you will agree that this is purely a computed reserve, will you not, Mr. Dunn?

A. I guess all reserves are computed.

Q. And computed by you here. Now can you answer that question, with the explanation made to the Examiner?

A. I can answer the question, I believe. I can answer it by saying that the total gas produced up to 1938, by years, has been included in this calculation, and that also the gas recoverable from the wells in service as of December 1938; and it seems to me that you don't completely understand this, and if you want me to explain just what I did, I will be glad to do it at this point.

Q. Well, I am sorry, you didn't quite answer my question, Mr. Dunn. Will you tell me now whether or not, in the past
3645 production which you have used to develop this computed total annual accrual of yours, you have not used production from wells for which you have allowed drilling costs in the adjusted book costs, as well as for wells for which you have not allowed drilling costs?

* * *

The WITNESS. When I answered by saying total production, I meant both types of wells.

3646 By Mr. MILDE:

Q. And by "both types" now you mean wells for which you have included drilling costs in your adjusted book costs, and wells for which you have excluded drilling costs, do you not?

A. That is correct.

Q. Now, Mr. Dunn, going back again to page 32 of your detailed schedule, column (b), let me ask you if your figures don't contemplate that of the $3,285,000 of cash which the Company must have to abandon the wells existing as of December 31, 1938, your method provides for the recovery of only $1,177,000, in round numbers, in the future?

A. Well, I am inclined to answer that yes; if I understand your question perfectly.

Q. Well, I think you do, Mr. Dunn; and it is perfectly clear, is it not, that all you have to do is to find out what this total cost is, which is $3,285,000, which will be incurred in the future, and you deduct from that $2,107,000, which you have set up in your lines 33 and 35; and that means that after 1938, by your method, the Company will recover the difference between $2,100,000 and $3,285,000, or $1,177,000?

A. On these particular wells.

Q. That is what we are talking about, these particular wells. And the fact of the matter is that your computation
3647 provides that when the Company actually spends this $3,285,000 in the future, as these existing wells are abandoned, it will draw down on the $1,177,000 which you are going to allow it in operating expenses in the future, and for the bal-

ance of the cost of $2,100,000, it has just got to take that out of its own pocket, hasn't it?

Mr. SPRINGER. Wouldn't it be more accurate to say that the rate payer would pay the operating expenses?

Mr. MILDE. No; I am sorry, Mr. Springer, but a rate payer pays for gas, not for operating expenses.

Mr. SPRINGER. It must include operating expenses.

By Mr. MILDE:

Q. Well, isn't it perfectly clear, Mr. Dunn, that under your method you are going to provide, starting in 1939, in operating expenses, by your accruals here, $1,177,000 to take care of these future abandoning costs, and that is all, from 1939 on; isn't that so?

A. Well, I would say that we start from 1913 to make provision for the total, and I don't see what particular significance 1939 has. If we are considering operating expenses in 1938, then we provide $56,000 in that year; if we consider operating expenses in 1937, we have provided $75,000 in that year, plus whatever cost of abandoning has been charged to expenses. Now if those years have no significance, we will start
3648 with 1939.

Q. Well, Mr. Dunn, isn't it a fact that the only money the Company will get for this future $3,285,000—that is, get in fact—is the amount you allow, or the Commission allows, in operating expenses by way of accrual for this future cost, starting in 1939 when this new system of accounts went into effect?

A. The amount that they will get in operating expenses will be largely determined by the years in which they consider operating expenses. If they do not consider the years 1937 and 1938 in operating expenses, your statement is correct, that is all they will get.

Q. So in fact, the Company is going to be allowed to recover only $1,177,000, and the $2,100,000 which you have assumed has been accrued in the past, will have to be provided out of what funds or property it now has on hand, won't it?

A. I would say no.

Q. Well, where is it going to get the $2,100,000?

A. If in fact the Commission allows 1937 and 1938 operating expenses in their estimate or allowance for operating costs, and considers them, then they will, in fact, get $75,000 for this accrual in 1937, and another $73,000 for cost of abandonment, which has been included in operating expenses in 1937; and the

same thing will be true for 1938, except that the amounts
3649 are slightly larger in the case of cost of abandonment, which is $82,000, and the other figure is $56,000.

Q. That brings your figure down to a little bit below $2,000,000. Where will it get the $2,000,000?

Mr. SLAFF. Do you understand that question?

The WITNESS. I certainly don't understand that last question.

By Mr. MILDE:

Q. As I understand it, what you have done is to refer to page 32, lines 32 and 31, and said that if the Commission took 1937 and 1938 operating expenses into account, the Company would get $75,800 in 1937, and $56,169 in 1938, on your method, plus some amounts which you mentioned for the actual cost of abandonment that was incurred by the Company in those years, following its old practice?

A. That is right.

Q. And in that connection, Mr. Dunn, of course these additional amounts you mentioned, which you say the Commission will allow, was not for the cost of abandoning any of these present wells, was it?

A. Nevertheless, it is a cost, and a cost of abandoning gas wells, and that is what this problem is devoted to. I don't know what your distinction is there. It is a cost of abandoning gas wells actually incurred, and you have brought out very clearly the fact that this has been charged to expense, and we must consider
3650 the fact that it is charged to expense.

Q. Well, Mr. Dunn, we are taalking now about the cost of abandoning the 3.261 wells which were in service on December 31, 1938, are we not?

A. Yes; we are talking about——

Q. (Interposing.) That is what this whole accrual of yours is for isn't it?

A. That is correct.

Q. And you have pointed out that in 1937 and 1938, if the Commission follows your method, the Company is going to get $75,000 and $56,000 in operating expenses towards the cost of abandoning the wells in existence at the end of 1938?

A. That is right.

Q. And that is all that it is going to have towards that cost, is it not, in those years?

A. It is also going to have another feature which, if we had not included it in operating expenses, would have been included here. Therefore, they will get more. That is directly related to this problem, and I tried to explain that a while ago, that you didn't seem to understand, but you apparently did not want to hear my explanation.

Q. I am afraid I understand it too well, Mr. Dunn. Let me ask you if it isn't a fact that excluding the $75,000 and the $56,000, which you show in your lines 31 and 32, which make $130,-
3651 000, roughly, that the Company must just dig into its own pocket, out of its cash resources, or borrow from somebody if it doesn't have the cash resources, to pay the $1,900,000 of future abandoning costs?

A. I believe what they will actually have to pay in the future will be determined solely by what the Commission allows in operating expenses. If they allow the method that I have set up here, there will be an allowance in operating expenses of $75,000 a year in 1937, plus the amount they actually spent that year to abandon wells——

Q. (Interposing.) That is for wells in the past, isn't it?

Mr. Slaff. Have you concluded your answer?

The Witness. No.

Mr. Slaff. Please finish it.

The Witness (continuing). As to just what they would have to dig into their pockets for, would be rather a complicated calculation that I just can't make right here.

By Mr. Milde:

Q. Mr. Dunn, it is perfectly apparent from what we have developed, is it not, that on your method of accruing for future well abandoning costs, all that you provide towards that future cost of $3,285,000 is whatever the accruals are from 1939 on, as I suggested to you, or from 1937 on, as you suggested?

A. Yes.

3652 Q. And that at the most, that would make, say, $1,300,000, or thereabouts, of future accruals towards this total future cost of $3,285,000; isn't that right?

A. Yes; I believe that is correct.

Q. And all I am suggesting to you is that the balance of the $2,000,000, or approximately $2,000,000, the Company just has to provide for out of some other source, does it not, than these accruals from 1937 or 1939 on?

A. Or has possibly provided for in the past.

Q. And the net effect of what you are doing—let me ask you this: Wouldn't you think it fair, if you are going to shift over to a new system of accounts, new system of accounting on well abandoning costs, whereby you are going to set up an accrual rather than charge your well abandoning costs currently as wells are abandoned, to say, "All right, we will set up this new system now, but in fairness we have got to let the Company set up that accrual over the remaining life of these existing wells"?

Don't you think that would be a fair way to do it?

A. I am afraid that would be a violation of accounting principles, and not fair.

Q. You don't think that would be a fair way to do it?

A. Not considering this case; no.

Q. Do you think it would be a matter of proper accounting principles to let the Company continue to charge well
3653 abandoning costs to operating expenses as the wells were abandoned?

A. That would not violate any accounting principle. It would not be conservative accounting, though, I don't believe.

Q. So that it would be perfectly proper accounting practice to continue to charge well abandoning costs to operating expenses as they occur, wouldn't it?

A. I wouldn't say "perfectly proper." I think the Company realized the need of providing a reserve when they started one themselves in 1932. So it is proper, but I would say not eminently proper.

Q. Well, everybody considered it so, did they not, for 20 or 30 years?

A. That is right, they considered it proper accounting.

Q. All right.

Now if that happened, Mr. Dunn, the fact of the matter would be that as these wells were abandoned in the future, 10, 15, or 20 years hence, whatever it might be, some each year, the Company would be reimbursed their $3,285,000?

A. That is right.

Q. Now——

A. (Interposing.) Wait a minute. I will have to qualify that as to what they will actually be reimbursed. This, of course, could present an extraordinary loss of $3,000,000 here,
3654 and whether or not the rates will be high enough to cover it, or could possibly be high enough to cover it, I don't know. So I can't say they would actually be reimbursed on it.

Q. On this method of accounting they would be reimbursed, would they not?

A. If the rates were high enough to cover any loss, no matter in what year incurred, they would be reimbursed.

Q. Of course, if rates are not high enough, Mr. Dunn, they just aren't high enough to cover expenses—that is all you are saying?

A. That is right; so I can't guarantee that they will be.

Q. Well, now——

TRIAL EXAMINER (interposing). You have to assume they will be?

The WITNESS. Yes.

By Mr. MILDE:

Q. Now if we followed that method of accounting, the Company would get back its $3,285,000. Now if we say, "Well, we don't like this method of charging well abandoning costs to operating expenses as wells are abandoned; we ought to begin to accrue a reserve"—isn't it a fact that the only way that the Company can be reimbursed this total of $3,285,000 is to accrue that reserve over the remaining production of these existing wells?

3655 A. By no means.

Q. You don't think that that is a fact?

A. I know it is not a fact.

Q. And isn't it a fact that what you have done is to provide for accruals, either from 1937 or 1939 on, towards this actual cost of $3,285,000, of $1,200,000 or $1,300,000, such as we have developed before—that is all you have provided towards that actual future cost, isn't that so?

A. Well, by looking at this total in column (b), page 32, you will see exactly what is provided here.

Q. Well, I think you can answer that question, Mr. Dunn, directly.

A. Well, I will answer it this way, that I have earmarked certain expenses in my calculations as being provisions for this cost. Now they are not earmarked as such on the Company's books. However, should the Company desire or find it necessary to set up this reserve, there is certainly a balance available on the books to transfer to this amount, and many millions of dollars left over. So in fact, the amount has been provided for.

* * *

3656. Well, let me ask you again, Mr. Dunn: What you are assuming is, is it not, that approximately $2,000,000 of these future abandoning costs which the Company has to

3657 pay out in cash, will be, in effect, supplied by using up a part of the reserves which the Company has set up on its books in the past?

A. Yes; that is correct.

Q. And it is perfectly clear, is it not, Mr. Dunn, that in the Company's past reserves, there has at no time been any provision made by the Company specifically for the future abandoning costs of future wells?

A. That is correct.

Q. Referring again to page 32, Mr. Dunn, let me ask you if these figures in your totals, under column (b), don't really constitute a reaccounting all the way back over the Company's history, for the abandonment reserve for existing wells?

A. I don't know whether you would call it "reaccounting" or not. It is a revised depreciation reserve all the way through, of which this is one small part, maybe a substantial part, and it is due to the fact that the Company now has an excess amount of accrued depreciation.

Q. Well, this is just reaccounting backwards over the history of the Company from December 31, 1938, back to 1898, for a reserve for abandoning costs of present wells, which reserve the Company never had?

Mr. Springer. I object. He has already said it wasn't a "reaccounting."

Trial Examiner. Yes, he certainly has. I don't see any reason why he shouldn't say "no" again, though.

3658 Mr. Milde. He didn't say that, he said he didn't know whether he would call it exactly that.

By Mr. Milde:

Q. But in substance it is a reaccounting, isn't it, Mr. Dunn?

A. I would call it a revised reserve for depreciation, of which this is one part, made necessary by the fact that the Company's book reserve could not be used in this case.

Q. Well, let me ask you this, Mr. Dunn: Isn't it a fact that you have set up these figures on page 32 on the assumption that this Commission's Uniform System of Accounts has been in effect for these present wells since the beginning?

A. No; not on that assumption, particularly.

Q. Well, generally, you have assumed that under the present System of Accounts a reserve for future abandoning costs should have been set up, and you have proceeded to set it up for these 3,261 wells, haven't you?

Mr. SLAFF. I object to that. There are two questions there. You have assumed something and you have done something—those are the two questions. I object to the two questions in one.

TRIAL EXAMINER. Read the question.

(The question was read by the reporter.)

TRIAL EXAMINER. Have you assumed that it should be set up?

3659 The WITNESS. I didn't assume that under the present System of Accounts, because I don't think there is a word in the present System of Accounts that even mentions such a problem as this. It is just ordinary accounting practice which the System of Accounts also follows.

By Mr. MILDE:

Q. Well, that last answer of yours is rather interesting, Mr. Dunn.

If there is nothing in the Commission's present Code of Accounts on well abandoning costs, why didn't you just carry out the past practice of the Company, permitting it to charge well abandoning costs to operating expenses as they occurred?

A. Well, I felt that an amount like that of $3,000,000, a known cost to be incurred in the future, should be provided for by this Commission, and it is eminently proper that they should recognize that and provide for it.

Q. Of course, that $3,285,000 would have been provided for by currently charging well abandoning costs as wells were abandoned, wouldn't it?

A. In such a cost as that, it is well to provide a reserve for it. That is what a reserve is for, to take care of such extraordinarily large expenses in future operating costs.

Q. And it is a fact that if the Company's past accounting practice had been carried out, then over the future years, as these existing wells were abandoned, the Company would be
3660 allowed to charge in operating expenses this $3,285,000 as the wells were abandoned; isn't that a fact?

A. That is correct.

Q. And isn't it a further fact that by this shifting theory of yours, which you——

Mr. SLAFF (interposing). I object to that right now, because it is obviously an improper characterization, and there is no point in going on with the rest of the question.

By Mr. Milde:

Q. Isn't it a further fact, Mr. Dunn, that by this method which you have used—and I understand that you say it is not required by the present Code of Accounts, is that right?

A. I don't think it is specifically required. There is an implication in the Code of Accounts that costs of abandoning should be charged to a reserve, but of course there must be a reserve provided for in order to charge it to that.

Q. Isn't it a further fact, then, that by this method which you have used here, you have and you will permit the Company to charge from either 1937 or 1939, whichever you select, only $1,300,000 in current operating expenses towards this future actual cost of $3,285,000?

A. That is right, that is all that can be charged in addition to the amount already provided.

Q. And if there had been no change in the past practice
3661 which the Company has followed for 40 years, it would have recovered, in current operating expenses, not $1,300,000 as you provide, but this actual $3,285,000 cost?

A. That is correct.

Trial Examiner. We will take a recess of 10 minutes.

(Whereupon, a 10-minute recess was taken, after which the hearing was resumed.)

Trial Examiner. You may proceed, Mr. Milde.

By Mr. Milde:

Mr. Dunn, these total figures on page 32, you carry over to column (f) on Schedule No. 2 at page 25, do you not?

A. Yes, sir.

Q. And you show there, in lines 33 and 39, under column (f), this figure of $2,107,000 of computed accruals that we have been talking about, do you not?

A. Yes, sir.

Q. Now isn't it a fact that that $2,100,000, you add in line 39 to your reserves for Operated Acreage, Field Line Right-of-Way and Construction Cost, and Gas Well Construction, to give you a total figure of $6,612,000?

A. I do.

Q. And referring to column (b), line 40, you show an adjusted original book cost, as you phrase it, of $9,956,000, do you not?

A. Yes.

3662 Q. And that is composed of your adjusted book cost of Operated Acreage, as shown in column (c); and Field

Line Right-of-Way and Construction Cost, in column (d); and your Gas Well Construction Cost, in column (e); is it not?

A. That is right.

Q. Now, then, you deduct from that $9,956,000 this figure of $6,612,000, as shown in line 41, isn't that so?

A. Yes, sir.

Q. Which includes this $2,100,000 of computed accruals for future well abandoning costs?

A. That is correct.

Q. And you deduct that and get a net book cost of $3,343,000?

A. Yes, sir.

Q. And isn't it a fact that the effect of that deduction is to reduce, by $2,100,000, your net book cost of Operated Acreage, Field Line Right-of-Way and Construction Cost, and Gas Well Construction?

A. That is true; it does reduce that.

Q. And if you hadn't worked this computed accrual for future well abandonment costs, into your reserves for Operated Acreage, Field Line Right-of-Way and Construction Cost, and Gas Well Construction, you would have shown a net book cost for those properties of about $5,451,000, wouldn't you?

A. Yes, sir.

3663 Q. So really the effect of your computed accrual is to
eliminate $2,100,000 of the net book cost of Operated Acreage, Field Line Right-of-Way and Construction Cost, and Gas Well Construction Cost?

A. That is correct.

* * *

Q. Will you turn to Schedule No. 3 at page 34? This is your summary schedule for production plant, is it not?

A. It is the depreciable property in the production plant.

Q. Whereas, your Schedule 2, which we last referred to, was the depletable property in the production plant?

A. Yes, sir.

Q. I notice that the second line of this Schedule No. 3, Mr.
Dunn, says "Annual and Accrued Depreciation." Isn't
3664 that so?

A. Yes, sir.

Q. Which figure on this Schedule No. 3 represents accrued depreciation in the production plant?

A. The amount shown on line 53.

Q. Line 53, which reads "Total Reserves for Depreciation of Production Plant as Adjusted, December 31, 1938"?

A. That is correct.

Q. And that figure is $8,673,000, in round figures?

A. Yes, sir.

Q. And doesn't that same figure appear at line 55, called "Adjusted Depreciation Reserves"?

A. It does.

Q. And immediately above is the figure of $16,352,000, called "Adjusted Original Book Cost"?

A. Yes.

Q. Now you say that $8,600,000 is accrued depreciation. What is the percent of accrued depreciation, as you determined it on this Schedule No. 3, for the total production plant—depreciable property?

A. Roughly, slightly over 50 percent.

Q. Well, isn't it 53 percent, Mr. Dunn?

A. I don't have the figure before me. I suppose it would be about 53 percent.

And that leaves a net book cost of production plant
3665 of about 47 percent, does it not?

A. Yes, sir.

Q. As derived from the figures in column (b)?

A. Yes.

* * *

3668 Q. Mr. Dunn, will you tell me what you mean—and not what Mr. Smith means—by the term "accrued depreciation" as used in the heading of Schedule No. 3 and in the headings of your other Schedules throughout this exhibit?

A. That represents the actual existing depreciation in the property, and it is determined by spreading the service value over the service life, in this case original cost.

Q. Now will you tell me what you mean by the term "actual existing depreciation?"

Mr. Springer. Well, Mr. Examiner, that is pretty obvious, isn't it?

3669 Trial Examiner. If it is, I don't see any reason why he shouldn't state it.

The Witness. It is the amount of the cost of the property that has been consumed in gas service.

3670 By Mr. Milde:

Q. You don't consume a cost in gas service, do you, Mr. Dunn; you consume property?

Mr. Slaff. I object to that. Again he has got two questions in one.

Trial Examiner. All right, separate the questions, please.

Mr. Milde. Will you read that last answer?

(The answer was read by the reporter.)

By Mr. Milde:

Q. What I am now asking you, Mr. Dunn, is whether it is cost or property that is consumed in gas service?

A. Well, undoubtedly both.

Q. Well, as I understood it, you were defining "actual existing depreciation" in property; is that right?

A. I have identified this as being cost dollars.

Q. Then, when you defined accrued depreciation as the actual existing depreciation in the property, you didn't quite mean that, did you?

A. Well, if the word "depreciation" is understood to mean depreciation in dollars, that is exactly what I meant.

Q. Well, wouldn't it be more accurate to say that what you mean is actual existing depreciation in the cost of the property?

A. I am not exactly sure as to just what that would
3671 mean. If it means the same as I defined it, then it is
right.

Q. Well, you are not really dealing with property here at all, are you; you are dealing with costs as you have adjusted them?

A. The cost is, of course, directly related to certain property.

Q. And I want to know whether, when you say "accrued depreciation" as you do throughout this exhibit, you mean accrued depreciation as existing in the company's properties, or whether you are talking about accrued depreciation existing in the book cost or some other cost?

Mr. Slaff. I object to that. He has answered it several times.

Trial Examiner. Go ahead and answer it again.

The Witness. I mean in terms of the original cost of the property.

By Mr. Milde:

Q. So this phraseology "accrued depreciation" or "actual existing depreciation" is related solely to the cost of the properties as you have determined them; is that so?

Mr. Springer. I object, Mr. Examiner. Mr. Smith has been the witness on the principles of depreciation, and he has defined very definitely what "actual existing depreciation" is. He says: "Actual existing depreciation is the expired, diminished,

or consumed service life, which I also term the economic
3672 life of a utility's depreciable plant." He has stated that at page 2831 of the transcript. Mr. Smith designed this exhibit and supervised Mr. Dunn, and I think the question should be presented to Mr. Smith, although it is very plain from the transcript already what the term means.

Mr. Slaff. I might add, Mr. Examiner, in line with Mr. Springer's statement, that we have Mr. Smith here and he has been here all the time and is ready to be produced on cross-examination of his direct testimony on the subject of depreciation at any time that the company indicates that it desires to examine him on cross-examination on the subject of depreciation.

Mr. Milde. Read the last question, please.

(The question was read by the reporter.)

Mr. Milde. I think I am entitled to an answer to that question, Mr. Examiner.

Trial Examiner. I don't understand just exactly what the fact that Mr. Smith has defined certain terms here, and the fact that Mr. Smith is available for cross-examination has to do with the use of those definitions and the application of those definitions in the preparation of this exhibit.

Now, I assume that this witness necessarily applied those principles, and the purpose of the question, it seems to me, is to determine just exactly how he construed them, and how he applied them in this case. It seems to me to be perfectly proper
3673 cross-examination, and the objection is overruled.

The Witness. The reserve does apply to the original cost of the property. I wouldn't want to say "solely," because depreciation reserve is a very broad term, and I don't know for what purpose the word "solely" was inserted.

By Mr. Milde:

Q. I wasn't asking you about your reserve, I was asking you about the term "accrued depreciation," or "actual existing depreciation," as you subsequently stated it.

A. And that also is synonymous with the reserve for depreciation, as shown on line 53.

Q. Then we are perfectly clear that that relates to the cost; is that right?

A. That is right.

Q. And we are not talking about accrued depreciation or actual existing depreciation in the sense that an engineer would determine that, or in the sense that an engineer might find that in the physical properties?

Mr. REEDER. I object to that.

Mr. SPRINGER. I object to what an engineer might do.

TRIAL EXAMINER. Objection sustained.

By Mr. MILDE:

Q. Let me ask you, Mr. Dunn, if it isn't a fact that this accrued depreciation, this actual existing depreciation, and this depreciation reserve of yours—which you say are synonymous;
3674 isn't that right?

A. That is right.

Q. (Continuing.) Is merely the sum of annual accruals that you have computed as applying to the adjusted book costs of the properties less retirement losses charged against this reserve, that you charged against the reserve?

A. That is absolutely correct.

Q. Now, referring you again to schedule No. 3, page 34——

A. (Interposing.) Wait a minute. There is liable to be a misunderstanding there. There are a few other items set forth on this exhibit, composing the accrued depreciation, which you will notice are reserves acquired from other companies. That also enters into the determination of the total, outside of the specific provisions set forth here.

Q. Well, we will come to that a little later, but let me just clarify your answer, if I may, Mr. Dunn. What you mean is that in addition to these accruals that you have worked out, you have added reserves acquired from other companies; that is what you are saying now, isn't it?

A. Yes, sir.

Q. So that we add some company bookkeeping figures to your exhibit figures, or you added the company's bookkeeping figures to your exhibit figures on these reserves?

A. Some company cost figures, which are also bookkeeping figures.

3675 Q. Company inherited reserves, isn't that what you are saying now?

A. I said acquired reserves.

Q. Now, referring again to schedule No. 3, on page 34, your first item there is "structures," is it not, column (c)?

A. Yes.

Q. And that has an adjust book cost of $212,000, as you show it in line 5; isn't that so?

A. Yes, sir.

Q. Now, that is a relatively small portion of the depreciable part of the production plant; is it not?

A. Yes, sir; that is.

Q. And for that reason I would like to turn to column (d), which is Field Line Material, Measuring and Regulating Station Equipment, where you show an adjusted book cost of $7,934,000; isn't that so?

A. Yes, sir.

Q. And that is almost half of your total for this property shown in column (b); is it not?

A. Yes.

Q. Now, under your line 5 there appear the figures 2.22 percent for this Field Line Material, column (d), and similar figures of 4.17 percent, 2.50 percent appear under columns (c) and (e); do they not?

A. Yes.

3676 Q. Now, those are the annual depreciation rates supplied to you by Mr. French, are they not?

A. That is correct.

Q. You made no investigation yourself as to the reasonableness or unreasonableness of those depreciation rates?

A. I did not.

Q. And if any of those rates should be in error as a matter of mathematical judgment, your computations, using those rates, would carry through those same errors, would they not?

A. They would reflect an error to that extent; yes, sir.

Q. Now, I would like to develop with you, Mr. Dunn, your general method as to what you did with Mr. French's rates, and using column (d) as an illustration, the column (d) relating to Field Line Material, isn't it a fact that you have applied Mr. French's 2.22 percent rate to the average book balances in the company's field line material account, from 1898 down to 1938?

A. That is correct.

Q. And those are simply the average plant balances as they were set up by the company; isn't that so?

A. They weren't exactly set up this way. We made a reclassification or redistribution of certain accounts in order to group them. That is, the company didn't use the same account all the way through, and sometimes they overlapped.

3677 Q. What you mean, Mr. Dunn, is that you simply regrouped the figures as appearing on the company's books for gross plant balances, into these categories of Structures and Field Line Material, and so on?

A. They have been so grouped.

Q. But they are the company's book figures?

A. Yes, sir.

Q. And you haven't made any adjustments retroactively to those book figures from 1938 back to 1898, have you?

A. Not on this account.

Q. Well, you haven't on any accounts, have you, except to eliminate the plant balances for the property used to transport coke-oven gas?

A. I recall one other adjustment——

Q. (Interposing.) Well, did you make that one?

A. Yes, we made that one; and then we included $1,400,000 in the year 1920, which the company for some reason wrote off to expense, but which we felt should not have been written off. So we naturally included that in a retroactive manner.

Q. And did you put that in retroactively as of the year in which you restored that to plant account?

A. Yes; rather than trying to divide those costs up into five years, of which only some portion remained, we took 1920 as the average year.

Q. But, apart from those two adjustments, you have
3678 simply taken the company's plant balances, per books, and applied Mr. French's rates each year to the average plant balance for that year?

A. That is correct; that is the only adjustments that I recall.

Q. And isn't that what these figures are in lines 6 to 46 under column (d)?

Mr. Springer. Mr. Milde, does that previous question refer to the restoring of the annual allowances which appear on page 34 in lines 6 to 46?

Mr. Milde. That is true; the accruals.

The Witness. Yes.

By Mr. Milde:

Q. In other words, Mr. Dunn, that $28.26 that appears in line 6 under column (d) for the year 1898 is 2.22 percent of the company's average plant balance for 1898 for field line material?

A. Correct.

Q. And so on down through each year?

A. Yes.

Q. And in the year 1938, as shown on line 46, for example, the $180,000, speaking in round figures, is 2.22 percent of the gross plant balance as shown on the company's books for the year 1938, averaged as between the beginning and the end of the year?

3679 A. That is correct.

Mr. SLAFF. Can I have that question back again, please?

(The question was read by the reporter.)

Mr. SLAFF. I am not clear as to whether that is the balance on the company's books or the balance on the company's books as adjusted by Mr. Dunn, and the application of the percentage made to that.

The WITNESS. That is the amount as adjusted for the 1938 balance.

By Mr. MILDE:

Q. You say that for the year 1938 it is the amount as adjusted by you, Mr. Dunn?

A. It is not; it is the average for the year, and the adjustment is only effective as of December 31, and I did not make it retroactive in any manner.

Q. Well, in order to clarify Mr. Slaff on this, Mr. Dunn, you have not reflected back to the year when they occurred, the adjustments which you made as of December 31, 1938, in connection with your determination of adjusted book costs, have you?

A. Outside of the items noted, there has been no adjustment made back.

Q. Outside of the coke-oven gas property, and that $1,400,000 to which you previously referred?

A. That is right.

3680 Q. And your 2.22 percent rate in 1938, 1937, 1936, and so on, has been applied to what the company's books show or showed as of those years for gross plant cost of field line material, and so on?

A. Correct.

Q. You have assumed in this calculation, have you not, that the company's properties—and when I talk of "properties" in connection with this examination here, I am referring to the properties that are comprised in the accounts we are looking it. You have assumed, have you not, that in 1898 the company's field line properties, as then existing, were depreciating at the annual rate of 2.22 percent?

A. That is correct.

Q. And in 1899 at 2.22 percent?

A. Yes.

Q. And so on down through the years, right down to 1938?

A. Yes, sir.

Q. And isn't the general method of approach that you have used here, to set up a reserve that the company would have accumulated if it had started in 1898 and had applied Mr. French's rates as he has now determined them, to the plant balances?

A. Yes; I believe that is the result.

3681 Q. Let me ask you if this first set of figures in lines 6 to 46 don't represent merely the accruals on that theory?

A. That is correct; those are the provisions; annual provisions.

Q. That is, that is what the company would have accrued if it had done what we have just talked about?

A. Yes, sir.

Q. And against that of course you have to, on your theory, make certain retirements and deductions and so on?

A. Yes, sir.

Q. Now I notice that your total accruals for field lines, which we are talking about here, field line material, at the end of 1939 amounted to $3,864,000, as shown in line 47; isn't that so?

A. Yes, sir.

Q. Now you next have an item in line 48, "Add—Reserves Acquired"—$780,416?

A. Yes, sir.

Q. Now is that figure the reserves which appeared on the books of the predecessor utilities and nonutilities for property which the Hope Company purchased?

A. Not in every instance.

Q. Well, generally what is it?

A. Well, in the case of the Clarksburg Light & Heat, it is a reserve. In some of the other companies it may be a
3682 reserve that appeared on their books. In other instances, the company set up this reserve as it recorded the property, at the time it recorded the property on its own books, because they didn't have the other companies' books.

Q. Well, from which predecessor companies or predecessor utilities or nonutilities, did most of these reserves acquired come from?

A. A very large amount came from the Mountain State Power Company.

Q. The Mountain State Gas Company, isn't it?

A. Yes.

TRIAL EXAMINER. When you say "It came from" there, do you mean it was actually on the books of the predecessor company, and then entered on the books of the company?

The WITNESS. I would have to check another work paper I have—analysis of acquisition. This merely is a break-down of the reserves acquired, and it doesn't show exactly whether or not it was entered on the predecessor company's books.

TRIAL EXAMINER. The records there simply show that the amount was set up on the books of the Hope Company when the property was acquired?

The WITNESS. Yes, sir.

By Mr. MILDE:

Q. You were saying that a large part of these reserves acquired came from the Mountain State Gas Company?

3683 A. Purchase.

Q. And another large part came, did it not, from the Clarksburg Light & Heat Company?

A. Yes; also a large part came from the Carter Oil Company.

Q. That was in the early days?

A. 1926.

Q. Well now, responding more directly to the Examiner's question, Mr. Dunn, isn't the situation generally that on these large purchases the Hope Company put on its books whatever the predecessor companies had on their books, and then put in its depreciation reserve whatever reserve the predecessor companies had set up; isn't that generally the situation?

A. Yes. I have a general discussion of that situation on page 4 of my direct testimony.

Q. And that is the reason that you called this line 48, as shown on this schedule, and similar lines on your other schedules, as "Reserves Acquired"; isn't that so?

A. That is not the sole reason, of course. The important point there is that these must be stated on the basis of the actual cost to the Hope Natural Gas Company, and the difference between reserves and original cost and purchase price must be correctly accounted for—and this is one step in that accounting.

Q. Well, what you have ultimately reflected in your Plant Accounts, as you adjusted them to determine the adjusted

3684 book cost as of December 31, 1938, is the purchase price to

Hope of the Mountain State Gas Company property and the Clarksburg property; isn't that so?

A. Well, I just said that it is reflected in the plant accounts, and the reserve accounts. They both must be taken into consideration when you consider purchase price.

Q. Was your treatment the same, Mr. Dunn, for properties purchased from nonutilities?

A. I might explain that by saying that Hope's treatment was approximately the same. Their practice at all times was to record original cost as nearly as could be determined. The difference between original cost and purchase price, if any, was recorded in the reserve for depreciation.

Q. Mr. Dunn, I don't want to quarrel with you about the practice of the company, but are you attempting to testify now that in connection with its bookkeeping over the years, the Hope Company ever attempted to find out the actual original cost of properties which it purchased?

A. Oh, I certainly am. That is very clearly indicated by the fact that they have got these books from the other companies, have made investigations of them, went out and took field inventories. I think they determined it in every instance that I have been able to check.

* * *

3687 Q. Now Mr. Dunn, in connection with these reserves that were acquired by the Hope Company from the Clarksburg Light & Heat Company, and the Mountain State Gas Company, and the Carter Oil Company, were or were not those reserves set up by these predecessor companies at an annual rate of 2.22 percent as applied to Field Line Material?

A. I doubt that they would be, I don't know of course in every instance.

Q. Did you make any investigation as to the annual rate at which these predecessor companies set up their depreciation reserves?

A. I have already testified that I did not. You asked me that very same question once before.

3688 Q. On another exhibit.

A. No; on this exhibit.

Q. You know, do you not, Mr. Dunn, that the Clarksburg Light & Heat Company, and the Mountain State Gas Company were affiliated companies of the Hope Company at the time of purchase?

A. I believe that they were, I don't recall exactly the extent of the affiliation.

Q. And wouldn't you expect that their annual depreciation provisions would be on a very conservative accounting basis, just as in the case of the Hope Company?

Mr. Reeder. I object to the form of the question. It seems to me this Commission is not interested in any speculations, and I don't think it is proper for counsel to ask the witness to speculate.

Trial Examiner. Read the question, please.

(The question was read.)

Trial Examiner. It seems to me that you have two questions.

Mr. Milde. I will withdraw it, Mr. Examiner, because of course actually Mr. Dunn ought to know this.

By Mr. Milde:

Q. Isn't it a fact, Mr. Dunn, that the books of the Clarksburg Light & Heat Company were available to you?

A. Yes.

Q. And that if you had examined the depreciation vouchers
3689 of that company, you could have determined the precise
rates at which that company had set up its depreciation reserves in the past?

A. Yes, sir.

Q. And isn't that same situation true of the Mountain State Gas Company?

A. I believe those records were available.

Q. And the fact is that you didn't look at them?

A. Oh, yes; we looked at them——

Q. (Interposing.) So far as ascertaining at what rates the depreciation reserves of these predecessor companies were set up?

A. I personally did not, because I was not interested in those rates, but some of the members of the staff may have looked at them.

Q. Well, did they advise you what they were?

A. Not that I recall.

Q. Do you know of any memorandum in Commission's files that states what they were?

A. No.

Q. Well, isn't it a fact, Mr. Dunn, that by adding what you call these "Reserves Acquired" in line 48, which we have talked about, you have just assumed that this acquired reserve at the date of purchase accurately represented the accrued depreciation in that property as of the date of purchase?

3690 A. I don't know that I have assumed it—it did.

Q. Oh, you think it did?

A. Yes.

Q. And did you know, when you used these figures in schedule No. 3 and elsewhere, what the relationship of the accrued reserves, as shown on the Clarksburg Light & Heat Company's books, was to its gross book cost of its plant at the time of purchase by the Hope Company?

A. Yes; I knew the relationship of reserve to the gross book cost and purchase price.

Q. And what was that relationship for the Clarksburg Light & Heat Company properties?

A. I don't have those acquisition work sheets down here.

Q. Well, will you have them after lunch?

A. Yes.

Q. Let me ask you to check on those sheets, Mr. Dunn, as to whether it isn't a fact that the depreciation reserve of the Clarksburg Light & Heat Company was about 43.8 per cent of the book cost of its properties at the time it was purchased by the Hope Company; and whether, in the case of the Mountain State Gas Company, the Mountain State Gas Company's bookkeeping reserve wasn't 52 per cent of the gross book cost of its properties at the time Hope purchased it?

* * *

3692 By Mr. Milde:

Q. Mr. Dunn, were you able to check during the recess the percentages I gave you just before adjournment?

A. I checked the percentages. I do not believe I found them exactly the same as yours. I will give them to you, though.

Q. What did you find?

A. On Clarksburg Light & Heat the reserve was 39.8 per cent of the plant account and the net book cost was 60.2 per cent of the plant account.

Q. That was at the time of Hope's purchase of Clarksburg Light & Heat?

A. That is correct.

Q. That was in 1929, was it?

A. Correct. On Mountain State the reserve was 48.9 per cent of the plant account and the purchase price or net book cost was 51.07 per cent of the plant accounts.

Q. Are those dollars shown in your work sheet, that
3693 is the figures from which you derive the percentages?

A. Yes.

Q. Was that Mountain State Gas Company purchase made in 1910?

A. Yes.

Q. Could you give us the dollars that you used for your computation for Clarksburg Light & Heat?

A. Yes. Gross book cost $2,169,692.69; reserves, $863,942.09. On Mountain State plant accounts, $1,299,418.21; reserves, $65,755.

Q. Did you check also the Carter purchase or not?

A. I did not check the Carter purchase.

Q. You did not make any investigation, did you, Mr. Dunn, as to whether the relationship between the reserves and the gross book cost of the Clarksburg Light & Heat Company and the Mountain State Gas Company corresponded in any way to the physical condition of the properties that were purchased by the Hope Company?

A. No; I did not.

Q. Or in any way measure the expired service life?

A. No. That would have required a service life study by the engineers, and I did not do that.

Q. And as far as you know, the engineers made no such examination or determination?

A. No.

3694 Q. Is it not also a fact, Mr. Dunn, that you did not determine what would have been a proper reserve for Clarksburg Light & Heat Company and the Mountain State Gas Company to have had at the time Hope purchased the properties on the depreciation rates that Mr. French supplied you?

A. No; I did not make such investigation.

Q. In other words, you did not redetermine the depreciation reserves or the accrued depreciation, or the actual existing depreciation, insofar as those properties were concerned at the time of purchase?

A. I would like to say that to Hope the actual existing depreciation stated on the cost basis was, in the case of Clarksburg, $863,942.09. Now, as far as Clarksburg is concerned, I did not restate their accrued.

Q. What do you mean by the statement that you hope the actual existing depreciation was so much?

Mr. SLAFF. He said "to Hope."

The WITNESS. As far as Hope's cost is concerned, that is what the actual existing depreciation is.

By Mr. MILDE:

Q. Just how did you arrive at that conclusion, Mr. Dunn?

A. Hope recorded an original cost of $2,233,252.76 as the original cost of the property, and——

* * *

3696 The WITNESS. The difference is $1,369,310.67, which they paid for this property, $1,369,300 even, making a difference of $10.67. Therefore the depreciation amount of $863,000 is the actual depreciation on a cost basis. It can not be otherwise. To do so would change the cost.

By Mr. MILDE:

Q. Mr. Dunn, will you now explain the difference between the figure of $2,169,000, which you gave me before, and the $2,233,000 which was the gross book cost of the Clarksburg properties?

A. Yes. That difference is largely some construction work in progress.

Q. I see. When you said that Hope recorded $2,233,000 as the original cost I judge that what you mean is that Hope recorded that amount of money which was the book cost to the Clarksburg Light & Heat Company in Hope's plant account, is that not so?

A. Yes. Those two figures combined make the original cost to Hope.

Q. And when you say that the difference between the purchase price and the gross book cost of the Clarksburg Light & Heat Company represents depreciation of Hope—is that
3697 what you said?

A. Yes.

Q. What you mean is, and all that you mean is that Hope paid $1,300,000 for property that the Clarksburg Light & Heat Company showed on its books as having a book cost of $2,233,000?

A. A net book cost of $1,369,310, exactly what they paid.

Q. Well, how can the difference between the cost to the predecessor utility of these properties and what Hope Company paid for them represent depreciation to the Hope Company?

A. Well, that is merely the difference between recording net purchase price and Hope's purchase price and reserve accounting. That is an option that is quite often made.

Q. That is all you meant by it? It is just that difference that you are talking about here?

A. I am talking about actual cost figures here all the way through.

Q. Well, so far as those properties which were purchased were concerned, you do not know, do you, Mr. Dunn, whether the difference between the gross book cost as shown on the Clarksburg Light & Heat Company books and what the Hope Company paid Clarksburg Light & Heat for those properties measured the correct reserve accrual for those properties or the actual existing depreciation, or the accrued depreciation as you
3698 used it in your exhibit, or the expired service life of those properties, do you?

A. I do not think that that point has any importance whatsoever in this transaction, of course not. Therefore I did not go back and investigate that, as I told you many times.

Q. I am not concerned with whether you thought it was important, Mr. Dunn. All I want to know is, you do not know and you made no investigation as to whether that difference between the book cost as shown on the Clarksburg Light & Heat Company books and what Hope paid, and the lesser amount that Hope paid the Clarksburg Light & Heat Company represented the items that I have just enumerated?

Mr. Slaff. He answered that already in the answer to the last question, at the end of his answer. He said, "And therefore I made no investigation." The question has been answered. Why can not we go on to the next question? I object.

Trial Examiner. That is your answer, is it?

The Witness. That is right.

Mr. Milde. I also asked him not only whether he made any investigation but whether he knew anything about it.

The Witness. I think this $863,000 is a very good measure of the accrued depreciation of the property.

By Mr. Milde:

Q. You reached that conclusion without having made any investigation, I judge?

A. I reached that conclusion because that is what Hope
3699 paid for it in cash.

Q. And if Hope got a good bargain, would you say that because it got a good bargain the properties were more depreciated than if it had made a bad bargain?

A. Possibly. On a different set-up I do not know just what my answer would be.

Q. If the Hope Company had paid the Clarksburg Light & Heat Company, say, $2,000,000 instead of $1,300,000, on your method of handling this matter you would have then shown, would you not, a reserve acquired of $233,000 or thereabouts instead of the $863,000?

A. Not necessarily. Again I would see what the relationship was between the amount recorded on the books as original cost, the amount recorded in reserve for depreciation and the purchase price. I would want to study all factors involved before I made a decision on the transaction.

* * *

6752 TESTIMONY OF F. P. C. WITNESS DUNN ON COMPARISON OF DEPRECIATION RATES

Transcript pages 6752–6756

Direct examination by Mr. SPRINGER:

Q. Referring to Exhibit 142, Mr. Dunn, did you prepare this exhibit?

A. Yes.

Q. Are the sources of the figures and explanations of the table shown at the bottom of the sheet?

A. Yes; they are.

Q. What is the purpose of this exhibit?

A. To show that different depreciation rates, when applied properly and consistently, make little or no difference when compared in terms of cost to ratepayers.

In a comparison of the factors determining costs and rates, it is necessary to present the comparative figures on a cost basis. This statement applies particularly to depreciation expense and net property.

The difference in net property have been stated in terms of cost, as shown by column "H" on page 1, by applying an assumed 6-percent rate of return.

Q. The figures on page 1 do not compare those accounts where reserves and expenses are computed on a depletion
6753 basis, do they?

A. No; the depletion accounts cannot be compared by the same method used to compare the depreciation accounts because the depletion rates vary with production.

Q. What does the comparison as between Rhodes and French depreciation rate show when stated in terms of cost to ratepayers?

A. The difference is a saving to ratepayers of $24,621 by reason of using French rates.

Q. The figures shown on page 2 make a comparison of cost to ratepayers for return and depletion of operated leases, do they not?

A. Yes; these figures are taken from exhibits in the record. The comparison is confined to operated leases because this is the only account where per cent condition is applied to original cost and related expense is stated in terms of original cost.

Q. Mr. Rhodes' shows a higher original cost, does it not?

A. Yes; approximately $85,000 higher as determined by Witness Antonelli.

Q. Even so, his per cent condition method shows a lower net cost, does it not?

A. Yes; in the amount of $145,855.

Q. If you both started with the same figure, the
6754 difference would be more pronounced?

A. Yes.

Q. Do you recommend a larger expense than the company claims?

A. Yes; $15,423 higher, averaged for four years.

Q. What does the comparison of depletion expense and return on operated leaseholds show when stated in terms of cost to ratepayers?

A. The difference is an increased cost to ratepayers of $24,174, by reason of using the Federal Power Commission Examiner's accounting method.

Q. And that amount is an offset to the $24,000 you referred to on page 1 for depreciation, isn't it?

A. That is correct.

Q. Operated leaseholds amount to $1,600,000 of cost at December 31, 1938. Is there much other property which you have accounted for by depletion methods?

A. Yes; amounting to over $8,000,000, which property has not been compared in this exhibit.

Q. Do you recall a question, shown on page 3123 of the record, by Mr. Reeder, concerning the method used in depleting the capitalized well construction of some 722 wells, as to whether your reserve would be higher or lower if you had used the company method? What was your answer?

A. My answer is just that I remember the question
6755 and I answered that I believed the reserve would be higher
using methods as proposed by the company. The company actually uses the accounting method and not a percent condition method on their books.

Q. Do you recall a similar question by Mr. Reeder concerning a higher or lower annual allowance for depletion?

A. Yes; and my answer was that the company method would have resulted in a lower annual allowance.

Q. That means that the company would have a lower rate base and less annual allowance?

A. Yes.

Q. Are you satisfied that your answers are correct?

A. Yes, because the same depletion methods have been applied to operated leaseholds. The net cost is lower and the annual expense is lower by reason of a percent condition method being applied to leaseholds, applying the percent condition method to well construction would produce similar results.

Mr. Springer. I offer in evidence Exhibit No. 142.

Trial Examiner. Any objection?

Mr. Milde. No objection.

Trial Examiner. Exhibit 142 is admitted into evidence.

(The document referred to was received in evidence as Exhibit No. 142.)

Trial Examiner. Is there any cross-examination?

6756 Mr. Milde. Just one question.

Cross-examination by Mr. Milde:

Q. Mr. Dunn, in this exhibit you have applied Mr. Rhodes' rates to your figures, have you not?

A. That is correct.

Q. That is, as shown in colnm "B", that is the adjusted book cost as set forth in other Commission exhibits?

A. Yes.

Q. And also you recognize, do you not, that column "H," if you used a 7 percent return for example, that that would about double the difference shown in column "J"?

A. Well, I don't think it would double it. I think I used 8 percent as a comparison, which I don't have noted here, just to see whether it would double it or not, and I don't think it increased it but very slightly.

Q. Our figure using 8 percent is $70,868 for the bottom column "J." Does that check with your figure?

A. Yes; I recall the amount.

Mr. Milde. That is all.

* * *

6394 **TESTIMONY OF F. P. C. WITNESS BLEASE ON COMPARISON OF METHODS AND RESULTS FOR CREDIT TO HOPE FOR GASOLINE AND BUTANE EXTRACTED BY AFFILIATE**

Transcript Pages 6394–6405

Mr. Springer. May I have marked for identification as Exhibit No. 127, this tabulation entitled "Hope Natural Gas Company—Comparison of Methods and Results of Commission Staff's Recommendation and Company's Witnesses' Recommendations for Proper Credit on Account of Gasoline and Butane Extraction"?

Trial Examiner. It may be so marked.

(The tabulation referred to was marked as Exhibit No. 127 for identification.)

Whereupon,

Ernest B. Blease, a witness appearing on behalf of the Commission, having previously been duly sworn, was examined and testified as follows:

Direct examination by Mr. Springer:

Q. Mr. Blease, referring to the exhibit marked for identification as 127, will you state the purpose of that exhibit which you prepared?

A. I prepared this exhibit from exhibits that have already been admitted in evidence in this hearing, for the purpose of correlating and showing in one place the effect of the exhibit on gasoline that I prepared, and also a comparison of that
6395 effect to the credit that Mr. Rhodes recommends for gasoline extraction by Hope Construction and Refining Company.

Mr. Springer. I offer in evidence Exhibit 127.

Mr. Milde. No objection except that I would like to ask Mr. Blease a question or two on cross-examination.

Trial Examiner. Does that complete the direct testimony?

Mr. Springer. Yes, sir.

Trial Examiner. You may cross-examine.

Mr. Springer. The exhibit was designed to be self-explanatory, showing sources of information, but if you have some additional questions, Mr. Examiner, Mr. Blease will be glad to answer them.

Trial Examiner. If it is self-explanatory, I don't have any. I haven't had a chance to look it over to see whether it is or not.

Mr. Springer. I know you haven't, and I thought perhaps you would like to have more of an explanation.

Mr. Milde. Perhaps I can ask a few questions on cross-examination that will help to explain it.

Trial Examiner. I assume that by referring to these other exhibits, this exhibit will be understood?

The Witness. The figures shown on this exhibit were taken from other exhibits and the reference to the exhibit and page number is shown on this exhibit.

* * *

6396 Cross-examination by Mr. Milde:

Q. On this exhibit 127, as I understand it, the top group of figures under the column headed "Computed Credit to Hope Natural Gas Company" are a summarization of your figures and conclusions in Exhibits 63 and 78, isn't that so?

A. That is correct.

Q. And you show, for example, on the third line, that the average net investment, as you determined it for all of the Hope Construction and Refining gasoline and butane plants was $681,000 in round figures in 1937, and $482,000 in round figures in 1940?

A. That is correct, with the exception of the fact that this only represents the West Virginia plants dealing in Hope Natural Gas Company gas.

Q. That is right.

And you have now excluded the net investment as you determined it of the Kennedy plant as shown on the next line in both 1939 and 1940?

A. That is correct.

Q. And that gives you a balance of net investment to which you have added working capital of $80,000 to give a sum total on which you apply 6 percent return?

A. That is correct.

6397 Q. And is that 6 percent return your determination of what is a proper rate of return for gasoline plants, or is that merely a figure assumed for the purpose of this calculation?

A. It is a figure assumed for the purpose of this calculation.

Q. Then you take the earnings as you adjust them by your revised depreciation rate, and take out the Kennedy plant earnings, in 1939 and 1940, to get revised net earnings of the company for these plants which you have described?

A. That is, the revised earnings over 6 percent on the net investment.

Q. Well, that is the figure you show opposite the side heading "Excess of Above Earnings Over 6 Percent of Net Investment"?

A. That is correct.

Q. Now, in the balance of the figures you give some information as to how matters were recorded on the books, and what Mr. Rhodes' charges are, or his adjustments?

A. Mr. Rhodes' credit adjustments, you might say.

Q. Let me ask you, Mr. Blease, if the royalty recommended by Mr. Rhodes is not shown opposite the side heading, "Total Credit Recommended by Rhodes," a few lines up from the bottom?

A. That is correct.

Q. And that is $215,000 in 1937, and $167,000, in round
6398 figures, in 1940, with other amounts for the other years?

A. That is correct.

Q. Now, you subtract that $215,000 from what figure in order to show your next line, "Difference (Commission Staff over Rhodes)"?

6399 A. I subtract that $215,000 from $510,000, which is the 7th figure above the bottom. It is in connection with the side heading, "Total Credit Recommended by Commission Examiners."

Q. In other words, for the year 1937, the sum total of the examiners' recommendations is that the Hope Company be deemed to have received $510,000 in connection with this gasoline extraction process?

A. That is correct.

Q. And Mr. Rhodes said they should have received $215,000?

A. That is correct.

Q. And the difference between the two figures, then, is your $294,000?

A. That is correct.

Q. Let me ask you if that $510,000, which the staff recommends, isn't practically 70 percent of the plant investment as you determined it for 1937?

A. That is correct.

Q. Now I am slightly puzzled by this next line of yours, Mr. Blease, "Vent Gas Returned Not Adjusted by Rhodes." What is the meaning of that line?

A. Well, in computing the difference between us, that line is shown to take up the greater portion had Rhodes treated the vent gas as a property of Hope Natural Gas Company, instead of treating it as he did——

6400 Q. (Interposing.) As the property of Hope Construction and Refining Company?

A. That is correct. Then our differences would have been those shown on the last line.

Q. And shouldn't you really, to make the last line of this exhibit not misleading, say "Net difference (Commission Staff over Rhodes if Rhodes had treated vent gas as the Commission's Staff has treated it)"?

A. In order to clarify that, let's say that it should read "Difference (Commission Staff over Rhodes had Rhodes considered the vent gas the property of the Hope Natural Gas Company)".

Q. As the Commission's staff has considered it?

A. I have considered it the property of the Hope Natural Gas Company, but under the method that I used, it would have made no difference, because that credit would have come into Hope Construction and Refining Company's books, and would have increased the amount of excess profits passed back to Hope by the same amount as the vent gas credit.

Q. I understand that, Mr. Blease. All I was trying to point out is that that phrase in parenthesis is not complete in that it is not really the "Commission Staff over Rhodes", but the Commission Staff over Rhodes as you have adjusted Rhodes in the preceding line?

A. That is correct. Perhaps it would be clearer to
6401 say that in the third line where I show "difference (Com-
mission Staff over Rhodes)," to add "as recommended by both." Then this next adjustment or next line, showing the vent gas returned not adjusted by Rhodes, would become clear, I think.

Mr. Milde. May I ask whether the Examiner understands that this last line means the difference if Mr. Rhodes' figures, as shown in the third line from the bottom, had been adjusted as Mr. Blease adjusts them in the second line from the bottom?

Is that a correct statement, Mr. Blease?

The Witness. Yes, it is correct, but I still don't think it clarifies it.

Trial Examiner. Well, the difference would be the same in either case, wouldn't it?

The Witness. As the exhibits are now in the record, the recommendations that we make are over the recommendations that Mr. Rhodes has made by the amount shown on the third line from the bottom.

Now I am merely stating that if Mr. Rhodes had adjusted for vent gas, the difference would have been that shown on the last line.

Trial Examiner. But Mr. Rhodes didn't adjust for vent gas?

The Witness. Mr. Rhodes did not.

Trial Examiner. And you did?

The Witness. I did adjust for vent gas, but whether I
6402 had adjusted for vent gas or not, using this method I would have come out to the same result. It was a debit and credit between two companies.

Mr. Milde. Well, this is just one of those questions where, when you get an exhibit up in a hurry, it is a little difficult always to select quite the right title to express what you have done.

By Mr. Milde:

Q. Well actually, as the figures appear in the two sets of exhibits, Mr. Blease, the difference between the Commission's staff and Mr. Rhodes' figures, as reflected in our exhibits, is shown in the third line from the bottom, right across the page, is it not?

A. It is.

Q. With the exception that for the years 1939 and 1940, as shown in the other Commission's exhibit, the Kennedy plant investment has not yet been taken out, and earnings?

A. For the years 1939 and 1940, the Kennedy plant has been taken out.

Q. In this exhibit?

A. Yes.

Q. But not in Mr. Dunn's exhibits and Mr. Lyon's exhibits, where they used your original figures?

A. That is correct. You will remember that there was a stipulation decided on between counsel while I was on the stand
6403 before, that that was to come out, and in this exhibit I have taken that out.

Q. So that the figures that should be reflected in these other exhibits on final determination of what the Commission's staff shows are the figures you set out here for 1939 and 1940?

A. To be in accordance with the stipulation

Q. That is right.

Mr. MILDE. That is all.

Redirect examination by Mr. SPRINGER:

Q. Will you explain your answer to Mr. Milde concerning the consequences of your adjustment for vent gas in any one of the years by an example, when you say you would have received the same answer in any event?

A. As the books are kept presently, H. C. & R. charges Hope for the vent gas returned, and Hope charges H. C. & R. for boiler fuel furnished in the same amounts with a slight difference in one plant.

In my study I have based the revenue due Hope Construction and Refining to a cost study, and limited the return to a ratio of the net investment. I have selected 6 percent here.

6404 So that, that return would be constant if the value of the plant remains constant, and any increase in revenue would be—any increase in gross revenue—would be that much increase in net revenue, or excess credit. So that, had I not adjusted for vent gas, I would have had that much additional credit on H. C. & R.'s books to come out down here as excess earnings over 6 percent of net investment; and when you combine the earnings of H. C. & R. with the earnings of Hope, it makes a Wash transaction and makes no difference in the final answer of the amount of credit recommended by Commission's staff.

Q. In what line?

A. That is the 7th line from the bottom, side heading, "Total Credit recommended by Commission Examiners."

Recross-examination by Mr. MILDE:

Q. Mr. Blease, I think I was mistaken in asking you if the figures in the third line from the bottom were not the ones to be reflected. That is just the difference between you and Mr. Rhodes, and actually the final figures that you recommend are shown opposite the side heading, "Total Credit recommended by Commission Examiners"—isn't that so?

A. That is correct. I understood that you meant that the difference between the two exhibits was the third line from the bottom.

6405 Q. Well, that is the difference between us, but the figures that are to be reflected in the Commission examiners' exhibits as the amount of money Hope is to receive on account of this gasoline extraction process conducted by the H. C. & R. Company are the $510,000 you show for 1937, ranging down, and up again, and then back to $313,000, as shown opposite the side heading I have indicated?

A. That is correct, and let me state further that for 1937 and 1938, they are the figures used, but for 1939 and 1940, they have been adjusted by the Kennedy plant here.

Q. That is right.

* * *

5663 TESTIMONY OF HOPE WITNESS COFFMAN ON INVESTORS' APPRAISAL OF COMPARATIVE RISKS OF CAPITAL IN THE NATURAL GAS BUSINESS

Transcript pages 5663–5725

Direct examination by Mr. COCKLEY:

Q. Mr. Coffman, you have been sworn and you previously testified in this case, did you not?

A. I did; yes, sir.

Mr. COCKLEY. I ask to have marked for identification as Exhibit 27–A, a paper entitled, "Hope Natural Gas Company—Investors' Appraisal of Comparative Risks of Capital in the Natural Gas Business, 1940—(Supplement to Exhibit No. 27)."

TRIAL EXAMINER. It may be so marked.

(The document referred to was marked "Exhibit No. 27–A" for identification.)

By Mr. COCKLEY:

Q. I hand you the paper, Mr. Coffman, marked for identification No. 27–A, and ask you if you prepared that exhibit, and if it contains your direct testimony supplementing
5664 your Exhibit No. 27 previously introduced in this case?

A. Yes, sir; it does.

Q. And the tables included therein weer prepared by you from ordinary statistical sources and in your office?

A. Yes, sir; they were.

Mr. COCKLEY. Mr. Examiner, I think it is unnecessary to ask the witness any questions in explanation of this unless the Examiner has some.

You will see on page 1 of the written statement of Mr. Coffman, a table which contains a summation of the results that he found in 1940, and the averages for the four years from 1937 to 1940. You will recall that his original Exhibit 27 was a study of electric utility operating companies, water companies, manufactured and mixed gas companies, and natural gas companies for the 3-year period, and that the determination of the investors' appraisel of the risk in those companies for the 3-year period, and the average for the 3 years. This exhibit merely adds the figures for 1940, and makes the average for the four years, and shows in general that while there have been slight changes, in general the same relation between the investors' appraisal of these various companies has been maintained right through the year 1940. I offer in evidence Exhibit 27–A.

Mr. SPRINGER. No objection.

TRIAL EXAMINER. Does the City of Cleveland have any
5665 objection?

Mr. REEDER. No objection.

TRIAL EXAMINER. West Virginia?

Mr. KOONTZ. No objection.

TRIAL EXAMINER. Exhibit No. 27–A is admitted in evidence.

(Exhibit No. 27–A was received in evidence.)

Mr. COCKLEY. You may cross-examine.

Cross-examination by Mr. SPRINGER:

Q. Will you please refer to page 2 of Exhibit 27–A? The first paragraph shows a statement by you that, "investors continued to appraise the risk of natural gas companies as a group at a rate considerably higher than for the other divisions of the utility industry studied."

Does that mean that all your exhibit shows for the particular companies selected for your study is that natural gas companies are considered a relatively greater risk than electric companies, and water, and so forth?

A. I would say that that statement means that in the study we made, in which, as you will recall, we tried to get and include in thiss tudy all the companies upon which we could find data which would indicate the investors' appraisal, that that particular risk shows a higher risk factor in the minds of the investors for the natural gas than does it show for the other divisions of the utility industry which I studied.

5666 Mr. SPRINGER. Will you read my question? I think you have answered the question, but I would like to have it read back to the witness.

TRIAL EXAMINER. Read the question.

(The question was read.)

Mr. COCKLEY. Do you mean by that question that that is all that the exhibit shows, and nothing else?

By Mr. SPRINGER:

Q. That is the purpose of the study, isn't it; a comparison study?

A. That is correct, Mr. Springer. All I wanted to make clear in my answer was that going back to the original study, as you will recall, I had gone over all of the various utility companies in these divisions that I have mentioned here, that is, the electric, water, and natural gas and mixed gas, that are reported upon in our services, and as I had explained in my original exhibit, certain of those were eliminated for lack of data which would not permit me to make such a study complete, with the result that I finally came down to the list of companies that was actually included in my first exhibit, and insofar as those companies represent the entire division of the various branches of the utility industry upon which I could get an investors' appraisal, I think it is as complete as
I could make it. I don't know whether that still answers
5667 your question, but that is about the only way I can answer
it, I believe.

Q. Then your exhibit shows, for the particular companies you studied in these classifications, that the investors' appraisal of risk shows a relatively higher risk for natural gas companies in your particular study than for electric companies in your particular study, and water companies?

A. Yes; I would say that, and qualify it with the statement that the companies given in the various divisions were all the companies in each division that I could find comparable data upon which to make the study.

Q. Now on that point did you take companies for your study, the ones which had bonds, preferred stocks and common stocks held by the public?

A. In each case I took the companies where the great bulk of the capital, whether it be bonds, preferred stock or common, was in securities which were held in the hands of the public as contrasted with some company that belonged to a system where I could not get market quotations on a large part of the capital structure. My study is based altogether upon securities that were in the hands of the public, where I could get fairly reliable market quotations.

Q. Are there any of your 13 natural gas companies in which not 100 percent of the common stock was held by the public?

A. Well, offhand I wouldn't want to say that 100 percent
5668 of the common stock in every case was held, but I would say
that a large part of it was held, and that there were sufficient
shares traded in the market to give a reliable market quotation.

Q. Now if a major portion of a gas company's securities were in bonds, not held by the public, it wouldn't be included in your study?

A. That is, if a large portion of the securities were not held such that we could get a market quotation on it, we eliminated that.

Q. Now, if a major portion of a natural gas company's securities were represented by preferred stock and not held by the public, it wouldn't be included in your study?

A. I would like to qualify that to this extent, that generally speaking that is true with one qualification, that if, taking the total capitalization, there were a sufficient number of bonds, preferred stocks or common, held by the public so that a reliable quotation could be secured, I used it. However, if there were some notes, for example, or a very small issue of preferred, which was not in the hands of the public, but that in proportion to the total was very small, then I used it anyway, because taking the total capital I still had a fair representation of the amount of investors' money in the particular company.

Q. Now there were some natural gas companies' securities
5669 on which you were unable to secure market prices, weren't there?

A. There were some companies in which a small part of the capital structure there was not a market for, and in that case I made an estimate.

Q. What did you use?

A. In that case we used our experience and our knowledge of the securities, plus making a study of another security we believed to be comparable, which did have a price in the market so it would give us some guide upon which to go.

In most cases, as a matter of fact, they were situations where a stock, for instance, if it was a preferred, had a callable price, or some other guide, and the security was in such position in the capital structure and the earnings of the company were such that we thought we were in no error in taking the call price, if that is the figure we used.

Q. Will you list by name those natural gas companies for which you secured no market price for the securities, and used your estimate?

Mr. Cockley. You mean a market price of all the securities?

Mr. Springer. Just what we are talking about.

The Witness. You are talking of 1940 figures, for the moment?

5670 By Mr. SPRINGER:

Q. Yes; just Exhibit 27–A.

A. Starting with my table marked Statement "D," page 6, the first company there is Duquesne Natural Gas.

In the case of Duquesne Natural Gas there were 124,556 shares outstanding of common stock; there were 2,410 shares of noncumulative convertible preferred \$4 stock; 28,179 shares of \$5 noncumulative preferred; and \$724,500 of general refunding 7's of 1948.

Now, in each case there was a quotation available, so I made no assumption in the case of Duquesne.

Q. You had the market prices for that?

A. There was a market quotation; yes, sir.

Q. Well, will you just give me the names of the companies for which you didn't have market quotations?

A. El Paso Natural Gas is the first one.

In the case of El Paso Natural Gas for 1940 there were 601,594 shares of \$3 par common stock outstanding. The indicated market value of that was \$20,418,000. There was a quotation upon those securities.

There were 14,797 shares of 7 percent cumulative preferred, \$100 par, which amounted to a million and a half, approximately, and there were quotations on that. Then there were also outstanding \$6,000,000 of first mortgage 3½'s of 1953; \$2,900,-
5671 000 of first mortgage 3's of 1955; \$1,445,000 of 3 percent serial notes, due 1941 to 1945; and \$1,000,000 of 2¾ percent serial notes due at the same time, outstanding. Now on the first mortgage 3½'s and 3's, and the serial notes, 3 percent and 2¾, there was no quotation.

Q. Those securities are all held by institutional investors, aren't they?

A. That is right; and in that case I took the par of the particular security, and the reason for that, so far as the notes were concerned, they were very near term maturity so that obviously they would approach par as they came to the date of their maturity; and the first mortgages, 3 and 3½'s, in studying other similar securities we felt safe in taking par.

However, for my purposes, of the total capitalization of \$31,-900,000, almost \$22,000,000 of the total was accounted for with actual quotations, and about 10½ million were on the mortgages and the serial notes upon which there was not a quotation and on which I took the par of the security. So that I had over twothirds of the capital structure accounted for with market quotations; and the others, upon which I made an estimate, I felt I had taken a conservative figure.

Q. My information is that the total securities outstanding
for El Paso Natural Gas Company are a little over
5672 $18,000,000, and that about $7,000,000 of those are held by
the public and about $11,000,000-plus are held by institutional investors.

A. Are you there including the common stock; is that everything?

Q. Yes; total outstanding securities.

A. That probably is right. I don't know your exact figure, but I would assume that that was about right, but for my study, so long as there were sufficient shares traded in on the market to give a bona fide quotation, I felt that was a reliable index of what the investors said, even though an institution might buy to hold, or for that matter might buy to trade in from time to time.

5673 Q. Then you had an elastic standard, it wasn't necessarily market quotations on the major portion of the outstanding securities of natural gas companies that you sought, it was some representative figure that you were after?

A. No; I wouldn't say that, Mr. Springer.

Q. Well, didn't you just say that of the outstanding securities of El Paso Natural Gas Company, of more than $18,000,000, $6,000,000 of that was held by the public which represented preferred and common stock, and that the remaining $11,000,000-plus which was bonds and notes was held by institutions? Now, there the major portion of the outstanding securities is held by institutions, so you substituted something for the securities held by institutions where you couldn't secure market quotations?

A. Well, just going back for a minute, my figures don't quite line up with yours. In the first place the total indicated market value, according to the figures I have, I have given you for 1940 on El Paso was $33,300,000.

Q. We aren't talking about the same thing. I am talking about the same thing. I am talking about total outstanding securities, and you are talking about total indicated market value.

A. But my point is that to appraise the value as the
5674 investor sees it, of the total capitalization, you have to
take some guide for each, and in the case of the great bulk of this item, which refers to common stock, I took market quotations and there are ample shares of common stock of El Paso

traded to give a good investors' appraisal of that particular portion of their capital structure. So whether or not the banks or insurance companies or some large individuals hold a certain portion of that, makes no difference as long as there was ample trading to get a quotation.

Q. Well, I just wanted to get your standards; that is one of your standards?

A. Yes; I took the market quotation, and whether an institution held these or not, I assume in practically every case—as a matter of fact, I know in practically each of these cases—there are one or more branches of the capital structure that are held by institutions, with respect to all these companies. We are advocating in many cases that they buy them. But I don't see that that has any bearing on my study so long as there were enough of the shares traded for me to get an idea of what you must pay if you go into the market to obtain certain additional shares or certain additional bonds.

Q. Well, your standards are limited by what is available
5675 in the market, and whether quotations are available or not,
and then the additional estimates that you make to get a study of each gas company?

A. Where there is not a quotation; but in each case, as I say, that is on a small fraction of the total, in each of these cases.

Q. Will you continue with the list of companies where you couldn't get market quotations on the security?

Mr. Cockley. Do you mean on all the securities?

Mr. Springer. No.

The Witness. If I may, I might comment on each of these. The Houston Natural Gas does not fall into your classification. There were quotations on everything. Interstate Natural Gas—also no problem.

Mr. Cockley. Do you mean by that that there were quotations on all classes of securities?

The Witness. Yes; I merely want to account for these companies as I go through.

By Mr. Springer:

Q. For the Houston Natural Gas Company, the total outstanding securities were a little over $5,000,000, all held by the public, and that is the reason you secured the information?

A. Well, I want to make my point clear again. I am not saying in any one of these things that all the securities—where I say

5676 there is a market quotation—were held by the public, unless you include as the public, the banks, the insurance companies and every other investor. So far as I am concerned, any securities that were issued by any company, which are not in turn held by another company, which makes it a holding company arrangement, are securities in the hands of the public. It makes no difference to me whether they are insurance companies or not.

Q. I see. Your classification of institutional investors puts them in the public investor class?

A. Exactly.

Q. As distinguished from the affiliated investors?

A. Absolutely; yes, indeed, because to me as an investment advisor, they are just as much a part of the investing public as Tom, Dick, and Harry.

Q. Well, they must be fairly good securities, or you wouldn't advise an institution to buy them?

A. Well, that is true, they have to be in most cases to qualify as a legal investment, as you know. Interstate Natural Gas—no problem. We come to Lone Star Gas Corporation——

Mr. Cockley (interposing.) Mr. Coffman, for the record, when you say "no problem," that doesn't mean anything. Can't you explain more specifically?

The Witness. In the case of the Interstate Gas Company, we had quotations so that no estimate was made.

5677 In the case of Lone Star Gas Corporation, there were outstanding approximately 5,500,000 shares of no par common stock, upon which we had reliable market quotations, and that accounted for approximately $50,582,000 indicated market value. There were also outstanding 3½ debentures of 1953 to the amount of $20,000,000, upon which there were reliable quotations which gave an indicated market value of $21,500,000. There were also some notes, 2⅞ percent, due 1945, in the amount of $4,200,000. On those notes, they were all held by a single investor, and there was no question, so I took those at par $100.

By Mr. Springer:

Q. By a single investor, do you mean an institutional investor?

A. In this particular case, I think it was. So that here, out of a total indicated market value of $76,287,000, I have accounted for about $72,000,000 by actual quotations. So that there, by far the greatest amount of the capital structure was accounted for by indicated market value, as based upon the investors' quotations in the market.

In the case of Memphis Natural Gas Company, there were 918,680 shares of common stock, $5 par value, outstanding, upon which there were market quotations, giving a total indicated market value of $4,023,000.

5678 There were also outstanding some 3 to 3½ percent promissory notes payable to banks serially in the amount of $1,700,000. Obviously, there was no quotation on those notes, and there was no reason to take them at other than par, which is the figure that I used, $100. So that, in that case, the great bulk of the indicated market value was based upon investors' quotations.

Q. And for Mountain Fuel Supply, their common stock is all held by the public?

A. In the case of Mountain Fuel Supply, all the stock is held, and I had quotations so I accounted for all that.

Q. Is that the same for National Fuel Gas Company?

A. Yes; the same is true there. In the case of Northern Oklahoma Gas Company, there were 189,300 shares of common stock, $1 par value, outstanding, upon which there were market quotations. There was also a first mortgage serial note which was held privately in the amount of $550,000, and upon that of course there was no quotation, and I took that at par; there was no reason for such securities to sell at anything in excess.

Mr. COCKLEY. What was the interest rate on that note?

The WITNESS. I believe that was 5 percent. Yes; 5 percent I am pretty sure.

5679 Now, in the case of the Northern Utilities Company, although there was common stock, 7 percent preferred and some first mortgage convertible bonds and income debentures outstanding, there were quotations on all branches, so I made no estimate there.

In the case of Oklahoma Natural Gas, there were 550,000 shares $15 par common stock outstanding, upon which there were quotations.

There were 58,000 shares of 5.50 convertible prior preferred no par upon which there were quotations, and 91,055 shares of 3 cumulative preferred, $50 par, upon which there were quotations.

There were $16,800,000 of first mortgage 3¼'s due in 1955 upon which there were quotations, but there were bank loans payable serially to 1946 of $5,500,000, upon which, of course, there were no quotations. So I took that at an estimated figure of $100 to complete it.

By Mr. Springer:

Q. Was that 2¾ percent?

A. I don't recall what that percent was. Three and three-quarters percent was the rate on the bonds, the first-mortgage bonds, and I do not have the rate that is required upon the bank loans.

Mr. Cockley. Do you have it, Mr. Springer, in a circular or in some form?

5680 The Witness. I don't have that bank loan rate.

Mr. Springer. That isn't important, go ahead.

Mr. Cockley. I was going to admit whatever figure your information shows, if you have it.

The Witness. Well, the 3¾ rate applied to the first mortgage bonds. I don't know what was the rate on the bank loans. In the case of the Pacific Lighting Corporation, there were 1,608,631 shares of common stock upon which there were quotations. There were 200,000 shares of $5 preferred upon which there were quotations. There was some 6 percent preferred $25 par of the Southern California Gas—897,564 shares—upon which there were quotations. But there was a long term serial bank loan from 1942 to 1949 of $6,000,000, upon which there was no quotation, and I took that at par $100.

By Mr. Springer:

Q. Do you know if that was a 3-percent note?

A. I may have that figure. No; I don't have that figure, but 3 percent would sould very reasonable to me.

Mr. Cockley. Have you the figure there? You say it is 3 percent?

Mr. Springer. That is my information.

Mr. Cockley. We will accept that.

5681 Mr. Springer. Now, will you proceed?

Mr. Cockley. May I just ask a question to clarify this?

Mr. Springer. Certainly.

Mr. Cockley. How much, out of the total of almost $166,000,000 indicated market value for Pacific Lighting Corporation have you not had market quotations for?

The Witness. It was merely on those bank loans of $6,000,000 which I took at par. Everything else was accounted for by a quotation.

By Mr. Springer:

Q. You show investors' appraisal for that company of 5.66 in your exhibit?

A. Yes, sir. In the case of Southern Natural Gas Company, the common stock—691,970 shares outstanding—was accounted for by quotations. There were some Pipe Line 4½'s due in 1951, outstanding, in the amount of $11,300,000, approximately, upon which there were quotations.

There were some other first Pipe Line 4½'s due in 1952 in the amount of $528,000, and those I took at 105½ because they had a long enough maturity date, in so far as the earnings secured them, to make them run above par, in comparison with other similar securities.

There were some adjustment mortgage 6's due in 1960 in the amount of $5,700,000, and those were accounted for by
5682 quotations.

Q. How did you get the quotations on $3,000,000 of those held by affiliates?

A. What, the adjustments?

Q. Yes.

A. As I have explained before, I didn't, where they were held by affiliates, as long as a sufficient portion of any branch of the capital structure was traded in the market so that I could get a security price, I took that. I don't mean to infer that in each of these cases, the entire amount of stock that is issued and outstanding or all the bonds that are issued and outstanding were necessarily traded in the market. I am not saying that, I am merely saying that there was enough trading in each one of the securities upon which I took a price to give me a reliable market quotation.

Q. Is this the fact with regard to Southern Natural Gas Company, that the adjustment mortgage 6's due in 1960 of $5,700,000, almost $3,000,000 of that was owned by the public, a slight amount held by institutions, and then nearly $3,000,000 held by affiliates?

A. I would say that figure is approximately correct. I think I have some details on that.

Q. And the portion that was held by the affiliates, you didn't consider?

5683 A. Yes; I considered it, but on that portion held by the affiliates I took the market quotation that was available and merely multiplied the total amount of bonds outstanding by the market quotation to see what the indicated market valuation of the whole was.

Q. Did you include in your indicated market value of capital the $3,000,000 worth of those adjustment mortgage 6's, due 1960, in your figures?

A. In every one of these cases I have included the entire capital structure. If I had a market quotation to go on, then I applied that against the total amount of securities issued and outstanding, regardless of how they were held.

Q. I see. If you had a market quotation on a segment, you applied that to the total outstanding security of that class?

A. That is correct.

Mr. COCKLEY. That isn't a fair statement of his testimony. He said if he had a market value on a sufficient number of shares to show a real market, then he applied that market price to the whole. I don't want the record confused on that.

By Mr. SPRINGER:

Q. In your opinion, a sufficient amount of a given class of securities is what, 50 percent or more?

A. Well, what I did was not look at the given individual security, for instance such as a preferred stock or a bond
5684 or serial note; what I did was to take the total indicated
market value of all the capitalization, and if I had 70 percent or better of that accounted for with quotations, I thought it was a very reliable indication of the investors' appraisal.

Q. Was your minimum 70 percent?

A. No; I had no minimum, because in each of these cases it runs higher than that, in every case. In other words, if the great bulk of the securities, and in most cases that relates to the common stock, had quotations to be reliable, you account for the great bulk of the total indicated market value in each one of these, so I thought it was a very reliable guide. As a matter of fact, I don't know of any other guide that could be used.

Q. When you speak of quotations, you are excluding the estimates that you made of the other type of securities not held by the public or institutional investors?

A. Let me make my point clear by a case we have already talked about. Take Pacific Lighting for example. Pacific Lighting had a total indicated market value in 1940 of $166,000,000, approximately. The only figure included in that entire total, based upon an estimate, is for the bank loans in the amount
5685 of $6,000,000, and I took those at par. So it is $6,000,000
estimated against $166,000,000 total, and that was my comparison all the way through.

Q. Now, can you make a similar comparison for El Paso Natural Gas where you had quotations only on about $7,000,000 out of $18,000,000 total outstanding securities?

A. No; I don't admit that, that statement is incorrect. The common stock outstanding was 601,594 shares, and there were market quotations on that which ranged from $41\frac{7}{8}$ to 26, and I took an average of 33.94 as the average price for the year per share. That amount gave an indicated market value for the total common stock issued and outstanding of $20,400,000 as a beginning figure.

Then there were some 7 percent preferred in the amount of 14,797 shares outstanding, which gave another $1,570,000.

So that is about $22,000,000 accounted for out of a total indicated $33,000,000 of capital.

Now, the approximate $11,000,000 that I had estimates on were on those serial notes which couldn't possibly be worth more than par, so I accepted them at par; and the first mortgage bonds, which I also took at par. So that certainly if I made an error at all it was on the conservative side.

Q. So, on your formula where you have an estimate for $11,000,000 of bonds and notes, and the quotations you had on the preferred and common stock for that company, it gave you
5686 what you considered a larger portion of the indicated market value of capital with quotations than without; so you included it in your study on the same formula that you have the other companies?

5687 A. With one further qualification, that it is my conviction and contention that on the serial notes, which were taken at par, in a company like El Paso there can't be any possible question about those notes at par. So that although it is an estimated figure, it is as reliable as any market quotation you can get. The only thing is that when a person takes a note, they don't buy and sell it, usually; they hold it.

Q. Now you were stating the exceptions where you didn't have market quotations, and you had finished Oklahoma Natural Gas Company, had you not?

Mr. Cockley. He had finished all of them.

The Witness. I think I had come down to the last, which was Southern Natural.

Trial Examiner. You got down that far, anyway.

The Witness. Well, I think I was just up to Southern Natural.

In the case of Southern Natural—yes; I gave that, I have covered that, also.

Mr. Cockley. How much of that did you have to estimate out of a total appraisal of $31,000,000?

The Witness. Of a total indicated market value of $31,000,000, it was all accounted for except $1,000,000. There was $1,000,000 that I estimated, and $30,000,000 that was actually based
5688 upon quotations, and those estimates were again on the first pipe line 4½'s of 1952, and there I took the call of 105½; and on the collateral notes due serially from 1941 to 1942 of $600,000, I took those at par.

By Mr. Springer:

Q. Will you state for clarification purposes your formula for securing indicated market value of capital, Mr. Coffman?

A. My procedure was to take, in each of these companies, the average of the various securities and long-term bank loans that were outstanding in 1940, including all of the common stock, the preferred stock, the various mortgage bonds, the various debentures and other bonds, any notes, and the bank loans.

In each case where I could find that there was a market quotation on the greater portion of the total outstanding capital structure, I used market quotations wherever they were available on each of the securities mentioned. Where there were no quotations, based upon my experience and knowledge of such securities I made an estimate, which in each case was par or greater for the security.

With respect to those securities, which for the most part were bank loans, and a few bonds, where I did make an estimate, they were accounting for a very small fraction of the total indicated market value except in the case of El Paso, where there was a larger percent.

5689 Q. And did I understand you to say that where a class of security was held partially by the public and partially by institutional investors, and the remainder by affiliates, that you took a market quotation and then an estimate for the remainder, to get a figure on the total of that outstanding class of securities?

A. No; I would like to make my point clear on that question.

Trial Examiner. You only required one quotation for the whole class of stock?

The Witness. Yes, sir; if there were enough shares or bonds traded so I had an indication of what the investors that were trading in this thing said it was worth, then it made no difference whether an insurance company or a bank had some of these securities and continued to hold them year in and year out.

By Mr. SPRINGER:

Q. Or an affiliate?

A. In the case of an affiliate, it made no difference, because if there were enough of the shares outstanding, not held by affiliates, to give me a quotation, then I said that that market quotation, times the total amount of that particular security issued and outstanding, gave me the indicated investors' appraisal.

Q. Now for the Southern Natural Gas Company, first
5690 mortgage sinking fund 4½ percent, due 1952, there was no market quotation, was there?

A. No, sir; that was $528,000, and I took that at the estimated figure of 105½, which is what that type of bond, which had a market quotation, was selling on a yield basis in the market at the time.

Q. Now for $2,907,000 of the approximately $6,000,000 of adjustment mortgage 6 percent, due 1960, held by affiliates, you had no market quotation on that, of course?

A. The adjustment mortgage 6's due in 1960—there was a market quotation, because they were not all held by affiliates. There was a market quotation of 102½ as a high, and 90 as a low, and the average was 96¼.

Q. Of course, there were $3,000,000 held by affiliates, and you translated your market quotation for the total sum of $5,771,000 of those adjustment mortgage 6's, due in 1960?

A. If I can say it again, if, let us say, the Chase National Bank holds some of these bonds, and they continue to hold them in their portfolio, and never trade, but I, and a group of other individuals, hold some of those securities and trade in them day in and day out, then I assume that Chase National Bank, if they wanted to sell theirs, would have to consider the same kind of quotation, if they came into the market, that I do going in day in and day out.

Q. And the total included $3,000,000 held by the
5691 affiliates?

A. Exactly.

TRIAL EXAMINER. You can't get a quotation on securities that aren't sold?

The WITNESS. No; but as long as there are securities traded, that is the only guide I have got to go on to know what you, as a holder who doesn't trade, will have to consider if you do want to trade.

By Mr. SPRINGER:

Q. For this particular period of time?

A. Yes.

Q. Now there were $600,000 of 4 percent notes, 1939–1942, held by institutional investors, and there was no market quotation on that so you made an estimate, I take it?

A. I took those at par; yes. That accounted for $600,000 out of $31,000,000.

Q. Now for the common stock of Southern Natural, approximately half of it was held by the public, and then slightly more than half held by affiliates. So you took the market quotation and applied it to the total $10,000 worth of common stock, did you not?

A. I took the quotation that was available on the shares traded, and applied it against the total amount of issued and outstanding capital, that is right.

Q. Now do you know what Moody's ratings are on the
5692 bonds that you included in your natural gas company list for your study here in Exhibit 27–A?

A. Well, I don't happen to know what Moody's are. I know what ours are.

Q. Do you mean that there is a wide variation in the trade between your ratings and Moody's?

A. Not a wide variation, but from time to time there is. The chief difference, however, is that we use one kind of symbol and they use another. We talk in terms of A–1 plus, and they talk in terms of Aaa.

Q. Could you make a general statement that is comparable to this statement, that a majority of the natural gas companies that you have selected for your study, have bonds rated by Moody at A or lower?

Mr. Cockley. I object to that. I don't think a general statement of that kind means anything. Bond ratings are individual matters, obviously, and it just doesn't mean anything.

Mr. Springer. Of course, it is a preliminary step before the meaning is revealed. It will dawn on you pretty soon.

Trial Examiner. The objection is overruled.

The Witness. Well, I will answer your statement this way, that so far as Standard and Poor's ratings are concerned, that many of these companies have bonds outstanding, and those bonds are rated A or in the B classification.

5693 By Mr. Springer:

Q. Now the electric companies which you have selected for your study, the bonds which are outstanding for most of those companies are Aa and Aaa bonds, are they not, on Moody's rating? What are they on yours?

Mr. Cockley. Let's have one question at a time, please.

The Witness. In the case of the Boston Edison, which was included, they had $53,000,000 of bonds outstanding, first mortgage series A, 3½'s, due 1965. Those were A-1 plus.

By Mr. Springer:

Q. Is that the highest rating you give?

A. That is the highest rating we give.

Q. Is that true of all the rest of the electric companies you have listed in your study?

A. Well, they vary, they are not all in the A-1 plus class by quite a margin.

Trial Examiner. Are these Standard ratings?

The Witness. These are Standard and Poor's corporation ratings—that is my firm. I have already qualified or made the answer that on Moody's ratings I don't have them with me, and I don't know. So if you want to know about ratings, you will have to take my ratings.

By Mr. Springer:

Q. Could we have this agreement, that the Aaa Moody
5694 rating is the same as your A-1 plus?

A. Generally so, we are not far apart.

Mr. Cockley. I submit that the witness ought not to be compelled to use a competitor's ratings.

Trial Examiner. I think he should be familiar with them.

The Witness. I am familiar with them on the basis that I know that our ratings don't vary greatly from theirs, but the symbols are different.

By Mr. Springer:

Q. Is this a fair statement, that the electric companies which you have selected for your study, which have bonds outstanding, that those bonds have a much higher rating, either by your organization or Moody's, than the bonds of the natural gas companies which you have selected for your study?

Mr. Cockley. Well, I object to the question in that it applies to a particular selection of companies, and the witness has carefully explained from the beginning that he used all of the companies on which he had available data, and he made no selection, and I don't like to have that included in there. If he wants to say the companies that appear in here, it seems to me perfectly proper, but if there is any emphasis placed on "which you selected," with the inference that he has picked companies——

Mr. SPRINGER (interposing). We have already developed the basis of his selection. Now he has 13 natural gas companies
5695 in his study, and 7 electric companies in his study, and he
makes a comparison. I am just asking him to compare the bond ratings of that group by electric and gas.

Mr. COCKLEY. I have no objection to that.

The WITNESS. Generally speaking, the bond ratings on the electric operating utilities as a class would be higher than bond ratings in the natural gas industry, but obviously that indicates the difference between the two types of investors' appraisal. In one case you can actually sell an A–1 bond and get by with it, and in the other case you can't, or they would if they could.

By Mr. SPRINGER:

Q. Is it a fair statement that natural gas bonds are relatively short-lived bonds, say around 15 years?

A. Well, generally in the natural gas industry that tends to be true, because there you have a wasting asset, and obviously you couldn't issue a bond for a longer life than you thought the asset was going to last.

Q. Is it generally true that the electric bonds are issued for 25 or 30 years?

A. Usually many of the electric bonds are longer term maturities, but there again, there is a difference in the industry. In one case it is a wasting industry, and in the other it isn't.

5696 Q. On page 6 of your Exhibit 27–A you show in the
last line a figure excluding Pacific Lighting Corporation. What was the purpose of excluding Pacific Lighting Corporation?

A. Well, as I pointed out in my first original exhibit, the Pacific Lighting Corporation was an unduly large company. From the standpoint of size and no other, it was not in line with any of the other companies——

Q. (Interposing.) Is size important?

* * *

The WITNESS. Well, I will answer your question of size in a minute. The nature of the territory that was served, the type of service rendered, and so on, were important, but the main thing was that in taking any group of companies for a comparison, where one item stands out so heavily in the total that it unduly weights the average, from a statistical standpoint, as I think we all know, it is unsound. So I showed it both ways, I showed it with the inclusion and with the exclusion. Size generally has a bearing on the extent to which one would consider it. Otherwise, it is just one of the factors I look at; I don't give it any more weight than anything else, particularly.

* * *

5697 The WITNESS. Further, I don't think I can make any better direct answer than what I originally stated on page 16 of the original exhibit, wherein I made this comment also, I think, to the same kind of question. I say here:

"Included in the above group of natural gas companies is Pacific Lighting Corporation. This company, through subsidiaries, distributes natural gas to 272 cities and towns in Southern California, including Los Angeles. Its subsidiaries serve about half the population of the State. Market prices of the securities of these operating companies are not available. In the absence of these, this holding company was treated as a single operating company in the above group. As a result, its indicated market value is nearly 40 percent of that of the entire group of natural gas companies.

"This gives entirely too much weight in the above table to a purely distributing company. Pacific Lighting Corporation owns no gas-producing facilities. It does not run any of the risks of a producing and transporting company, as does the Hope Natural Gas Company. It purchases its gas from independent oil and gas producers operating in the immediate territory
5698 served by it, where the actual and potential reserves are the greatest in its history.

"For these reasons, the risks of capital employed in this company more nearly approximate those of strictly distributing companies serving manufactured or mixed gas. Comparison of the investors' evaluation of the risks of this company as compared with the risks in the manufactured and mixed gas companies set forth above is as follows." Then I went on to show the Pacific Lighting Corporation separately and then the manufactured and mixed companies as a group.

5699 Q. Did you know that Pacific Lighting Corporation's system was an integrated system of approximately three to four hundred miles extending from the center of California down to the southern portion of California?

A. I know it serves that general area.

Q. Do you know that it has 1,600 miles of main transmission line?

A. I know it has transmission lines, but it still has to buy all of its oil.

Q. Do you know whether it has 1,600 miles of transmission line?

A. If you want to get the exact figure, I will check it. [After a pause.] It has properties including 240 miles of field gathering lines, 1,600 miles of transmission line, 11,400 miles of distribution line, and 24 miles of leased line.

Q. Do you know that one of the companies in that group, the Industrial Fuel Supply Companay, purchases, compresses, and transports gas for its affiliates in that integrated system?

A. Well, according to my figures here, the Industrial Fuel Supply Companay operates as a nonutility company and provides gas either for compression, transmission, or sale of natural gas under special contract, and is not engaged in the
5700 business of supplying gas to the public.

Q. Could you get the complete information and check me on whether or not the Industrial Fuel Supply Company purchases, compresses, and transports gas for its affiliated companies in that integrated system, in addition to these special contracts that you mentioned?

A. I think I can find that out.

Mr. Cockley. I certainly object to asking the witness to go out and make an investigation and come back here and testify.

Mr. Springer. I just asked him to check me. I would be willing to show him the source of this at recess.

* * *

By Mr. Springer:

Q. Do you know that the integrated system of Pacific Lighting has 18 field compressor stations with a capacity of 50,000 horsepower?

A. Yes; I know that.

Q. Do you know they have 21 booster stations with a
5701 horsepower of 49,000?

A. Yes; I know that.

Q. Do you know that they have 37 low-pressure and 79 high-pressure gas storage holders with a total capacity of 120,000,000 cubic feet?

A. Approximately 120,000,000; yes, I know that.

Q. Do you kno wwhen the Pacific Lighting System was converted to all-natural gas?

* * *

A. I have it here. It was 1927.

Mr. Cockley. That is it was converted from manufactured gas to natural gas?

The Witness (reading). "Natural gas first introduced in the Los Angeles metropolitan area in 1913 was served by the
5702 subsidiaries mixed with manufactured gas until 1927, when straight natural-gas service was inaugurated throughout the system."

By Mr. Springer:

Q. Now, Mr. Coffman, do you know that the Pacific Lighting system owns two gas-producing fields?

A. Do you include in there Southern California Gas Company's holdings?

Q. Well, in the integrated system it would be included; yes.

A. All that has is one dry well, if you mean to include that.

Q. Doesn't your information show that there are two gas-producing fields held by the Pacific Lighting system? Do you know that, as you have stated, they purchase most of their requirements from three areas, the San Joaquin Valley area, which is hundreds of miles from Los Angeles; they purchase their natural gas from the coastal area, which is also many miles from some of the distribution centers, and they purchase natural gas from a basin area near Los Angeles; do you know that?

A. Generally.

Q. Of course they have to use those 1,600 miles of main transmission line to get the gas to market?

A. That is correct.

5703 Mr. Cockley. Well, just a minute. Are you testifying or are you asking the witness what he knows about that?

Mr. Springer. He said yes.

Mr. Cockley. Did you answer the question?

The Witness. Generally; that is correct.

By Mr. Springer:

Q. Mr. Coffman, you omitted from your study, Exhibit 27–A, the Arkansas-Louisiana Gas Company which has total outstanding securities of $34,000,000, all held by institutions and affiliates, didn't you?

A. The Arkansas-Louisiana Gas Company was eliminated for two reasons; first, the common stock was all owned by the Arkansas Natural Gas Corporation, but for another important reason, which was that 70 percent of the holding company's revenue comes from oil operations, it doesn't come from the gas business at all.

Q. Now, do you know that the Arkansas-Louisiana Gas Company has first mortgage bonds, 1940–1944, which sold in 1939 to yield 2.75 percent?

A. No; I don't know that right now, I don't have those figures here.

Q. You omitted from your study the Atlantic Seaboard Corporation which has total outstanding securities of $14,000,000. I suppose because it is all owned by affiliates?

A. I guess I eliminated that for another reason. We
5704 don't carry it in our service. Apparently there is no investment interest in it at all.

Q. Do you mean that if you don't carry it in your service, there is no investment interest on it?

A. We carry all the corporations in our service upon which we have any demand, and we have probably as large a list of investors as anybody in the country. I mean that is our whole basis for selecting the companies in our service. If we have a demand from any of our clients or any outsider, we try to get the information.

Q. Of course, if all the outstanding securities are held by affiliates as in this case they naturally wouldn't be any investment interest.

A. There wouldn't be any demand for information, and we don't have it and probably couldn't get it if we tried.

Q. And that is just another limitation of your study; you don't have complete information?

A. I made that announcement in my original statement, that I took only the companies we covered.

* * *

Q. Now, Mr. Coffman, you omitted from your study
5705 Cabot, Inc., which has total outstanding securities of $4,000,000 held by institutions and affiliates, did you not?

A. Yes; that is not included in the study.

Q. Now, for Canadian River Gas Company, which you omitted, the total outstanding securities are $6,000,000, all held by affiliates?

A. Well, that is according to my recollection; yes. I don't have anything on that.

Q. Now, for the Carnegie Natural Gas Company, which you omitted, there is $300,000 worth of common stock held by affiliates?

A. Well, I don't have the information here on that company. I don't know, really.

Q. Well, it is not included in your study?

A. That is correct.

Q. And you omitted from your study the Chicago District Pipe Line Company with $2,600,000 of total outstanding securities held by affiliates?

A. That company is omitted—I don't know about your figures.

Q. And you omitted the Cincinnati Gas Transportation Company with $6,800,000 of total outstanding securities held by affiliates?

A. Well, that company is omitted. Again, I don't know the figures.

5706 Q. You omitted the Cities Service Gas Company, with total outstanding securities of $73,000,000, $33,000,000 of which are held by institutions and $40,000,000 by affiliates?

A. That company is omitted—I don't know the figures.

Q. And you omitted from your study the Colorado Interstate Gas Company with total outstanding securities of $13,200,000 approximately, $8,800,000 of which were held by institutions and $4,300,000 of which are held by affiliates?

A. That company is omitted—I don't know the figures.

Q. You omitted from your study Consolidated Gas Utilities Company, with total outstanding securities of $8,000,000?

Mr. Cockley. Where is that? Is that in New York? What Consolidated Gas Company are you referring to?

Mr. Springer. That company is engaged in the production, transportation, and wholesale of gas in western and northern Oklahoma and central and southeastern Kansas.

The Witness. That company is omitted—I don't know the figures.

By Mr. Springer:

Q. Do you know that almost $8,000,000 or a major portion of those securities are held by the public?

A. I don't know that at the moment.

Q. Your study omitted the East Ohio Gas Company
5707 which has $38,500,000 total securities outstanding, all held by affiliates, didn't it?

A. That is not included—I don't know the figures.

Q. And of course the Hope Natural Gas Company, with almost $28,000,000 total outstanding securities held by an affiliate wasn't included?

A. That is not included—I don't know the figures.

Q. The Kentucky-West Virginia Gas Company, with total outstanding securities of $9,600,000 held by affiliates, was omitted?

A. That is not included—I don't know the figures.

Q. And you omitted Manufacturers Light & Heat Company with total outstanding securities of $22,500,000, all held by affiliates?

A. That is not included—I don't know the figures.

Q. And your study omitted Michigan Gas Transmission Corporation, with total outstanding securities of $8,700,000, all held by affiliates?

A. That is not included—I don't know the figures.

Q. And your study omitted Mississippi River Fuel Corporation with $16,400,000 total securities outstanding, $9,800,000 of which are held by institutions and the remainder held by affiliates?

A. That company is not included—I don't know the figures.

5708 Q. Do you know that the Mississippi River Fuel Corporation has $2,200,000 of notes held by institutions with interest at 2.75?

A. I don't know that.

Q. Now, your study omitted Montana-Dakota Utilities Company with total outstanding securities of $28,399,000, $24,400,000 of which were held by the public and $3,900,000 held by institutions?

A. I omitted that because 25 percent or better of its business is electric, and I couldn't segregate its income.

Q. Now, your study omitted the Natural Gas Company of West Virginia, with total outstanding securities of $5,300,000 held by affiliates?

A. The company was omitted—I don't know the figures.

Q. And your study omitted the Natural Gas Pipe Line Company of America with total securities outstanding of $51,400,000 all owned by affiliates?

A. The company is not included—I don't know the figures.

Q. Your study omitted New York State Natural Gas Corporation with securities outstanding of $6,590,000, all owned by affiliates?

A. That company is not included—I don't know the figures.

Q. Your study omitted Northern Natural Gas Company
5709 with securities outstanding of $41,200,000, $22,000,000 of which is held by institutions and more than $19,000,000 of which is held by affiliates?

A. That company is not included—I don't know the figures.

Q. Do you know that the first mortgage sinking fund $3\frac{1}{4}$'s due 1954 of Northern Natural Gas Company—$16,000,000 worth—held by institutions sold in 1939 to yield 3.25 percent?

5710 A. I remember something about that issue, but I don't know the specific figures.

Q. Do you know that the Northern Natural Gas Company has notes, 1940–1946, in the amount of $6,000,000 held by institutions with an interest rate of 2.125 percent?

A. I don't.

Mr. Cockley. I object to that. There is no point in all this interrogation about specific securities without any question as to what they are a lien upon, what proportion of the total assets of the company they represent, what the dates of maturities of many of them are, and it is wholly disassociated from the properties and the business upon which they are a lien.

Mr. Springer. I just stated all of those dates of maturity.

Trial Examiner. I assume that the purpose of the questions is to test the knowledge of the witness. Certainly it won't be evidence of anything when the witness answers each time that he doesn't know what the figures are.

Mr. Cockley. Well, if the purpose of it is to test the knowledge of the witness about apparently a lot of companies which, under the very term of the question and the limitations that the witness had imposed upon him by the necessities of having a market, show that most of these companies were perfectly properly excluded by him just because he couldn't get a market on them, that is
5711 all. Now when it comes down to these specific securities,
this witness isn't testifying here as to the rate for short-term bond money or for short-term obligations of any kind, or for bond obligations of any kind, or anything else. He has done a statistical job, that is all. So when you go to inquire about these mortgages and short-term loans and the rate of interest on them, isolated from all other securities, it has no pertinency at all to his direct examination.

Mr. Springer. We are glad to know it is purely a statistical job, but we are entitled to test the basis of the selection of information to get those statistics.

Mr. Cockley. I would be glad to have you state how you think the witness can take into consideration capital securities which have no market when he has undertaken to determine the investors' appraisal as shown by markets.

Mr. Springer. Of course, I have revealed several companies here with securities in the hands of the public which would show a market value.

Mr. Cockley. I haven't heard one.

Trial Examiner. Objection overruled.

By Mr. Springer:

Q. Now your study omits North Penn Gas Company, with total outstanding securities of $7,200,000, $3,400,000 of which are held by the public and $605,000 by institutions, and the re-
5712 mainder, in excess of $3,000,000, held by affiliates, is that right?

A. The North Penn Gas Company was not included in the study because all the common and half the preferred is owned by the Penn Gas & Electric Corporation, and the balance is owned by the Penn Gas & Electric Company, and there were not facts enough to make any conclusion at all.

Q. Now your study omits Ohio Fuel Gas Company, with total outstanding securities of $71,000,000, 4½ million of which are held by institutions and the remainder by affiliates, is that right?

A. That company is excluded; I don't know about the figures.

Q. Your study excluded Panhandle Eastern Pipe Line Company, with total outstanding securities of $54,400,000, $13,500,000 of which are held by the public, $11,250,000 held by institutions, and the remainder by affiliates, is that right?

A. Panhandle Eastern was eliminated, that is just a straight pipe line company.

Q. What do you mean by a "straight pipe line company"?

A. It is just a transmisison and producing company, it is what we call a long distance pipe line company.

Q. Do you know whether or not any of the companies to which it sells gas are affiliated?

A. The company is partly owned by Columbia Gas &
5713 Electric, and the rest is owned by the Missouri-Kansas Pipe Line Company.

Mr. Cockley. Is there any market for all of its securities?

The Witness. There is a market for some of its securities, but not for the majority, they are held by the Columbia Gas & Electric and the Missouri-Kansas Pipe Line Company.

By Mr. Springer:

Q. Do you know that Panhandle Eastern Pipe Line Company's first mortgage and first lien 3 percent, 1960, in the amount of $12,000,000, owned by the public, sold in 1941 to yield 2.87 percent?

A. I don't recall what the figure was.

Q. Do you know that the public owns a million and a half dollars' worth of common stock of Panhandle Eastern Pipe Line Company?

A. A very small portion of the total is owned by the public.

Q. Do you know that institutional investors own $6,250,000 of first mortgage, first lien, 1946–1950, of Panhandle Eastern?

A. I don't know those figures.

Q. And that they were sold in 1941 to yield 1.65 percent?

A. I don't know those figures.

Q. Do you know that Panhandle Eastern Pipe Line Company notes, .75 to 1.50 percent, 1941, in the amount of $5,000,000,
5714 are held by institutions.

A. I don't know those figures.

Q. Your study omitted Peoples Natural Gas Company, with total securities outstanding of $16,950,000, all held by affiliates?

A. That company is not included; I don't know the figure.

Q. Your study omitted the Pittsburgh and West Virginia Gas Company, with total securities outstanding of $21,690,000, all held by affiliates?

A. That company is not included.

Q. And your study omitted South Penn Natural Gas Company, with $10,000,000 of total securities outstanding, all held by affiliates?

A. That company is not included; I don't know the figures.

Q. Your study omitted Texhoma Natural Gas Company, with total securities outstanding of $19,450,000, all held by affiliates?

A. That company was not included.

Q. And your study omitted United Fuel Gas Company, with total securities outstanding of $19,335,000, 4½ million held by institutions and the remainder by affiliates?

A. That company was not included; I don't know the
5715 figures.

Q. Your study omitted United Gas Pipe Line Company, with total securities outstanding of $125,860,000, $5,230,000 of which were owned by the public, $858,000 by institutions, and the remainder by affiliates?

A. That company was not included; I don't know the figures.

Q. Your study omitted Virginia Gas Transmission Corporation, total securities outstanding of $4,000,000, all held by affiliates?

A. That company was not included; I don't know the figures.

Q. And your study omitted Warfield Natural Gas Company, with total securities outstanding of $10,300,000, all owned by affiliates?

A. That company is not included; I don't know the figures.

Q. And one more company was the West Texas Gas Company, with total outstanding securities of $5,000,000, $3,000,000 owned by institutions and $2,000,000 by affiliates?

A. That company was not included; I don't know the figures.

Q. Now, Mr. Coffman, of the total of $1,185,000,000 of outstanding securities of the major natural gas companies in the United
States, would it be a fair approximation to say that 31 per-
5716 cent is held by the public, a little over 15 percent by insti-
tutions, and more than 53 percent by affiliated interests?

A. I wouldn't want to pin myself down to those percentages for the moment, but generally speaking there are a number of companies in the industry which are controlled, one way or another, through systems and therefore no part or any part of their securities is traded in the market and consequently has a market quotation.

Q. Well, can you state from your knowledge that you gained by making this study of selected companies, that more than half of the total outstanding securities of the natural gas companies in the United States are owned by affiliated interests?

A. Well, I would say that that is approximately correct.

Q. Then you don't know that 28 natural gas companies have all their securities owned by affiliated or institutional investors, and that 15 natural gas companies have their securities held by the public?

A. Well, generally, I know the names of the companies. As a matter of fact, I considered all of those in the original study and eliminated them wherever there were not market quotations to get information from.

Q. You didn't make a rate of return study for the Hope Natural Gas Company, did you?

A. No; what I did was to make a study which showed the
5717 investors' appraisal of the risks of capital, on the basis stated
in the report filed.

Q. A purely statistical study?

A. Purely a statistical study.

Q. And you didn't make any comparative analyses of your 13 natural gas companies and the Hope Natural Gas Company on a consideration of operating revenues, earnings, dividends, gas supply, and gas markets, did you?

A. No, sir.

Mr. SPRINGER. That is all.

TRIAL EXAMINER. I am not sure whether you made this matter of market quotations clear in your original testimony as to just how you determined those market quotations. I assume that the quotations were of actual sales of securities?

The WITNESS. Well, in most cases they are either New York Stock Exchange or New York Curb Exchange quotations, except in one or two instances where they were bid and asked prices for the entire year. What I did was, if it were a stock market quotation, to take the high and the low for the entire year, and then I took the average of that as being the best approximation of the even figure in between, and did the same on a bid and asked quotation.

TRIAL EXAMINER. All the securities you used, then, were listed either on the New York Stock Exchange or on the Curb, is that correct?

5718 The WITNESS. That would be correct for the great proportion of the indicated market value. For instance, if I had an indicated market value as in Pacific Lighting of around $166,000,000, the greater proportion of that was based upon the securities that were traded in a recognized exchange, and did have a high and low and closing price quotation.

TRIAL EXAMINER. Now on what was the smaller proportion based?

The WITNESS. That would be in those few instances, such as I told Mr. Springer, where there might have been a bank loan or a serial note upon which there was no trading whatsoever, and I took those at par as indicated, or if there was a call price higher than the par, I took that; otherwise, if I made an estimate where in one case I said 105.56, that was based on the position of the particular mortgage bond in the capital structure, and the maturity date, which I knew from the way securities of that type were selling, should have sold above par, and I would take that which approximated the actual yield basis——

TRIAL EXAMINER (interposing). You didn't take into consideration the activity of the stock in the market, did you?

The WITNESS. No; I didn't consider volume. What I wanted to be sure of was that there were actual shares traded or bonds traded day in and day out, which gave enough of markets. Now

whether it might have been, during the course of a year,
5719 ten million shares traded or five, I didn't consider that; no, sir.

Trial Examiner. But there had to be sales from day to day and not just perhaps once a month?

The Witness. Yes, sir; there had to be sales from day to day; and I did not consider private sales where there was just one sale, such as to an institution or an insurance company, where it was going to be locked up and not in the market any more, such as these that Mr. Springer has been mentioning recently.

Mr. Springer. You are not an investment counselor, are you?

The Witness. Standard and Poor's Corporation is investment counselor, and I am Vice President in charge of one division of that business.

By Mr. Springer:

Q. You don't counsel on investments and advise clients to make certain investments?

A. I personally have in charge people that do; I don't do much of that directly myself.

Q. You don't?

A. No, sir.

Trial Examiner. Well, the number of shares of stock of a particular company being traded in would affect, to some extent, the market price of the stock, wouldn't it?

The Witness. I think I would have to answer your ques-
5720 tion this way, that if there were some unusual conditions in the market whereby volume increased considerably, let us say on the selling side, that the price might be driven down. The reverse would be true if the volume increased because there was a sudden run for the stock and people were buying and buying and the price might go up. But that, generally speaking, would be for a relatively short period of time, and I felt that in this study where I took 1937, 1938, and 1939, and now have included 1940, and took the year range, that any such wide fluctuations as you might get by an unusual situation were wiped out because you don't have a condition of that sort ranging over a long period of time—I mean for those odd fluctuations. So that, taking a year's range, you would get a fairly close approximation of what would be considered a reasonably normal figure for the amount of trading that is being done during that period.

Trial Examiner. Does the City of Cleveland have any questions?

Mr. Reeder. No questions, Mr. Examiner.

Trial Examiner. West Virginia?

Mr. Koontz. No questions.

Trial Examiner. Is there any redirect?

Redirect examination by Mr. Cockley:

Q. Mr. Coffman, does your exhibit show, in your opinion,
5721 the investors' appraisal of the risk of capital in the natural gas business for each of the years you have given?

A. I think it does, because on any other companies that were mentioned, which were owned by affiliates or otherwise, there was no way to appraise that risk, to my knowledge.

Q. But my question now is whether or not, in your opinion, the figures shown by you each year for the natural gas business are the investors' appraisal of the risk in that business for that year?

A. I think it very definitely is.

Q. And is the same true for electric companies, year by year?

A. Yes, sir.

Q. And for the other utilities that you show?

A. Yes, sir.

Q. Now, Mr. Springer has called your attention to a number of companies. Has he called your attention to any company which you now think properly should have been included by you in this study?

A. No, sir.

Q. And which you omitted?

A. No, sir; I do not think any of the companies he has mentioned could have been included on the basis of the study as I made it. I stated clearly the basis of the companies that were considered, to begin with, and what the final selection
5722 came down to.

Q. And I am correct that the companies that you have included here include all of the natural gas companies upon which information of the kind that you were seeking was available?

A. To my knowledge it includes them all within the limits that I have stated in my two reports.

Q. Mr. Coffman, I don't know whether you completely cleared up the matter or not, but the question is still in my mind as to whether or not you in any case took a market price or a market quotation that represented completely inactive or a very inactive market, as for instance only an occasional sale, once a month, or something of that kind?

A. For the great bulk of the total indicated market value, there was ample trading on the securities. There are, on a few items, bid and asked prices, where there was trading, but I think we all know over-the-counter trading cannot be accurately checked as to the volume of shares, so that many times, although you have a reliable quotation, you don't know how many shares it involves.

Q. But that would be in case of the minor securities of a few of these companies?

A. In every case it was.

Q. And when you talk about quotations on the New York Stock Exchange, of course you refer to the reported price
5723 at which securities were actually sold?

A. Yes; I am taking the quotations as recorded in all the reputable papers, and by the New York Stock Exchange and Curb Exchange themselves as to the quotations.

Q. Now do you know of any producing field owned by the Pacific Lighting Corporation or its subsidiaries?

A. I don't know of any.

Q. Am I correct that Pacific Lighting Corporation, in addition to its distribution of natural gas, until a few years ago was also a very large distributor of electricity?

A. It was, yes, sir; until recently.

Q. And in what year, can you tell us, where the electric properties sold and its activities thereafter limited to the distribution of natural gas?

A. I believe it was 1937.

Mr. Springer. That is right.

The Witness. January 1937, the electric properties and business were sold to the city.

By Mr. Cockley:

Q. The City of Los Angeles?

A. Yes, sir.

Q. Am I correct, then, that the history of the company is that it served—the history of this holding company—that it and its subsidiaries served manufactured gas and electricity in Southern California territory up to 1913?

5724 A. That is correct.

Q. And from 1913 to 1927, it served mixed manufactured and natural gas, and electricity?

A. That is correct.

Q. And then from 1927 to 1937, January 1, it served straight natural gas and electricity?

A. Yes, sir.

Q. And it is only since 1937 that its sole business has been the distribution of natural gas?

A. That is correct.

Mr. SPRINGER. What do you mean by distribution? There are 1,600 miles of transmission lines in that integrated system. I object to the form of that question, and move that the question and answer be stricken.

TRIAL EXAMINER. Why?

Mr. SPRINGER. Well, it assumes facts not in evidence here. There is no evidence that it is purely a distribution system. He has admitted that they have 1,600 miles of transmission line.

Mr. COCKLEY. All right, if it will please Mr. Springer, I will say the transmission and distribution; will that make you happy?

Mr. SPRINGER. That is more accurate; that is, all I am seeking are the facts.

The WITNESS. That is correct.

5725 By Mr. COCKLEY:

Q. How many cities and communities did you tell us, Mr. Coffman, this company serves?

A. I think it is about 242.

Q. And do you know what the total population served is?

A. Yes——

Mr. SPRINGER (interposing). About 3½ million, isn't it?

The WITNESS. I have got the figure, the territory covers an area of about 38,500 square miles, and the population is about 3,495,000.

* * *

TESTIMONY OF HOPE WITNESS BROWN ON HISTORICAL RATE OF RETURN

Transcript Pages 5881–5914

(Omitted in Brown's Testimony Printed in Supplement to Brief of Petitioner)

5881 Cross-examination by Mr. SPRINGER:

Q. Mr. Brown, referring to your testimony on the historical rate of return related to the four periods of the Hope Company's history, I believe it was your testimony that you thought a rate of return reasonably to be expected in the period 1898 to 1907 was 15 to 20 percent?

A. Yes.

Q. And you called that the development period?

A. The early development period, yes, and I considered the minimum return to be expected to attract capital, 15 to 20 percent. I might say that I understated that.

5882 Q. Now in your second period, 1908 to 1926, you reached the figure of 12 percent?

A. That is correct.

Q. And you called that the maturity period?

A. A certain stage of maturity and permanency.

Q. Now in the period 1927 to 1934, you reached a conclusion of 10 to 11 percent?

A. That is correct.

Q. And you called that the period of rising quality rating for natural gas companies and the long distance pipe line era?

A. Well, the rising quality rating of natural gas companies I put in the fourth period, but a big broad expansion of markets for natural gas companies fell in this period from 1927 to 1934, with a very large increase in interest on the part of the investing public and the investment banker.

Q. Now in your fourth period, 1935 to date, you reached the conclusion that an 8 percent rate of return might reasonably be expected?

A. Not less than 8 percent is correct.

Q. And you described that period as one of declining money rates?

A. Declining money rates and increased quality rating to the senior securities of natural gas companies.

Q. Now when you speak of the rate of return reasonably
5883 to be expected by the investor, do you relate that to the cash contribution that is made by the investor to the enterprise?

A. In general. It means the rate of return that is necessary in the best judgment to attract capital. Capital usually means cash, cash investment.

Q. Now at pages 5209 to 5210 of the transcript, Mr. Cockley stated the purpose of presenting your type of testimony on historical rate of return. I wonder whether you adopt his theme, which in essence is this: If you are going back to a rate base that is an accumulated history over a long period of years, then the right rate of return to go with that is the historical rate of return that should accompany original cost. Then he explains the rate of return that they reasonably had a right to expect at that time when they invested their dollars in that property. Do you adopt that theme?

A. Yes; I adopt that theme, on this basis, that it seems a matter of fairness and justice on the part of any regulatory body that if a rate of return on the investment is allowed for bonds or stock, and the investor makes his investment on that basis, that he is entitled to the end of his investment at that rate of return. He has got to take his chances on an increase in values or on a decrease in values, and on the improvidence on his part and the part of the managers of the property, he has to cast in his lot.
5884 If the investment increases in value, it seems to me that it would carry with it a contemporary rate of return, but if the investment remains stationary, the rate of return has got to carry through to the end, based on its original figure.

So I adopt Mr. Cockley's thesis in full, on the basis of fairness.

5885 If I invest a dollar in 1900 on the basis of 20 percent rate of return, then I expect to get 20 percent indefinitely, but on the other hand if my dollar advances, then I should expect to take my luck on any increase or decrease, presumably a decrease, in the rate of return.

Q. Now, when you say "rate of return on investment," do you originally relate that to the cash investment of the investor, and now when you speak of a change in the value of the investment, what do you mean?

A. Well, if I invest a dollar in farm land in 1900, with labor at 15 cents an hour, I should expect to get the same rate of return on that indefinitely in that farm land, at 15 cents an hour. If that farm land advances in value, based on 40 or 50 cents an hour labor, and a rising cost in land, then I should expect to take my chances on whatever the market rate of return was in the future. Answering your question specifically, your capital that is invested in any property years ago, naturally in the form of cash, would carry on with the same rate of return on that particular property in my mind or in the minds of any investors.

Q. The labor cost that you mentioned for operating a farm, related to a regulated utility, is an operating expense which is covered by the consumers' rate, is it not?

A. Yes.

Q. Now, on page 12 of your Exhibit 19, you say that
5886 it is your opinion that investors would not at the present time provide the capital for the Hope Natural Gas Company unless it was allowed and was earning at least 8 percent upon whatever is determined the fair value of its natural gas properties. Now, that seems to be at odds with the theme that you adopted on the rate of return to be expected upon the cash invested in the enterprise?

A. I don't see the discrepancy, Mr. Springer, but I might amplify it by saying that if you were to attract capital today to the Hope property, in my judgment it would cost you at least 8 percent over-all return on whatever is found to be the fair value of that property as of today.

Now, if you go back to some smaller value, naturally the 8 percent still holds.

I am not concerned particularly with what the rate base is going to be, I am testifying as to the rate of return on some rate base, and in my judgment it is not less than 8 percent.

Q. Whether or not the investor has contributed $50,000,000 or $100,000,000 to the enterprise, you would still recommend an eight percent rate of return?

A. That is correct.

Q. Now, on Exhibit 19, page 45, you state that more specifically the problem reduces itself to one of what rate
5887 of earnings the Hope Natural Gas Company would have to enjoy at the present time on its natural gas properties to enable it to replace the money invested in them.

How do you reconcile that with the theme adopted by Mr. Cockley, and by you?

A. Well, I am concerned entirely with a theoretical refinancing problem. As I testified the other day on direct rebuttal, I called attention to the Southern Natural Gas Company which was practically a complete refinancing job. The investor is interested in yield on his money; in security; in future prospects; and other things. He is given a prospectus of what the value of that property is.

Now, the property may be a large figure, it may be a small figure. He is interested in the items that I have just mentioned.

Now, in reconciling this with what Mr. Cockley said, if the investor thought that in the next 15 or 20 years this property—assuming a refinancing operation as of today—would not be allowed to advance with advancing costs of materials and labor and other things, he would be rather hesitant to invest his money in it.

In other words, the theory of "heads he loses, tails the other fellow wins" would scare the investor away in part at least.

The investor takes his chance on a decrease in investment,
5888 or an increase in investment; and by "investment," I mean the rate base.

Over a period of 100 years, I think it is well known that labor costs have gone up, many materials have gone up. If the investor feels that he is going to be shut off from any advance in the future on materials and labor costs, for future rate bases, I think he would be pretty well scared and stay out.

Q. Are you making any distinction between the speculative investment in industries that are not regulated and investment in the utility industry?

A. No; they are one and the same because capital will go into a speculative industry or into a public utility industry along the same general principles.

Q. And those principles are hope of gain and fear or loss, I take it?

A. Those are two of them. There is also security as regard first mortgage bonds, where there is no hope of gain. In other, words, a man buying a first mortgage bond is not particularly interested in any gain, he wants security of principal and security of yield, income.

Q. Well, I consider yield a gain.

A. All right, I will accept that.

Q. Now, you relate your rate of return to be expected at the outset, to the capital invested by the investors, isn't that so?

5889 A. Yes.

Q. Now, that is distinguishable from the original cost or historical cost of the properties, is it not?

Mr. Cockley. I don't know what is distinguishable from what. Your question is not clear to me.

Trial Examiner. As I understand it, it is the amount of money invested as distinguishable from the original cost.

Mr. Cockley. How is there any difference between those two? I don't get it.

Trial Examiner. Do you understand the question, Mr. Brown?

The Witness. I think I understand the question, Mr. Examiner, but I am trying to think of an answer. Naturally a million dollars put into a property in 1900——

By Mr. Springer:

Q. (Interposing.) Is this a cash investment?

A. $1,000,000 in cash put into a property in 1900 is worth more than $1,000,000 today, everything else being equal, assuming the company to have been in operation successfully during the last 40 years.

5890 If you allow the original cost of the property which was paid for with cash, and allow no increment due to rising costs of everything in the last 40 years, or nearly everything, I think you would have a tough time attracting capital to a utility today, or tomorrow, or for the next period of years.

Q. Do you make any distinction between investors' capital contributions and consumers' capital contributions in a utility enterprise?

A. I don't know of any consumers' capital contribution except the price of a stove.

Q. Well, do you know that excessive rates for the service rendered is considered a consumers' contribution?

A. It might be so. I don't approve of any excessive rates.

Q. Mr. Brown, your four periods for the Hope Company correspond generally with the Nation's economic history, do they not?

A. Yes; with that chart you have there. They correspond in general with the chart showing the economic history of the United States, but there are many more than four periods during the last 41 years.

Q. Then, it isn't a coincident that the four Hope periods you selected are parallel with the economic history of the nation?

5891 A. If I understand your question, there are many more than four periods in the last 43 years, 1898 to 1941. I grouped them in four periods due to certain characteristics which obtained in the entire natural-gas industry. Now, breaking those periods down into smaller periods, they would in general correspond to a chart of the economic history of the United States.

Q. Now, do you, as an investment banker, contend that an investor making a permanent investment in capital stock expects always to get the rate of return that happens to be current at the time he makes that investment?

A. Now, he has got to take his chances with decreased or increased dividends, but he makes the investment at the time with the hope and reasonable expectancy of that same rate of return, subject to the good and bad of the future.

Q. And do you know that a rate of return higher than the then prevailing average will in time attract more and more investors to a particular enterprise?

A. I think that is self evident.

Q. In other words, an attractive investment will secure additional investors until that rate that was higher than the prevailing average has raised the norm, more or less?

A. Well, when we come to float a bond issue, we compare all the other bond issues of that type that we can find—in fact, I have done it in the last 48 hours—and we take the
5892 average of the yields. If the average of those yields is 3.50
percent, then we set up our bond issue to yield 3.55 or 3.60, a very slight increase in the bond issue yield, to make it more attractive.

With the stocks, the principle obtains, with possibly a slightly wider margin of yield, but that difference is very small and doesn't affect my rate of return of 8 percent.

Mr. Springer. May I have my question read? I think your answer is "yes" to my question.

(The question was read by the reporter.)

The Witness. I should have started my answer with "yes."

By Mr. Springer:

Q. Your answer is "Yes"?

A. Yes; with that qualification.