

Q. In other words, the investors are aware of the law of supply and demand as it is related to capital?

A. In general, they are; yes.

Q. And the investor, particularly as a common stockholder, knows that his return will not be the same each year but that he must suffer the ups and downs of the economic cycle?

A. Yes; that is true.

Q. Now, in Exhibit 19, page 8, you state that from an investor's viewpoint, the Hope Natural Gas Company does not have possibilities of growth, and therefore its securities would
5893 be less attractive than, for example, some other gas company, and on page 9 you say that fluctuations in revenues, plus the declining trend of production in West Virginia, and other considerations, indicate to the investor declining rather than increasing sales for the Hope Natural Gas Company over any considerable future period. Those are statements that appear in your exhibit, are they not?

A. That is correct.

Q. Now, did you testify that long-distance transmission lines have tended to stabilize the natural gas industry?

A. I did.

Q. Now, in view of the testimony by Mr. Tonkin that there has been a tremendous increase in the sales of the Hope Natural Gas Company, and that they propose to spend millions of dollars to augment the production and transmission system of the Hope Natural Gas Company to meet increased demands, and have even proposed a \$25,000,000 pipe line extension to Louisiana, exceeding 800 miles, I believe, would you care to alter any of your statements in Exhibit 19?

Mr. COCKLEY. I object to that as not a complete statement of Mr. Tonkin's testimony at all. In the first place, the proposal is to become effective several years hence, and I don't think the question fairly includes all of Mr. Tonkin's testimony. If he
5894 wants to ask an expert witness, I think he should give him an opportunity to read Mr. Tonkin's testimony, or read it to him, and then ask him any questions he wants to about it. This isn't, as I understand it, cross-examination on his testimony of the other day, but rather it goes back to his original testimony at Clarksburg.

Mr. SPRINGER. That isn't so at all, because he reiterated that he didn't choose to change his original—

Mr. COCKLEY (interposing). I am not objecting on that ground, but I think if you want to be fair to the witness you should ask him to read Mr. Tonkin's testimony, or else read it to him.

TRIAL EXAMINER. Or state a hypothetical question, if you are unable to state just exactly what Mr. Tonkin's testimony was. Of course, you are tying this in directly now to Mr. Tonkin's testimony.

Mr. SPRINGER. Well, if Mr. Brown doesn't know about the growth of the Hope Company's system, and the proposed new pipe line, I don't see how I can ask him any questions about it.

TRIAL EXAMINER. I don't know that that makes any particular difference. You can state a hypothetical question, including those elements, and ask him whether or not that would have any effect on his judgment. That is what you are trying to find out, isn't it?

Mr. SPRINGER. Yes; I didn't want to resort to hypotheses
5895 when there is evidence in the record of the growth and the proposed pipe line.

TRIAL EXAMINER. I don't know what else you can resort to, unless the witness already knows what the testimony is.

By Mr. SPRINGER:

Q. Do you know, Mr. Brown, that Mr. Tonkin testified that there was an increase in gas sales of from 50,000,000 M. c. f. in 1939 to an expected 70,000,000 M. c. f. in 1941?

Mr. COCKLEY. I don't think that is a correct statement. Have you the figures before you for 1939?

The WITNESS. I have, for 1939. I know in general about the plan for an extension at a cost of roughly \$25,000,000 down to Louisiana. I don't know when that can be completed, or any of the details about it, but it seems to me it confirms my testimony of a year ago that the growth possibilities were extremely limited.

On page 8 of my direct testimony of a year ago, I show the declining tendency in West Virginia natural gas output, and I bring out that point very distinctly, that the growth possibilities would go a long way towards scaring off the investors in Hope Natural Gas property a year ago. I see nothing to change my opinion as of today.

The Hope Company, in M. c. f. of output reached its peak back in 1915, approximately duplicating it in 1916. Then, there was a
long decline until 1933; then there was some pick-up
5896 from 1933 until 1937; then a decline, and then a very marked

pick-up for the last year and a half, very largely due to the boom.

Now, an investor goes into a utility not with any view of a boom but with a long-range investment standpoint, and the building of this pipe line would indicate a ceiling on output in the neighborhood of 60 or 70 million M. c. f., which is much below what the output used to be, in fact it is below what it was prior to the first World War in 1912 or 1913.

That is what I was alluding to when I said that the growth possibilities were extremely limited and I put growth possibilities at the top in weighted value, as to the list of factors necessary to attract capital.

By Mr. SPRINGER:

Q. Do you mean by "growth possibilities," the possibility of additional natural gas in West Virginia for Hope?

A. West Virginia and over into Kentucky, without a very large outlay of money. Now, what they have got to do, as I understand it, is to put a very expensive pipe line down into Louisiana, and I remember testifying to this last year, that it meant either Louisiana or Texas in order to fill the demands.

Q. Do the statistics for the tremendous increase in the sales of natural gas reconcile with your statements in Exhibit 19?
5897 Mr. COCKLEY. I object to the question unless it is more specific, specifying what increases and what statement and—

TRIAL EXAMINER (interposing). What increases are you talking about, and over what period?

Mr. SPRINGER. Well, I believe you are aware of the 50 million M. c. f. sales in 1939?

The WITNESS. Yes.

By Mr. SPRINGER:

Q. And the increase which is predicted to reach 70 million M. c. f. this year?

A. Yes.

Q. Then, on page 9 of Exhibit 19, you say there is an indication of declining rather than increasing sales for Hope Natural Gas Company?

A. I state on page 9 that the declining trend of production in West Virginia plus the fact that for a few days in 1940 many industrial consumers dependent on Hope were curtailed to conserve the supply for domestic users, indicate to the investor a declining rather than increasing sales for the Hope Natural Gas Company over any considerable period.

Now, I say nothing about going out and buying a property, or extending a line 800 miles away. That is always in the range of possibility to any company, but at an additional cost of 5898 capital which will at the same time dilute the capital already invested.

Q. But, of course, Hope has experienced these increased sales without building a new pipe line to Louisiana?

A. True, and have reached a ceiling there at 70 million M. c. f.

Q. Do you predicate that that is the ceiling?

A. Well, I don't know whether that is the exact ceiling, but I think it is common sense to call it a ceiling when they are going out and spending \$25,000,000 to get an additional supply of gas. It seems to me that it is self evident.

Q. Do you mean to imply that an investor, who invested his money in the first period of Hope's history, expected to earn a rate of return of 20 percent forever on that investment?

A. Yes; and I am understating it at 20, probably 25 percent. If you knew anything about the mining or oil business in those days, you made anywhere from 25 percent to 100 percent or else you didn't put any money into the ground.

Q. Now, you have related the Hope Natural Gas' early history to the oil business.

A. It has many similarities with the oil business, and it has today.

Q. Well, now, isn't one of the chief causes of regulation, the higher rate of return that was made possible by the high prices of monopoly in the early years?

5899 Mr. COCKLEY. I object to that, we are getting awfully far afield on speculations of that sort.

TRIAL EXAMINER. I don't know just what knowledge this witness would have of that.

Mr. SPRINGER. Well, he has spoken about the Standard Oil Company with its operations in oil and natural gas, and he has related the natural gas business to the oil business, and I think it logically follows that the history of the nation has recorded the development of regulation to control the high rate of return made possible by the high prices of monopoly in the early years.

TRIAL EXAMINER. You think this witness then should know what has caused the regulation?

Mr. SPRINGER. He really should if he is a student of the economic history of the United States.

TRIAL EXAMINER. Well, I will let the witness answer.

The WITNESS. Well, I am a firm believer in regulation of natural gas companies, and I am a firm believer in regulation of all public utilities. To that extent, natural gas companies differ from oil companies, and naturally any company that is subject to regulation perhaps has two differing factors involved as governing the attraction of capital; one, the regulation tends toward stability; and two, the regulation tends toward a restriction of profits. One is favorable, perhaps, and the other is less favorable.

By Mr. SPRINGER:

Q. Do you know that the natural gas industry was subject to regulation through the whole period?

A. I do.

Q. That you have testified about?

A. Yes.

Q. Now, wasn't the investment of the Standard Oil Company, of money in the Hope Natural Gas Company at a time when Standard Oil was, as you have testified, able to earn about 25 percent on its investment, an indication of the high profitableness of the natural-gas business in West Virginia, perhaps to its monopolistic nature, rather than an indication of the cost of money for a natural-gas public utility?

Mr. COCKLEY. Well, that is a statement——

The WITNESS (interposing). No; I don't think so. The Standard Oil Company had properties all over the world. Of course, they were much smaller then than they are today, and to get anybody to go out into the hills of West Virginia and sink a gas well in 1898 called for a high cost of money, and there were mighty few individuals that were willing to do it; and outside of the two or three oil companies, I don't think it could have been done.

My point in bringing that Standard Oil figure of 25 percent in, was to get some idea of what the Board of Directors of the Standard Oil Company might be thinking in 1898 when they wanted to risk some money in the West Virginia hills, which was a young industry and a brand new enterprise in a young industry.

I can't think for a Board of Directors in 1898, but applying the same conditions of 1898 to 1941, I wouldn't sit on any Board of Directors and start to sink money out in the wilds of Australia for natural gas, with no market and only a half a knowledge of what I was going to find, for less than 25 percent.

By Mr. SPRINGER:

Q. Do you mean that the people in Ohio weren't begging for natural gas in the early period of Hope's history?

A. They were, but they were getting it from little local fields around Ohio. They didn't introduce it into Cincinnati until many years after 1898.

Q. Do you know that the Hope Company was supplying natural gas to the East Ohio Company?

A. It started very early, yes; but the great majority of the output of the Hope Company for several years after 1898 was field sales to oil and gas companies in West Virginia for use under their boilers. In other words, it wasn't a public utility in any sense of the word.

Q. But immediately after that it entered into the public-utility phase of its history?

5902 A. No; I wouldn't say it did until about 1906 or 1907 when the percentage of sales of Hope turned from being mostly field sales to being sales to domestic and industrial consumers. When the percentage crossed the 50-percent line to industrial and commercial consumers, then it became essentially a public utility.

Q. Now, one of the incentives to invest in a new, untried enterprise is the prospect of a higher rate of profit, isn't it?

A. Yes.

Q. And this is probably true because there is no past history for enterprises to assure the investor of the degree of safety of his investment?

A. Yes.

Q. But as the industry becomes seasoned and proven, it is reasonable to expect the rate of profit to decline?

A. Yes; generally.

Q. Now, you have stated that one of the stabilizing influences in the natural-gas business has been the transmission of gas by means of long-distance pipe lines since 1926, I believe?

A. Well, since about 1926-1927; yes. I wouldn't use the word "stabilizing" exactly. That was what made the public interested in natural-gas securities on a national scale. It did stabilize
5903 it to a large extent, but it brought in new markets, great metropolitan areas.

Q. And of course that means that the cost of money is reduced?

A. That is correct.

Q. And this act of stabilization should tend to lessen the risk to the investors in a company like the Hope Natural Gas Company?

A. Yes.

Q. Now, on page 5225 of the transcript you testified that 1934 was the end of the normal money market. What do you mean by the words "normal money market"?

A. Well, that is a rough figure, 1934. We started to see a decline in money rates—any table of bond yields will show that—money came very easily around 1935, increased in easiness in 1936 and the following years, and we had an abnormally easy money market in the last five or six years, with yields of high grade bonds declining from $4\frac{1}{2}$ to 5 percent down to $2\frac{3}{4}$ percent.

Q. In your opinion, then, low interest rates constitute abnormality?

A. Well, that is a large subject. My personal opinion is that 10 or 20 years from now, or less—I don't know—high grade bonds will work back towards a $4\frac{1}{2}$ percent yield, but when that day comes no man knows, it always has in the past.

5904 Q. Do you think low rate of interest is an unusual thing?

A. It certainly is. The lowest interest rates in the history of the United States have been in effect in the last few months.

Q. What is your norm so that you can reach a description of this period as being abnormal?

A. I just gave it to you—high grade bonds, $4\frac{1}{2}$ to 5 percent; the next type of quality bond, 5 to $5\frac{1}{2}$ percent.

Q. And do you know of any period in the nation's history that was relatively close to that cost of money?

A. Yes; it appeared around 1900 when railroads could finance on a 3 percent basis, but it wasn't as low a rate level as it is today.

Q. Again we are speaking in relative terms?

A. Well, yes; what was the question?

(The question was read by the reporter.)

The WITNESS. For a few months it was relatively close, in 1900, it was relatively close to today.

By Mr. SPRINGER:

Q. I believe you described the Hope Company at certain periods as essentially a mining company?

A. I did.

Q. And what is the basis of that description?

A. Well, the essence of a mine is something that is
5905 taken out of the ground, and you have only a partial
knowledge of what is underground. Therefore, you have a
very substantial factor of risk. The reserves can be measured only
in part, and at best they are estimated, and at the same time you
have a wasting asset; a wasting asset, in the eyes of an investor,
is a very serious thing. It means you have got to look for more
reserves all the time, either in the same territory or further
afield, and I would say that Hope has many of the essentials of
a copper mine of the better class, or an oil company of the
better class. I don't rank them with these "cats and dogs," I
put them on the same basis as the upper group of mining com-
panies and oil companies.

Q. The risk you speak of related to wasting assets, a wasting
asset industry, will be minimized for the Hope Company by the
new pipe line to Louisiana, and then the proposed extension to
Texas that Mr. Tonkin testified about?

A. Certainly the risk will be reduced by this pipe line, but at
the same time there is an element there of probable decrease in
earnings due to the increased cost of capital. You can't raise \$25,-
000,000 and put it to work overnight. It will take some time before
that is reflected in increased earnings.

Q. Are you informed that the Hope Company will go into
the public market for this money?

A. I don't care whether they go into the public mar-
5906 ket or whether the Standard Oil Company advances the
money, it is all one and the same. The capital is the
same whether it is advanced by A or B.

Q. What if the Hope Company has sufficient funds of its own?

A. Well, it hasn't got sufficient funds of its own. It can bor-
row.

Q. Do you know how many millions it has invested in secu-
rities?

A. I do, or at least I looked at the December 31, 1940, balance
sheet, recently, and it hasn't got \$25,000,000 of cash and Gov-
ernments.

Q. Would you say that they would have to earn an 8 percent rate
of return on that \$25,000,000 to attract investors?

A. Not at all. I would say they would have an 8 percent over-
all rate of return if they went into the public markets.

Q. Now, do you know that what you referred to as a wasting
asset is covered by consumers' rates in annual depletion allowance?

A. Yes, I do.

Q. And do you know that the history of the natural gas industry has been that additional gas reserves have been discovered which have gradually increased the total amount of natural gas reserves recoverable in the United States in the last two decades?

5907 A. I do, a very large increase in the natural gas reserves throughout the United States, but you will find that that increase is almost entirely confined to the far west and the southwest.

Q. And Hope has a proposed pipe line to go to Louisiana now?

A. Yes.

Q. Where additional reserves are located. Now, do you know how much gas is purchased by the Hope Natural Gas Company to meet its requirements, just the proportionate amount?

A. Oh, two-thirds, roughly. I can give you the exact percentage. I have checked with the engineers, but I don't recall the exact figures.

Q. Now, the fact that Hope purchases two-thirds of its requirements, does that change your opinion that it is essentially a mining enterprise?

A. Not in the slightest. You asked me the same question in June of 1940, and my answer was substantially as follows: That the vendors or independent producers mined gas and sold it to Hope, and they had all the risks and uncertainties that go with the Hope Company's own wells. They are one and the same in the eyes of the public.

Q. I believe you stated that Hope was essentially a public utility since 1907?

5908 A. I wouldn't put it as definitely as 1907—since about 1906 or 1905.

Q. Well, the fact that Hope—

Mr. COCKLEY. You are not asking that in any legal sense, are you, Mr. Springer?

Mr. SPRINGER. Well, all my questions are legal questions.

Mr. COCKLEY. Well, if they are, then I move to strike out the whole cross-examination, but as I understood Mr. Brown's testimony it was because so large a part of Hope's sales were field sales prior to about 1906 or 1907, and he wasn't very specific about the date; that he didn't really consider it to be a public utility before that time, without trying to put that in a technical sense, and

you are not now trying to ask him whether legally and technically it was a utility subject to regulation, are you?

Mr. SPRINGER. Well, of course, Hope was rendering service to the public in this period you speak of since 1906, and was subject to regulation by West Virginia by an early period.

The WITNESS. Yes, it was rendering service to the public prior to 1906 in a small way. The public looks at things in a large way, and technically it was a public utility prior to 1906, but actually it was in the same category as an oil company.

By Mr. SPRINGER:

Q. You mean that if it purchases two-thirds of its 5909 requirements it isn't a merchandising company?

A. Well, the word "merchandising" covers a broad field. I don't call it a merchandising company. It mines gas from its own wells, and it buys gas from somebody else's wells. Now, they are one and the same type of wells—it has its gathering lines. If a well belonging to an independent operator gives out, then that gathering line becomes obsolete or has to be taken up and placed elsewhere.

Now, the same risks and uncertainties follow the independent operator as they do the Hope Company with reference to its own wells. It is a mining or producing company, and I don't make any distinction between those two types of wells, owned by Hope and owned by the other people.

Q. Is the basis of your opinion on these various unusual rates of return, the average investor's attitude toward the gas industry? You spoke of the general public, I believe, the small investor.

A. No; because the small investors were not in the natural-gas industry in the early days. The National Fuel Gas has a common stock issue which came about by a former merger. The Company was originally a trust, starting in 1882. In 1890, sometime, it developed into shares of stock which didn't have any market value until, I think, about 1921.

5910 There were no small investors in natural-gas companies, to amount to anything, prior to 1921, and even later.

Southern California Gas started a subsidiary, Pacific Lighting, which had both electric properties and gas properties. In fact, Southern California Gas started originally as a manufactured-gas company, and then a mixed-gas company, and it is only in recent years that it turned to natural gas. Its first bond issue was put out in 1917, and that was sold to the public, and that has

been the highest grade natural-gas company in the United States, and the only gas company that ever had an Aaa bond on it.

Q. Mr. Brown, is it a fact that more than half of the money invested in the natural-gas industry has been contributed by affiliated companies or institutional investors?

A. I think that is a fair statement.

Q. And you advise institutional investors, don't you?

A. I certainly do, and I have sold lots of natural-gas bonds to banks and to insurance companies.

Q. And institutional investors are relatively well-informed on any prospective investment?

A. They are well informed.

Q. So your small private investor test is probably a minimum test, isn't it?

Mr. COCKLEY. I object. He just stated he didn't use the small private investor test, if I understood his testimony.

5911 The WITNESS. It is just the same thing selling a bond to a country bank as it is to an individual.

By Mr. SPRINGER:

Q. Well, you seem to convey the impression that the small private investor has a psychology, a complex about the natural-gas industry which isn't supported by the facts of millions of dollars invested by institutional and well-informed affiliate investors in the natural-gas industry. I just wanted to clear that up.

A. Well, I don't think you have cleared it up. Your affiliates are totally distinct from institutional investors. The institutional investors, generally speaking, include banks and insurance companies, and the larger banks and the insurance companies are pretty careful investors, and they buy, in general, only the senior securities. I know of only one common stock of a natural-gas company which is owned by an institution, and that is Harvard College.

The common shares have got to be sold to the public, so you have got to take the little investor, as you call it, into account if you are going to have an over-all picture of the cost of capital.

Now the natural gas industry never would have been built up to its present size had it not been for the foresight and courage of the larger affiliates, notably Standard Oil and Cities Service and Columbia Gas & Electric, and Pacific
5912 Lighting.

Q. And they realized a handsome profit, rate of profit, on what you call their courage?

A. They did through the years.

Q. You didn't mean to imply that the Standard Oil Company was the original promoter of the Hope Natural Gas Company, did you?

A. Well, no; not technically. There was a small group of men who started it, but the Standard Oil came into the picture through one of its subsidiaries, at a very early date, I think it was 1900.

Q. About the beginning of your second period, wasn't it?

A. Oh, no; long before that. You will find the National Transit was the largest stockholder either in 1900 or 1901. I can look it up.

Q. Well, there is information in the record on that.

A. Well, I have the Government record, the historical record, the corporate history.

Q. When you speak of the wasting asset characteristic of the natural gas industry, and compare it with a mining enterprise, do you recognize the distinction that is related to this factor, for example, that in the natural gas industry, exploration and development costs are contributed by the consumers
5913 through the rates, and the markets for the natural gas are essentially protected markets?

A. Why, certainly, but take the Cleveland Railway Company, they have substantially a guaranteed 10-cent fare, but that doesn't make the 6-percent dividend certain. For a number of years they haven't paid dividends. You can't guarantee a return to the stockholder by having a consumer pay for the exploration.

Q. In a mining enterprise, the investor contributes the money for additional exploration and development, isn't that so?

A. Indirectly he does, because it has got to be charged into operating expenses before arriving at the net available for dividends.

Q. Mr. Brown, are you aware of the new drilling methods and the advances in the transmission methods which have revolutionized the natural gas industry in recent years, so that it might be said that investment yardsticks which were applicable in times past are not applicable today?

Mr. COCKLEY. I object to that. There is no evidence of it; it is the first time I have heard of any revolution here. It certainly isn't in this record.

TRIAL EXAMINER. I believe he was just asking him if he was aware of the revolution.

The WITNESS. Well, I went over the property of the Hope Company in December of 1939, and watched them drill a few wells by the then latest methods. I haven't heard of 5914 any particular advances since then in inventions. Assuming the methods of today to be better than they were in 1900, I wouldn't say that it would change my opinion in the slightest. There has been an advance in methods of manufacture, and everything else during the past 40 years. At the same time, there has been a change in cost of construction during that period, due to high labor cost and cost of materials. When we finance a company, my firm, we always have an engineer's report on the value of the property made, and that is the general attitude of the public in buying new securities. We put that report into our prospectus, and that is the normal thing to do.

By Mr. SPRINGER:

Q. Do you rely on the estimates of gas reserves as religiously as you rely on the appraisal of the property by your engineers?

A. Well, I think that the estimated gas reserves are for an indefinite period of years. I haven't assumed that it is any short number of years. No; I don't rely on that as accurately as I do on bricks and mortar that are above ground, and I don't think anyone else does.

Mr. SPRINGER. That is all.