LELAND OLDS IS NOT QUALIFIED

TO BE A MEMBER OF THE

FEDERAL POWER COMMISSION BECAUSE --

1. As "Industrial Editor" of the Federated Press, Leland Olds has urged "comrades" to enroll in "training courses" in the Communist movement and tactics so as "to clarify their ideas and equip themselves for greater usefulness in the movement."

2. Leland Olds has sneered at the Fourth of July "as the day set apart by the world's greatest exploiters to glorify their rise to power."

3. Leland Olds has desecrated the Church by alleging its "decay as a religious institution and its transformation into a handmaiden of the capitalist system."

4. Leland Olds has asserted that educational institutions are subservient to the "money princes who govern industry, endow education and generally distribute royal gifts to the glory of God and the admiration of the populace."

5. Leland Olds has specifically advocated nationalization of the coal, railroad and utility industries.

6. Leland Olds has jeered at the "popular delusion" that the American political system of representative democracy can be "effective," he has characterized that system as "played out," and he has expressed contempt for our major political parties and politicians generally as engaged in a "fake struggle."

7. Leland Olds has clearly demonstrated by his published writings, which form a definite pattern showing his alien political and economic philosophy, that he is fundamentally opposed to the American system of private enterprise and the American way of life.

(a) Leland Olds has repeatedly denounced the American system in all of its aspects.

(b) Leland Olds has exulted in its so-called "decay" and he has anticipated and urged its downfall.

(c) Leland Olds has advocated the elimination of private property in productive enterprise, he has said that it is headed for the "discard" because "inevitable changes in the economic organizations of society are exposing it as just another myth preached in the interest of a small class seeking to retain power and privilege," and he has asserted that owners of property exist only as "a privileged class of parasites whose idleness and dissipation become an increasing stench in the nostrils of the people."

(d) Leland Olds has gloated over the alleged "fatal illness" of the profit system as such, and he has predicted dire consequences unless it is "superseded."

(e) Leland Olds has advocated a "planned economic order" to displace the "anarchy of competing private capitalists."

(f) Leland Olds has preached class war and he has echoed the communist doctrines of class struggle, surplus value, exploitation, elimination of capitalist enterprise, and international action by workers -- all as proclaimed by Karl Marx in his Communist Manifesto and his Das Capital.

(g) Leland Olds has repeatedly praised the Russian system as the coming world order and as a model for the United States, and he has exhorted American labor to engage in "advance preparation" because "that change is coming in America."

8. Leland Olds has grossly misrepresented the true nature of his writings for the Federated Press by stating to the hearing subcommittee of the Senate Committee on Interstate Commerce in 1944 that he did not "advocate anything" in articles such as those referred to above.

9. Leland Olds by his writings and by his misrepresentation thereof has shown himself to be a security risk who should not in these troubled times be trusted with power over industries vital to the national defense and safety.

10. Leland Olds is, as revealed by his writings over many years down to the present, a firm and ardent advocate of theories and proposals leading to the establishment of a rigidly planned and regimented economic order.

11. Leland Olds is an unscrupulous propagandist who has manipulated and distorted facts, spread misinformation, and concealed from the President and the Congress his underlying views and designs.

12. Leland Olds has been a crusader for alien revolutionary doctrine, utterly devoid of a judicial temperament and outlook and completely incapable of rendering impartial judgments upon the matters which come before a body such as the Federal Power Commission which regulates key American industries vital to the national defense and safety.

13. As a member of the Federal Power Commission Leland Olds has shown himself to be an opportunist who shifts his declared positions in accordance with the circumstances of the moment and who cannot be relied upon to say what he means or mean what he says.

14. Leland Olds has shown himself, while a member of the Federal Power Commission, to be a practitioner of the philosophy that the end justifies the means, to be a master of evasion, equivocation and indirection, and, by employing misinformation and whatever other tactics might seem to advance his objectives, to have sought to induce the Congress into allowing him free rein to work his lawless will.

15. Leland Olds has demonstrated his disregard of the expressed will of the Congress and his unwillingness to conduct himself in a straightforward manner in administering faithfully the legislative acts committed by Congress to administration by the Federal Power Commission.

16. Leland Olds has persistently sought by misrepresentations and devious tactics to stake out and to extend his own sphere of authority by administrative fiat and to arrogate to himself the legislative powers of the Congress.

APPENDIX A

Views of Commissioner Leland Olds on the "Investment Return Principle" and Related Matters, as Given in his Testimony on S. 1498, May 24, 26 and 31, 1949

The following detailed excerpts from his testimony on S. 1498, in response to searching questions by members of the Senate Committee, reveal how Commissioner Olds would give effect to his theories for fixing the prices to be received in arm's length sales in the fields by independent producers and gatherers of natural gas. It is evident that he would restrict their returns on the basis of original cost, would strip all gas moving in interstate commerce of any value as a commodity, and would pursue a so-called "Investment Return Principle" to its ultimate result -- a Vanishing Rate Base.

Olds the Recognized Spokesman of Commission Majority

The following excerpts from the hearing record (Tr. 282-283) show that Commissioner Olds was the recognized spokesman for the majority of the Commission, which also included Commissioners Buchanan and Draper:

> " Senator McFarland. Mr. Olds, right there: This testimony that you are going to give--The chairman referred to a report of the Majority

and a report of the minority. Your testimony will represent your own individual views; is that correct?

"Mr. Olds. In support of the majority's report.

"Senator McFarland. But we want to know whether what you are saying represents your own views or is it a compromise of views of the majority?

"Mr. Olds. I think I can say that is has the approval of the majority of the Commission.

Once In, Never Out

Commissioner Olds was emphatic in his view that, although an independent producer or gatherer could not be forced to sell his gas to an interstate pipe line, once he had undertaken to do so he would have to continue deliveries at whatever price the Federal Power Commission thought reasonable. (Tr. 304-308)

"Senator Kerr. In fact, if he sold it in interstate commerce, he would become a natural gas company, and then he would not have any choice about whether he would take it. He would take it, would he not?

"Mr. Olds. He would take it, yes, sir. (Tr. 304)

. . . . .

"Mr. Olds. I just want to say this: When a producer finds it to his advantage to sell to a utility market and decides to sell to a utility market, thereafter I think he should be subject to regulation because it is a utility business just as much as the sale by a pipe line to a utility market.

"He can choose, however--he can say, 'I prefer not to sell to a utility market,' and in that case he can keep his gas and sell it to some local manufacturer, sell it any way he wants. But once he chooses, once he finds it to his advantage to supply a utility market, then he assumes that responsibility, which both the Federal Government and State governments have indicated require regulation in order to protect all interests concerned." (Tr. 305)

Commissioner Olds here seems to assume an identity between "utility" gas and interstate markets, whereas actually less than half of the gas supplied to utility customers moves in interstate commerce. Moreover, the States in their regulation of <u>intrastate</u> gas do not apply, and have never applied, to gas production the kind of utility regulation which Commissioner Olds and his associates strongly advocate and insist they would pursue unless prevented.

Later in his testimony (Tr. 424-438), Commissioner Olds was asked further questions about his concept of the "utility obligation" of independent gas producers or gatherers. On the matter of abandonment, he took the following position:

"Senator Kerr. And the position that has taken place here is that the Interstate case makes a producer a natural-gas company the instant he sells any gas at all in interstate commerce so, therefore, he can never abandon that service, contract or no contract, until given the permission by the Commission. That is correct, is it not, Commissioner?

"Mr. Olds. That is correct. (Tr. 427)

Could Change All Prices in Existing and Future Contracts

At another point Commissioner Olds expressed his view that the Commission could change any and all contracts for the sale of gas destined for interstate commerce, in these terms:

> "Senator Kerr.....If and when your Commission does assume the jurisdiction which you now feel that you should have and should exercise, you can change all of these prices under the position you took a while ago, can you not?
>
> "Mr. Olds. They would be subject to regulation, and if found unreasonable--
>
> "Senator Kerr. I mean, subject to change.
>
> "Mr. Olds. (Continuing)--they would be subject to change.
>
> "Senator Kerr. At the order of the Commission.
>
> "Mr. Olds. That is correct.
>
> "Senator Kerr. All of these contracts.
>
> "Mr. Olds. The contract prices that come within the jurisdiction of the Natural Gas Act, and I have said--
>
> "Senator Kerr. If they sell gas in interstate commerce they come under it.
>
> "Mr. Olds. They come under it.
>
> "Senator Kerr. So that all of these prices that have been before your Commission in these hearings and used as a basis for these pipe line companies to get permits are just mere scraps of paper, if your Commission decides to make them so.

"Mr. Olds. If the Commission decides that they are unreasonable prices. (Tr. 337-338)

<u>Could Require Increased Deliveries by Independent Producers</u>

Commissioner Olds also indicated (Tr. 431-438) that, except perhaps where additional major expenditures were involved, the Commission could require a producer to increase his deliveries from "dedicated" fields and reserves. His testimony on this point includes the following:

"Senator McFarland.....Suppose that in this instance, as I understand you, they have got to continue -- you can make them continue; suppose that the wells that they then have are beginning to be exhausted, and they have a proven field. Would you have the authority to make them drill some more wells in order to supply this gas if they become a little balky on you, and did not want to cooperate and they said, 'Well, if we cannot get out one way, we will get out another,' and so they just quit drilling wells. Could you make them drill some more wells for us?

"Mr. Olds. This is the first time that question has been raised, so I am going to do my best with it. I think that the situation would be this: They are under obligation to supply, with certain reserves which they have made available.

"Senator McFarland. I am assuming a proven reserve here, and one -- but, as I understand it, sometimes they have to drill new wells in order to tap that reserve.

"Of course, I am not assuming, Mr. Olds, in order to make my question plain, I am not asking you whether they would have to go out and drill wildcat wells; I am talking about proven reserves, what they call proven reserves.

"Mr. Olds. Well, I think that if it involved a specific field that had been dedicated to the supply of that pipe line--

"Senator McFarland. That is what I am talking about.

"Mr. Olds. (Continuing) -- I think we probably could.

. . . .

"Senator McFarland. You could make them go ahead and drill enough wells to make their supply complete?

"Mr. Olds. I should say within -- I think that the general question of well-drilling would have to be within whatever they were entitled to drill under a state authority over the spacing of wells, and over those general matters of conservation of gas in the ground, and allowable deliveries, and so forth.

. . . . . .

"Senator Kerr. I take it you mean by that, let me repeat, when the production has begun the process and has been started to be sold in the interstate pipe line that that constitutes the dedication, whether the producer intended it or not.

"Mr. Olds. I think, yes, that there is a dedication to public service. I remember the majority --

"Senator Kerr. By the act of the sale in interstate commerce.

"Mr. Olds..That is correct.

. . . . . .

"Senator McFarland. There is one other question I would like to ask you. I want to develop this just one more step. As you well know, the demand for this natural gas is increasing, and in various localities, and particularly in my state.

"Senator Kerr. Section 7(a)(b) gives them the authority, Senator, to compel the increase of services, as I understand it, does it not, Commissioner? If they are natural-gas (companies) under your jurisdiction?

"Mr. Olds. If they can be done without the addition of major facilities.

"Senator Kerr. I understand, Mr. Commissioner.

"Mr. Olds. If they have capacity, without additional investment, then we can order them.

"Senator Kerr. If it is just a matter of turning the valve you can have them turn that valve, and put 100 million instead of 50 or 10 instead of 9.

"Mr. Olds. Well, what would happen would be that a customer of a pipe line, we will say a distribution company, could come in under what we call a 7(a) proceeding. It is under 7(a) of the Natural Gas Act.

"Senator Kerr. Yes.

"Mr. Olds. And ask the Commission to direct the company to make additional deliveries.

"Senator Kerr. Larger production.

"Mr. Olds. Or to deliver to another community, and if the Commission can do that without requiring the pipe line company to build additional capacity, then the Commission may issue such an order.

"Senator Kerr. You have the jurisdiction to do that?

"Mr. Olds. We have the jurisdiction to do that, yes.

. . . . .

"Senator Myers. Both the natural-gas companies and independents are subject to the same rules and regulations?

"Mr. Olds. That is correct. (Tr. 432-438)

Escape Clauses

Commissioner Olds' insistence that, once an independent producer or gatherer has undertaken to deliver gas to an interstate pipe line he has assumed an irrevocable "public utility obligation" making him subject to Commission control, is significant in another respect. Many independent producers 1/ have caused to be inserted in their sales contracts with the interstate pipe lines provisions, known as escape clauses, which would terminate such contracts in the event that the Federal Power Commission were found to have jurisdiction over such independent producers by virtue of such sales. The Commission, moreover,

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1/ Supplemental Hearings before a Subcommittee of the Committee on Interstate and Foreign Commerce, House of Representatives, 81st Cong., 1st sess., on H.R. 79 and H.R. 1758, June 8 and 16, 1949, pp. 353-359.

has issued to certain interstate pipe lines certificates on showings of adequate gas supplies based in substantial part on gas purchase contracts which contain these "escape clauses." Now it is Commissioner Olds' position, however, that such escape clauses are of no effect, according to his testimony at the recent hearing on S. 1498:

"Mr. Olds. Personally I do not think very much of the weight of those escape clauses.

"Senator Kerr. But they are in the contract, and they have been approved by the Commission.

"Mr. Olds. In some instances they are in the contracts.

"Senator Kerr. And in some instances have been approved by the Commission.

"Mr. Olds. We are not approving any contracts; we are approving certificates for the pipe line deliveries of gas.

"Senator Kerr. Based on those contracts.

"Mr. Olds. Because, as far as I am concerned, I do not think that those escape clauses carry any particular weight.

"Senator Kerr. You think that the producer is bound to deliver even though the escape clause is later, by the Commission, declared to be of no effect?

"Mr. Olds. I think that once the delivery starts that that would certainly be the case.

"Senator Kerr. You think once they put that gas into that pipe line they are forever under your jurisdiction?

"Mr. Olds. I think that they are under the present Act, yes, sir. (Tr. 328-329)

Such "escape clauses" affect the supply contracts of at least five major interstate pipe lines which operate or are being constructed on the basis of certificates of public convenience and necessity issued by the Federal Power Commission. In view of the position now taken by Commissioner Olds, on behalf of the Commission majority, regarding the "escape clauses" in such contracts and with respect to the jurisdictional status of all independent producers and gatherers of natural gas, one of two conclusions must follow:

(1) Either the pipe lines in question do not have an adequate gas supply under firm contract which would have justified the issuance of certificates to them, knowing that the "escape clauses" would be invoked upon the assumption of Commission jurisdiction over independent producers and gatherers which a Commission majority now declares its purpose to be, or

(2) Certain members constituting a majority of the Commission deliberately concealed and withheld their real view that the "escape clauses" are of no force and effect anyway, thus deceiving the gas suppliers who were led to believe that the unchallenged contracts with "escape clauses" in them were acceptable as a basis for the recent issuance of certificates to the applicant pipe lines by the Commission.

Neither of these explanations can be characterized as straightforward administration of the Natural Gas Act in good faith by the majority of the Federal Power Commission which has now exposed its real purpose and intentions.

Regulation Based on Cost

Commissioner Olds also made clear the basis on which he would proceed in fixing the prices to be received by independent producers and gatherers for their gas. In his testimony he said:

> "Mr. Olds.... The cost of producing gas in this (Southwest) area, including legitimate exploration and development expenses, delay rentals, and a 6 percent return on investment, and without credit for by-products, is not more than 4 cents per M.c.f."(Tr. 339-340)

The word "legitimate" plainly indicates that Mr. Olds would not only fix such prices for Southwest gas on a cost formula, but that he would intend to pass judgment on the wisdom of expenditures for the exploration and development of gas reserves. There would be no way of knowing what Mr. Olds, with the full advantage and majesty of hindsight, might choose to regard as "proper" or "prudent" with respect to such essentially risky operations.

It may be doubted, however, that producers of gas could expect much compensation for unsuccessful ventures in the determination of "costs" of production to be allowed. Clearly, producers of gas would, under Mr. Olds and those who follow with him, be subject to control but not protected by it.

In this connection Mr. Olds suggested that the independent producer might be better off under regulation:

> "Mr. Olds.... I was going to point out later in relation to the testimony of Mr. Rae before this committee in these hearings where he indicated that he was concerned with respect to the Skelly Oil Company, which had contracted to supply a pipe line with gas at a price which might prove to be less than cost, that he would receive protection by Federal Power Commission regulation because if that proved to be less than cost he could come in and ask for a rate increase and would get a rate increase.
>
> "Senator Kerr. The Commission then would be willing to give the producer what it cost him.
>
> "Mr. Olds. That is correct.
>
> "Senator Kerr. For his gas.
>
> "Mr. Olds. That is correct, yes, sir."(Tr. 303)

Referring later to the same matter, Mr. Olds said:

"It might be pointed out that if a producer selling gas in interstate commerce for resale is not recovering his costs he may be granted an increase by the Federal Power Commission under the Natural Gas Act as presently on the books." (Tr. 516)

Treatment of Exploration Costs

When he was asked whether he thought the Commission would make full allowance for exploratory costs in unproved territory, Mr. Olds significantly qualified his affirmative answer by reference to "improvident" expenditures, as follows:

"Senator Johnson....If I just left my present operations and went to new territory....there is no question in your mind but what the Commission would make full allowance for those exploratory costs?

"Mr. Olds. I think the Commission would. I think the Commission would be in duty bound to keep in touch with the company and advise them as to whether they felt that the expenditures were improvident, but I think basically that as long as those--

"Senator Johnson. Of course, they all thought the expenditures in Texas were improvident.

"Mr. Olds. Yes, sir, if it was along the regular line of activity of the exploratory activity for gas in the oil and gas companies' line, I am sure the Commission would allow for such costs. (Tr. 585)

The first question presented is how Mr. Olds can so assuredly predict just what the Commission might do regarding such matters in the future, especially in view of Mr. Olds' own distinctions between "legitimate" and "improvident" expenditures, as noted above. No one could foretell just how far the Commission in the future would be willing to go in such matters, before it would see fit to exercise the benefit of hindsight and cast out various expenditures as "improvident." It seems most unlikely, however, that a Commission dominated by Mr. Olds' type of thinking would say to producers: "Go ahead and drill and search; if you are unsuccessful in your efforts, we will require the consumers of gas to bail you out." Under Mr. Olds' theories and practices, there would surely be a large element of "heads-I-win; tails-you-lose" in the process of second guessing by Monday morning quarterbacks.

The problems which would confront gas producers in these circumstances were well pointed up in these terms:

> "Senator Johnson. Might they not be afraid that instead of 5 cents they might get 4 or 3 or 2 cents, or perhaps nothing at all?

"Mr. Olds. I would assume that under the present circumstances -- and I am going to give you some instances of what has been said in this record and elsewhere-- that their main interest was that becoming free from regulation they could get higher prices. (Tr. 527)

"Protection" of Producers

On the matter of "protection" to producers, Mr. Olds also made particular reference to the smaller companies, as follows:

"Senator McFarland. Do you think that for the protection of these smaller companies maybe it would be better for them if they would be regulated and would come in under this so that you could make them pay a fair price for this gas?

"Mr. Olds. I think it is a definite consideration. I think you have had testimony by at least one producer, not a very small one, but one producer where he felt that the 4 cents he was getting for his gas was inadequate, and I think that that producer would find it adequate if he were under regulation and could seek a change.

"Senator McFarland. Why did you advocate not bringing that 90 percent (of smaller producers) in?

"Senator Johnson. He is willing to take them all in, but if we are going to compromise, why, we will let 90 per cent of the little ones go. You are not insisting, Mr. Commissioner, that we exempt the 90 per cent, are you?

"Mr. Olds. No, I certainly definitely am not. (Tr. 488)

Notwithstanding this emphatic statement, however, Mr. Olds elsewhere in his testimony took a different position regarding the smaller producers:

"Mr. Olds.... Probably we should find some way of relieving the small producers from regulatory requirements. By rule or statute or otherwise, I personally would be willing to fix a maximum amount of sales in interstate commerce before jurisdiction would attach. (Tr. 498)

Further on in his testimony Mr. Olds came back to the treatment of small producers and, after considerable hesitation, recommended their exemption from regulation:

"Mr. Olds. Earlier in my testimony I stated that I believed it would be feasible and in the public interest to relieve all small producers either by rule or statute from regulation.

"Senator Johnson. And you do so recommend?

"Mr. Olds. I would be glad to furnish the committee with --

"Senator Johnson. Just say yes.

"Mr. Olds. I am not making a recommendation that the Act be amended, but I will be glad to furnish --

"Senator Johnson. Well, you say it would be in the public interest. Why would you not recommend something in the public interest?

"Mr. Olds. I think it can be done under the Act by classification, if the Congress decides that it is best done by regulation.

"Senator Johnson. I am not talking about whether it is done by act or by regulation; I am asking you to submit what you suggest there, and you say it is in the public interest, and I assume you must recommend it if it is in the public interest. You would not recommend something that was not in the public interest.

"Mr. Olds. I think it can be done by statute or rule.

"Senator Johnson. I am not specifying the method by which it can be done; I am just asking you whether you recommend that it be done.

"Mr. Olds. I am recommending that it be done, Yes. (Tr. 506-507)

Treatment of Dry-hole Expenditures

Mr. Olds gave his views on the treatment of dry-hole expenses, including both those made by a producer in his established field and those which he might make in some outside area in searching for additional gas supplies. Again, as in other matters, Mr. Olds undertook to predict what the Commission would do in the future on these matters:

"Senator Johnson. Do you allow a company to charge off its investment in a string of dry holes outside of its established successful field? You either do or you do not.

"Mr. Olds. I do not know whether we have had that specific question presented to us. I think in case --

"Senator Johnson. The answer then is 'I do not know.'

"Mr. Olds. I do not know, without looking it up. (Tr. 512)

....

"Mr. Olds. Mr. Head also stated that my testimony before the House committee concerning the treatment of dry hole cost was untrue unless the Commission had reversed its opinion on that matter during the past month. But Mr. Head did not point to a single instance where the Commission had disallowed the dry hole costs of a natural gas company, nor can he, for his statement is wholly unsupported.

"Senator Johnson. Let me say on that point, that Mr. Head said that you allowed companies to 'expense' dry hole costs incurred in connection with the development of a specific field, but you do not allow investment capitalization of those costs. Now, who is right?

"Mr. Olds. Well, I think-- To my knowledge, the Commission has always allowed the company subject to its regulation, to either 'expense' or in certain instances to capitalize all dry hole costs.

"Senator Johnson. And for the record, you do allow investment capitalization of those costs?

"Mr. Olds. Under certain conditions. After the companies come under our regulation, then the dry hole drilling subsequently is 'expensed' year by year. It is a part of the annual expense, but in cases where there has been a long period prior to the regulation it depends somewhat on how the companies in the past accounted for their drilling, their exploratory drilling.

"Senator Johnson. Now, Mr. Head said that you would not allow dry hole costs for operations outside of a proved field; that you would not permit a company to charge off its investment on a string of dry holes outside its established successful field. Now, is he right on that, or is he wrong?

"Mr. Olds. I think he is wrong on that, Mr. Chairman. It is my knowledge-- To my knowledge that is true. To the extent that we have had situations arise, that is true.

"Senator Johnson. In other words, in his field where he has eight wells, he goes out, leaves Texas, and goes into the State of Oklahoma and drills a dozen dry holes, and then you would allow him to charge off that investment in those dry holes, even though it was not in connection with his established field?

"Mr. Olds. As long as it is a part of his effort to supply a market, that is, to secure gas reserves, to that extent--

"Senator Johnson. I assume that he would not be drilling them unless he was going to supply a market.

"Mr. Olds. That is right. It would be my assumption; you would have to project it ahead somewhat in dealing with independent producers, but if an independent producer were engaged in drilling in several fields, exploratory drilling, presumably he would be drilling for oil as well as gas, but in connection with that it would all appear in the general accounts of the company, as expense associated with exploratory, a regulatory procedure assigned in proportion to the amount of gas that had been discovered.

....

"Senator Johnson. Let us get this clear at this point in the record: No. 1, you do allow investment capitalization of those dry hole costs?

"Mr. Olds. That is right.

"Senator Johnson. The answer is yes.

"Mr. Olds. The answer is: Yes, that is right.

"Senator Johnson. Second, you do permit a company to charge off its investment in a string of dry holes even though that exploratory is outside of its successful field, just as long as they are out looking for gas or drilling for oil and bringing gas; you make that allowance?

"Mr. Olds. That is right.

"Senator Johnson. Your answer to that is "Yes"?

"Mr. Olds. Yes. (Tr. 579-582)

Thus, Mr. Olds wavered between "yes" and "maybe" and between assumptions and certainties in presuming to settle questions which might arise before the Commission in the future if it were attempting to fix the field prices to be allowed independent producers and gatherers. Moreover, Mr. Olds' remarks on this point should be related to his earlier comments, cited above, wherein he sought to distinguish between "legitimate" and "improvident" expenditures by producers.

A further inconsistency bearing on this matter appears where Mr. Olds cited with approval (Tr. 513-514) statements that the successful producers seldom do much wildcat drilling and instead buy from those who bring in the field. Mr. Olds expressed the opinion that this alleged circumstance is of "very material significance" with respect to Commission regulation of the large oil and gas-producing companies. (Tr. 514) Just previously, however, Mr. Olds made the contradictory observation (Tr. 510) that "wildcatting today is done increasingly by big companies covering wide areas able to average their dry holes and production holes in such a way that the romantic wildcatter's risk of all his capital on a wildcat well is no longer characteristic of discovery." It is evident that Mr. Olds varies his testimony depending upon the point he is trying to make at the particular moment.

Mr. Olds' Version of the Investment Return Principle

The foregoing excerpts from Commissioner Olds' testimony also are significant in relation to his explanation of the "investment return principle," which he advocates and which he endeavored to explain and justify. (Tr. 374-387; 572-575) In this connection, Commissioner Olds said that he thought the Commission would continue to allow some return on investment even though all of the producer's costs had been fully recovered prior to a rate proceeding. In support of this position, he cited the *Hope* case, but, as will be shown below, Commissioner Olds did not see fit to disclose fully or accurately what the Commission actually did in that case. The highlights of Commissioner Olds' testimony regarding the "investment return principle," as he views it, are summarized below.

Risks Minimized

The following excerpts from his testimony show that, in Commissioner Olds' view, the fixing of field prices to be received by independent producers and gatherers would be largely a routine matter based on accounting and statistical data relating to past operations:

> "Mr. Olds.... I do not mean to imply that there are no risks in the search for and discovery of oil and gas. But, except for the small wildcatter who goes ahead and drills without the benefit of geological and geophysical studies, such risks are calculable as well as diversified. The discovery cost of oil and gas has been pretty well established through cost accounting and statistical controls. (Tr. 509)
>
> ....
>
> "Furthermore, it brings out the extent to which development of scientific exploration departments has taken the place of hunch and luck, while the application of cost accounting controls where regulation allows all exploration costs, has rendered the discovery, operation of natural gas companies susceptible of regulation on <u>the same principle as is applied to the production properties of an electric utility</u>. (Tr. 510)

<u>Hedged Replies</u>

Commissioner Olds was obviously reluctant to commit himself in specific terms as to how the "investment return principle" would be applied:

> "Senator Kerr. I take it that the Commission would base the reasonableness on whether or not they were getting a reasonable return on their investment?
>
> "Mr. Olds. That is correct.

"Senator Kerr. After the producer had gotten all of his money back and a reasonable rate of return, and a hundred percent profit, then you think it would be reasonable that they would just go ahead and furnish the gas for nothing?

"Mr. Olds. I am going to point out in connection with the Hope case that the Commission has not taken that position.

"Senator Kerr. I know, but they would have the authority to, would they not?

"Mr. Olds. I think not. I think they would not be upheld by the courts in any such position.

"Senator Kerr. How far down do you think they could reduce the price and be upheld by the courts?

"Mr. Olds. I think the whole thing is a question of reasonableness, and that is the question in any regulatory operation.

"Senator Kerr. Let us assume that the producer has gotten all of his money back, and a reasonable rate of return, and one hundred percent profit, and has still got two-thirds of his reserve, and thinks he has a contract whereby he is getting or going to get a certain price for it. Would it not be within the power of the Commission to say, ' Well now, you have gotten all your money back; you have had a good return on it, and you have made a hundred percent profit and, therefore, we are just going to let you furnish the rest of it for nothing."

"Mr. Olds. I do not think so, Senator.

"Senator Kerr. You do not think so. Well now, how low do you think they could go?

"Mr. Olds. I do not think you could establish that in any general terms. I do not think you could determine the rule.

....

"Senator Kerr. It would be a matter up to the Commission, would it not?

"Mr. Olds. It would be up to the Commission, with the further things that the whole thing would be passed upon by the courts.....

"Senator Kerr. Well, you say the court has approved the investment return principle....Is that not your testimony?....

"Mr. Olds. That is correct.

"Senator Kerr. Well, when all of the investment is returned, and a one hundred percent profit, and a good rate of interest for the time, then, what would it be reasonable to pay that producer thereafter?

"Mr. Olds. That I would have to determine in an individual rate case......I think, however, I can say definitely that you would not have a situation exist where there would be a zero rate base.

....

"Senator Kerr. But, you see that you have established the investment return principle.

"Mr. Olds. That is correct.

"Senator Kerr..... Then, out of the experience that you have had, what is the reasonable basis whereby you determine what the producer is paid thereafter?

"Mr. Olds. Again I say that would depend on the individual case....

....

"Senator Kerr. What would be the difference then as between two companies, both of whom had received a one hundred percent return on investment or reasonable return, while receiving it, and a one hundred percent profit? What would differentiate your decision as to what would be a reasonable rate for one of them to receive and what would be a reasonable for another to receive?

"Mr. Olds. Well, the Commission, looking at all the facts in the history and all the elements in the picture of the company, makes their determination as to what a reasonable rate base is.

....

"Senator Johnson....What do you take into consideration where a company has received complete return of its investment?

"Mr. Olds. We take into consideration how it has received that complete return; we take into consideration what it has been charged to; we take into consideration the ownership factor in the thing.

....

"Senator Johnson. But the investment has already been returned. Then, where do we go from there?

"Mr. Olds. I can only talk about specific cases. (Tr. 374-380)

"Depreciated" Rate Base

Finally, after all of this reluctance to describe his conception of how the "investment return principle" might be applied, Mr. Olds suggested that, even though the entire investment in a gas-producing property had already been recovered, a rate base would be determined in accordance with a "proper accumulation of depreciation" calculated on the basis of the remaining unproduced reserves as compared with the past production up to the time of a rate proceeding. His explanation of this procedure follows:

> "Senator McFarland. What general standards do you maintain, then, in regard to the case--the question that has just been put-- of the general standards of a company which has been returned fully its investment, with a reasonable rate of interest thereon?
>
> "Mr. Olds. I should say that in general, in terms of a company that was just coming under regulation, it had not been under regulation, we had not regulated it before, and where their situation had arisen, during the period when it was not subject to regulation, that we would establish what we considered in terms of a proper accumulation of depreciation, a proper accrued depreciation on that property. We take the original cost; we deduct that accrued depreciation, and we give them a return on the remainder.
>
> "Senator Kerr. Suppose all of it had been depreciated, and 100 percent more?

"Mr. Olds. No, I said we would establish what we would consider on a life basis the proper accrued depreciation. We have had many companies, several companies, which have accrued more depreciation than we have actually deducted in arriving at a rate base.

"We have determined that the proper accrual of depreciation, based on the nature of that property--we will say that a property that had an original cost of $20,000,000; we will assume that they had an accumulated amount actually in terms of depreciation $18,000,000. We study that property and determine that a proper accrual, based on the life of that property, was $10,000,000 in the depreciation reserve. That is what the reserve is that they should have had in terms of all the characteristics of the life of that property.

"We deduct that $10,000,000, and give them a return on the other $10,000,000, plus working capital.

"There have been cases where we have allowed pipe line companies where that situation has existed, to transfer an excess accumulation of depreciation into their surplus account, so that it becomes actually property of the investors in the property.

"Now, that is as near as I can come to giving a precise answer to the way we deal with this.... (Tr. 380-382)

The foregoing explanation by Mr. Olds is entirely in terms of depreciation--as shown per books v. what might be regarded as the "proper" amount according to accounting formulas preferred by the Commission. It does not run directly to the basic question of what the procedure would be if the entire investment had been returned from past income, regardless of what the depreciation method might be. Under further questions Mr. Olds continued to elaborate upon his theory of what the Commission's procedure would be, with reference also to situ tions where oil as well as gas might be involved:

> "Senator Johnson....Should the Federal Power Commission be given the opportunity to regulate the sales price of gas in the Richard King Field, under its practice it first would determine the 'prudent investment cost' that should be allowed the property from which the gas is produced, and it would find that the investment cost had been recovered entirely. Now, how would you handle that particular situation?
>
> "Mr. Olds. I would handle that particular situation, I would say, this way: that whatever they had retired in the way of investment through the sale of oil would have nothing to do with the rate base which the Commission had established.
>
> "Senator Johnson. All right. They have retired it all, so you start clean. Now, what we want to find out is if you are given this authority, how it is going to be applied to cases like that.
>
> ....
>
> "Mr. Olds. He would be entitled to a return on his investment, with a proper allocation as between oil and gas; but the fact that out of the sale of oil he had retired his investment in oil wells which also produced gas would not reduce his investment for purposes of a rate base.

....

"Senator Johnson. Can you regulate the gas business without regulating the oil business if the well produces the same things?

"Mr. Olds. I think so, yes, sir....

"Senator Kerr. I appreciate your asking questions, and I would appreciate your asking the question of what his return would be if his investment had been paid back out of the return of gas, and then what it would be.

"Senator Johnson. Let us assume that, for the purpose of the answer, that they had already had their investment returned from the sale of gas. Then, where would we go?

....

"Mr. Olds. At the risk of being criticized by technicians who know it much better than I do, I would say that we would proceed as follows: We would find out when those wells first began to produce gas; we would find out at the present time, currently, what the anticipated further life of those gas wells would be, and how much they would produce in the period; how much they had produced; how much they would produce. In other words, find out how much of the available gas there had been produced out by those wells.

"We would establish in terms of the life of those wells from here beyond the present to the future, what would be a proper accrual of depreciation and depletion; we would deduct that from the total investment. That would be on the assumption that it would be a certain proportion of the retirement of that capital for the full anticipated life.

. . . .

"Senator Kerr. Is that what you call the investment return principle?

"Mr. Olds. Yes, sir, that is the way we apply the investment return principle, and, as I say, we have had similar situations.

"Senator Kerr. Then the statement of the investment return principle, any relationship between that principle and the return of investment, is just purely coincidental.

"Mr. Olds. No, it is related definitely to the characteristics and life of the property.

"Senator Kerr. But, suppose the investment is fully returned, Mr. Commissioner?

"Mr. Olds. I have tried to give you a very precise answer in terms of a situation where that investment has been completely returned.

"Senator Myers. Are there many companies that fall under that category, Mr. Olds?

"Mr. Olds. We have not looked into producing properties. Actually, I am going to point out later in connection with the Hope Natural Gas Company case, they had retired both through using income to do their drilling, and so forth, and their very large accrual of depreciation--they had, to all intents and purposes, had the situation where if you deduct both what they invested out of income and what they invested out of depreciation reserves, you would have had pretty close to a zero rate base, and now the Commission went in there and determined what was a proper accrued depreciation on that property." (Tr. 382-387)

Misrepresentation of Hope Case

Mr. Olds' reference to the Hope case is particularly significant in view of what the Commission actually did in that case, which Mr. Olds did not fully reveal in his testimony. Reference will be made subsequently to the opinion of the U. S. Supreme Court in that case.

Commission Free to Follow its Own Judgment

First, however, it is important to note that in his later testimony, subsequent to the foregoing, Mr. Olds finally agreed that, in fixing the price allowance to be received by gas producers according to the "investment return principle", the Commission would be free to exercise its own judgment, limited only by the "framework established by the courts." His admissions in this regard were stated as follows:

> "Mr. Olds....A somewhat analogeus question was decided by the Commission back in 1942 in the Hope case. That company had recovered almost all of its investment in its production and transmission properties. A perusal of the Commission's decision in that case will make it clear that the Commission did not fix the rate base at the company's unrecovered cost but fixed a rate base some sixteen million dollars higher. In that case the cost had been recovered through the sales of gas and it would be all the more improbable and illegal for the recovery of costs through the sales of oil to be applied to diminish the investment in natural gas facilities.
>
> "Senator Kerr. I would like to ask this question there, Mr. Commissioner. You indicate there

"that even though the recovery had been from gas and almost complete, you indicated the other day that although it had been complete the Commission probably would develop a formula that would give him a return on it based on a situation as though he had not returned his investment. I want to ask you this question: Operating on the investment return basis, as the Commission does, and when the jurisdiction of the Federal Power Commission over the producer of gas thoroughly established as it is, under the Interstate case, and if no legislation is enacted to change that, and the Commission goes forward in the future exercising this jurisdiction, and assuming that the investment rate of return had been approved by the Supreme Court, as you tell us it has, there is nothing to keep a future Commission from changing the basis on which they would let him figure a return? There is nothing to keep a future Commission from limiting him to practically no return for his gas [after] full investment had been restored or recovered by him, is there?

"Mr. Olds. I think the producer under those circumstances would have the protection of the courts if the Commission attempted to deduct from the rate base anything more than a reasonable amount--I mean from the actual early investment anything more than a reasonable amount representing the expired life of the producers' properties, or in other words, the proportion of the total ultimate production which had been produced up to the time that the regulatory activity took place.

"Senator Kerr. There would be nothing to keep the Commission from making an order that would limit his return for his gas to a very low amount after the day had arrived when his entire investment with reasonable return had been recovered, would there?

"Mr. Olds. <u>There would be nothing to stop a Commission from doing probably, or attempting to do, anything, however unreasonable except the fact that the Commissions operate within the framework established by the courts.</u>

"Senator Kerr. As I understand it the court has approved the principle of the investment return base for fixing the price of gas.

"Mr. Olds. <u>The court has done it and left open to the Commission that kind of regulation which produces an end which is practical in terms of the operation of the particular utility business that is involved.</u>

"Senator Kerr. Have they not endorsed the principle of investment return described by you?

"Mr. Olds. I do not think in specific language that they have endorsed that as the only criteria.

"Senator Kerr. Have they endorsed it as a criteria?

"Mr. Olds. They have accepted and recognized it as a criteria in terms of the way in which the Commission has handled specific cases.

"Senator Kerr. <u>Then the amount the producer receives would be up to the judgment of the Commission as either affirmed or changed by the court after his investment had been recovered</u>?

"Mr. Olds. <u>The Commission is free to choose that method of regulation which it thinks is in the public interest, checked by the courts.</u>"
(Tr. 572-575)

In presenting to you the results of my investigation of the record and writings of Leland Olds my purpose was to provide an enlightened basis for you to decide whether he is or is not a fit person to serve as a member of the Federal Power Commission. When I discovered the real nature of his past record, I concluded that it was my duty to assist you in avoiding a repetition of the circumstances which occurred in 1939 and 1944, when no thorough investigation was made prior to his appointment or his confirmation to the Federal Power Commission.

Following my testimony before this Committee on September 28th one of the local newspapers saw fit to refer to my disclosures as a "despicable and preposterous attempt to smear Mr. Olds as a Red because he worked and wrote for labor unions twenty years ago." Both of these statements are untrue. I did not assert that he is or ever was a Communist in the party sense of that term, and it is preposterous to suggest that I criticised Leland Olds because he "wrote for labor unions." Many fine and loyal Americans have done that and are doing it today.

I do not know whether Leland Olds is or is not a member of the Communist party, or whether he has ever been one. It does not seem to me that it makes very much difference, for I think you can better judge this man by what he has said and done and advocated than by any of his associations.

I do know this. His writings clearly reveal that he has embraced and espoused the basic tenets, doctrines and programs of international Communism as proclaimed by the master of them all - Karl Marx. The parallels between the writings of Leland Olds and the Communist Manifesto are clear and unmistakable.

Neither do I regard it as of first importance that many of his writings have appeared in the Daily Worker, although it must be evident that this official organ of the Communist Party would not have filled its space with his material unless it conformed to the party line. The same observation applies to Industrial Solidarity, the official organ of the Industrial Workers of the World (I.W.W.), whose editor enthusiastically applauded the stuff Leland Olds was writing and called for more. But the really significant thing, after all, is that Olds stood for and advocated the ideas and doctrines which I have described and fully documented by his own writings.

The same local paper to which I have previously referred chooses to describe Mr. Olds as "a member of a non-capitalist right," whatever that preposterous exercise in wild semantics is supposed to mean.

It has also been suggested that Leland Olds' writings for the Federated Press represent merely the lusty outcries of a callow youth. Such apologetics are incredible. This is not a man who indulged, for some purpose or other, in a little diversion in the sowing of "ideological wild oats." For an extended period of at least seven years, from 1922 until 1929, he bared the fullness of his views in public writings and agitations. Such writings were by a man of mature years, for in 1929 Leland Olds was almost 40 years of age.

Leland Olds would also have you believe that his purpose was merely to "shock" people, and that he did not really mean to advocate any basic change in the American political and economic system, or in the fundamental institutions which we cherish in this country. In fact, he had the effrontery to declare before this Committee in 1944, when his reappointment was before your body at that time, that he was "not advocating anything" in his writings for the Federated Press. This is an unmitigated falsehood and an effort to conceal from you his real background, as the evidence now in this record plainly shows.

I have submitted to your Committee for consideration exact copies of his writings. They speak for themselves. If there is anything "despicable" surely it must be in the contents of his articles, rather than in the fact they they have now finally been brought to light for you to consider. Is it suggested that the Senate of the United States should not know these things? Why is there so much agitated concern and alarm about these disclosures if they have no real significance? Is there no confidence in the ability of the Senate to distinguish between fact and fiction?

The self-serving contention by Leland Olds that he was only trying to give the American people a shock treatment will not stand examination. Any one who really wants to preserve the American system and see it improved does not advocate the "complete" elimination of the capitalist system, or propose the "discard" of the institution of private property in productive enterprise, or say that the profit system should be "superseded," or urge American workers to engage in "advance preparation" for the introduction of the Russian system as the new world order into our country.

Leland Olds has clearly demonstrated by his own published writings that his real aim is not to improve our American system but to supplant it in conformity with alien philosophies, programs and tactics. He has shown himself to be fundamentally opposed to the American system of private enterprise and to the American way of life.

In this connection I invite your particular attention to certain of his articles which have already been introduced into the record:

(1) Here is one which Leland Olds wrote in 1925 in which he says that the American system of "political democracy based on geographical representation is played out" and in which he applauds Lenin and Mussolini and their wisdom in establishing a different kind of system. In order that you may see that these are not words taken out of context, may I read to you this entire article. (Photostat #13, Federated Press Labor Letter, November 11, 1925, p. 1)

(2) The editor of the Industrial Solidarity, official organ of the Industrial Workers of the World (I.W.W.), in the issue of August 11, 1926, p. 1, enthusiastically urged that "I.W.W. papers

publish just such articles as Leland Olds is writing." In this particular article, Leland Olds suggests that all income should be distributed in wages, in accordance with the slogan contained in the masthead of Industrial Solidarity which reads: "Labor Creates All Wealth - All Wealth Must Go to Labor." (Photostat #21)

(3) Here is another all-out article by Leland Olds appearing in the Federated Press Labor Letter, April 6, 1927, p. 1, in which he asserts that "the problem of attacking capitalist control will have to be met." Referring to the coal industry he argues that "the opposition of the United mine workers to competitive wages can only be made effective through the elimination of competitive private capitalism," and he goes on to conclude that the "miners have two alternatives: To develop, along with the rest of organized labor, political power sufficient to put over nationalization, or to seek control by the workers themselves under a worker government. (Photostat #22)

(4) Under the heading "Property Beware," in the Federated Press Labor Letter, July 28, 1927, p. 1,

Leland Olds suggests that private property in the capitalist sense is headed for the "discard", and he says that "inevitable changes in the economic organizations of society are exposing it as just another myth preached in the interest of a small class seeking to retain power and privilege." (Photostat #29)

(5) In the Federated Press Labor Letter for September 22, 1927, p. 7, Leland Olds deplores what he calls attempts by the capitalist press "to discredit the Russian movement in the eyes of American workers," and he predicts that out of such maneuvers "will come eventually a labor international, international in fact as well as in name."

"The creation of a real international," he continues, "requires not only bringing together what remains of the Amsterdam Int. Federation of Trade Unions with the Red Int. of Labor Unions but also the inclusion of the American Federation of Labor with its Pan-American satellite." (Photostat #35)

(6) Here is another message from Leland Olds in which he predicts dire consequences "unless the profit system is superseded." He was not proposing any moderation of profits thought to be too great. He was suggesting the abolition of profits when he wrote this piece in the Federated Press <u>Labor Letter</u>, April 12, 1928, p. 1. (Photostat #41)

(7) Here is another one on the profit system as such, in which Leland Olds criticizes former President Coolidge for believing that the profit system is "raising society to a higher level than communism." That article appeared in the Federated Press <u>Labor Letter</u>, April 19, 1928, p. 1, when the "boy author" was 37 years of age. (Photostat #42)

(8) On June 14, 1928, in the Federated Press <u>Labor Letter</u> for that date Mr. Olds scored "the popular delusion" that the American political system could any longer be "effective," and he represented that "politicians must perpetuate this idea for their jobs depend on it," but the true view "would reveal the politician government handling certain administrative details for an immensely powerful ruling class." These assertions by Leland Olds, it should be noted, are categorical denunciations of the American system. (Photostat #43)

(9) In the same vein Leland Olds in the Federated Press Labor Letter, July 26, 1928, pp. 1-2, flatly predicted "the complete passing of the old order of capitalism" because it is "outworn." (Photostat #48)

(10) Then on November 1, 1928 in the Federated Press Labor Letter, p. 1, Mr. Olds really got down to business. Among other things he said that the 1928 national elections "must mark the beginning of the end of the democrats if it is to be a forward step for the workers." This article is not very long and I should like to read it to you in its entirety. (Photostat #49)

(11) Once again, paying his respects to private property, Leland Olds in the Federated Press Labor Letter, January 24, 1929, p. 1, stated that owners of property exist only as "a privileged class of parasites whose idleness and dissipation become an increasing stench in the nostrils of the people." (Photostat #50)

It has been my purpose to lay before your Committee the results of my investigation of the record of Leland Olds. For the first time the dark corners of that record have been brought clearly to light before this Committee. So informed, the Senate may or may not want to give its stamp of approval to the philosophies and the methods he has practiced. That is for you to decide. For my own part, I firmly believe that the record of Leland Olds reveals him as utterly unfit to serve on a regulatory body such as the Federal Power Commission which wields great powers over key industries vital to the welfare and safety of our Nation. He is unqualified by his own expressed beliefs and by the kind of tactics which he practices.

It has been suggested by Leland Olds that, even though he admittedly gave public expression to radical and subversive doctrines in former years, his views have since changed. For those who have not witnessed the facile changes of position and the opportunistic twists and turns executed by this devious and versatile man, such pleadings might seem plausible and convincing. As a member of the Federal Power Commission Leland Olds has shown himself to be a spreader of misinformation and a master of evasion, equivocation and indirection in his performances before committees of the Congress as well as in his administrative conduct.

During the unrestrained period of his writings for the Federated Press he was openly committed to destroying and overturning our basic American political and economic institutions to conform them with alien systems which he revered. Now he pleads that he didn't really mean what he said in his categorical denunciations of the American institutions and undertakes instead to present himself in the guise of a "social reformer."

In his testimony here last Wednesday he would have you believe that his categorical denunciations

(1) desecrating the Church as a "handmaiden of the capitalist system,"

(2) sneering at the Fourth of July "as the day set apart by the world's greatest exploiters to glorify their rise to power,"

(3) jeering at the "popular delusion" that the American political system can any longer be "effective,"

(4) exulting in the "decay" and "doom" of the private enterprise system,

(5) predicting "inevitable changes" leading to the "discard" of the institution of private property in productive enterprise,

(6) gloating over the alleged "fatal illness" of the profit system and predicting dire consequences unless it is "superseded,"

(7) advocating a "planned economic order" to displace the "anarchy of competing private capitalists,"

(8) preaching class war,

(9) echoing the communist doctrines of Karl Marx,

(10) praising the Russian system in contrast with our own, and

(11) exhorting American workers to join with Russian unions in international action to abolish capitalism and establish the "coming world order"

should all be regarded simply as statements which "in retrospect have seemed to carry an unfortunate connotation"! This, in reality, is his explanation. Beyond this he merely added that "if I were writing of the same conditions today I would probably use language based on more experience." In short its the same old Olds, the same underlying views dressed up in different language.

In the light of the foregoing, I think it is appropriate and just to say that with respect to Mr. Olds "the past is prologue" and that in recent years he has merely gone underground.

Leland Olds and certain of his supporters have also attempted to picture him as the great defender of the consumers' interests and the public welfare, as the stalwart strong man who fights against insuperable odds to protect our society against evil and harm. Effective regulation will be ended, it is alleged by the modest Mr. Olds, unless he is the one who controls and plans and manages according to his standards.

For such assertions of indispensability I have these answers for your consideration. I am confident that no one will be appointed to the Federal Power Commission or confirmed by the Senate who is not sincerely devoted to the public interest. If, on the other hand, we have reached the point where we must rely upon a man like Leland Olds to safeguard the public interest, we have reached a sorry pass indeed. I, for one, do not believe that it is necessary, and I think it would be extreme folly to continue a man with the record and performance and underlying designs of Leland Olds in a position of public trust and responsibility with great power over industries vital to the security of the United States.

COPY

The Federated Press has been much referred to in connection with these hearings. I therefore feel that such information as is available with respect to some of its present and former personnel should be included in the record.

During the years when Leland Olds was writing his inflammatory articles for the Federated Press he was, and this is a matter of public record, closely associated with Carl Haessler. It is also a matter of public record that Carl Haessler served a term in prison during World War I, the offense being either draft evasion, sedition, or possibly both. Haessler has long been recognized as having Communist affiliations. Nor does it appear that the Federated Press has even today disassociated itself from Communist influences.

During World War II the Washington Bureau of the Federated Press employed Virginia Gardner as a correspondent. She later became Washington editor of the _New Masses_, a Communist Party magazine, thereafter a correspondent for the _Daily Worker_, the official Communist daily mouthpiece in the United States, and, subsequently, a staff member of the _Daily People's World_, a West Coast Communist daily.

She was succeeded in the Washington office of the Federated Press by the present incumbent, Travis Hedrick. Hedrick has registered with the Department of Justice as an employee of the Soviet Embassy in the capacity of editorial assistant on the information bulletin of the USSR. Further, during Olds' editorship of the Federated Press, the Washington representative of the Federated Press was Mr. Lawrence Todd. Mr. Todd today is Washington correspondent of Tass, the official USSR news agency.

X. The "Investment Return Principle" or "Vanishing Rate Base Theory", as Expounded by Commissioners Olds and Buchanan

In their testimony on S. 1498,[1] Commissioners Olds and Buchanan attempted to explain how they would proceed to regulate independent producers and gatherers of natural gas on a "utility" basis of price fixing if they are permitted to give effect to their theories and designs. Such price fixing was proposed despite the fact that the search for and production of natural gas have none of the characteristics of a public utility operation. They advocated the application of a so-called "Investment Return Principle," which, as applied to producers of natural gas, should properly be designated as the Vanishing Rate Base Theory because of the likelihood that the regulatory procedures proposed by them would result in no further return being allowed to producers upon their producing and gathering properties after discovery costs were recovered from sales of gas.

1/ Hearings before a Subcommittee of the Senate Committee on Interstate & Foreign Commerce, U.S. Senate, 81st Cong., 1st sess., on S. 1498, May 17, 18, 24, 26 and 31, and June 7 and 8, 1949.

In simple terms, the "Investment Return Principle" as applied to gas production, which is considered more fully below, would operate essentially as follows: A producer has invested, for example, $1,000,000 in discovering and developing a natural-gas reserve estimated to amount to 50 billion cubic feet. The initial "rate base" consists of this $1,000,000 of costs. Assuming that production from this reserve will continue over a period of 20 years, an annual charge to operations of $50,000 ($1,000,000 x .05) is made to cover depreciation and depletion and this amount is deducted each year from the "rate base" which, therefore, declines in amount at the rate of $50,000 per year. A return of 6 percent is allowed on this declining rate base, which, together with the producer's operating expenses, taxes, etc., determines the total price which he is permitted to charge for his gas. Thus, at the end of 10 years, his "rate base" is reduced in half and his allowed return in this case would then be $30,000 ($500,000 x .06). At the end of the 20-year period, his "rate base" would have disappeared and his allowed return would likewise be reduced to nothing. If the various estimates and assumptions on which this procedure is based turn out to be in error, the producer would receive thereafter nothing for his remaining gas, except his operating expenses in producing it. At no time would such producer be permitted to receive any value for his gas as a commodity; he would be allowed to recover only the "cost" of producing it.

Summary of Their Positions

To summarize their testimony on this and related matters, it is observed that Commissioner Olds or Commissioner Buchanan, or both of them, under questioning by members of the Senate Committee at the hearings on S. 1498, expressed the following views:

1. Advocated the fixing of prices of arm's length sales by independent producers and gatherers on a "utility" basis of calculated "investment return" as measured by costs incurred in the past, with no recognition of the value of gas as a commodity. (pp. 239-244, 321-2).[2/] "We are not talking," said Commissioner Olds, "in regulation about what the commodity is worth. We are talking about regulation, as nearly as possible, on a cost basis." (P. 241)

2/ References are to the printed Hearings on S. 1498, 81st Cong., 1st sess.

2. Opposed any definite grant of authority from the Congress to impose such a novel system of regulation, suggesting that ample authority already exists under the present Act despite conclusive evidence to the contrary in the legislative history (Pp. 201, 212-13, 411, 419).

3. Undertook to prophesy as to what the Commission's procedures in the future would be on matters concerning which the Commission has never had any occasion to take a position. (Pp. 246, 325).

4. Maintained that "utility" regulation according to cost formulas can properly and readily be applied to speculative ventures in exploring for and producing natural gas. (p. 296).

5. Contended that the fixing of field prices to be allowed independent producers and gatherers would be just a matter of determining "discovery cost .... through cost accounting and statistical controls." (p. 296).

6. Asserted that the discovery and production of natural gas are "susceptible of regulation on the same principle as is applied to the production properties of an electric utility." (p. 296). This position was taken despite the basic difference that electric energy is manufactured by man, whereas natural gas is discovered

in nature under speculative and extremely variable conditions, and has a market value bearing no relationship to discovery and production costs.

7. Regarded as unimportant the impracticalities, extreme variables, unpredictable factors and weird results which would be involved in attempting to apply regulation on a cost basis of "investment return" to the risky and uncertain operations required in searching for and producing a resource such as natural gas. (P. 296).

8. Contended that once an independent producer had begun to sell gas in interstate commerce, he could be compelled, regardless of any contract, to continue to furnish such gas indefinitely from his "dedicated" supplies and could not discontinue or diminish deliveries without specific permission from the Commission. (P. 261). In other words, every independent producer selling any gas which subsequently moved in interstate commerce would be a "natural-gas company" subject to all the provisions, requirements and obligations of the Natural Gas Act which apply to the interstate pipe lines.

9. Stated that "escape clauses" in gas supply contracts, under which many independent producers in recent years reserved the right to terminate their contracts in the face of burdens of utility regulation by the Federal Power Commission, "do not carry any particular weight." (P. 220).

10. Suggested that the Commission could require a producer not only to maintain but to increase his deliveries, irrespective of contracts, except perhaps where additional-major expenditures might be involved. (pp. 262-5).

11. Contended that the Commission could, with respect to all gas eventually destined for interstate commerce, revise the price and related terms of any and all contracts, existing and future, for the arm's length sale of natural gas in the fields by independent producers. (p. 224).

12. Suggested that the Commission might see fit to raise some contract prices for gas and to lower others, in accordance with "utility cost" procedures. (Pp.209, 287, 299 and 303).

13. Differentiated between "legitimate" and "improvident" exploratory and "dry-hole" expenditures, indicating that hindsight would be the basis for judgment on such matters, and that some actual bona-fide costs would not be allowed. They failed to suggest any criteria whatever for the classification of these expenditures necessarily made in connection with the unavoidably speculative and hazardous venture of discovering gas. (Pp. 224-5,327).

14. Admitted that "arbitrary" allocations of joint costs, as "purely an accounting matter," would be made between oil and gas operations in the many instances where these two resources are inherently associated in exploration and/or production (Pp. 416-7).

15. Admitted that the Commission could, under the regulations proposed, deny any further return to a gas producer after all of his costs had been recovered and retired from prior operations, although Commissioner Olds suggested that the Commission would not necessarily be so drastic, in all instances, in applying his version of an "investment return principle." (Pp. 241-4,321-2).

16. Suggested that the Commission would vary its methods depending "on the individual case" and the "characteristics of the thing," thus creating additional uncertainty. (P. 240).

17. Concluded, by Commissioner Buchanan, that after a producer had got his investment back according to the "investment return principle," the Commission would, henceforth, allow him only his operating expenses for all the gas which he had left for subsequent production and sale. (Pp. 416-8). Later, however, Commissioner Buchanan endeavored to disavow this view in attempting to reconcile his own testimony with some of the statements made by Commissioner Olds. (P. 421, and supplemental statement submitted by Commissioner Buchanan to the Senate Committee on June 17, 1949, as included with the record of Hearings on S. 1498).

18. Gave the Senate Committee a misleading explanation of the Commission's determinations in the Hope case, the true significance of which Commissioner Olds withheld in citing it to explain his version of the "investment return principle." He failed to point out in his testimony that the Commission in the Hope case ruled out entirely from rate-making consideration $17,000,000 of production properties on the ground that all the costs thereof had been returned from past income, prior to the beginning of regulation. The effect of this prodedure was to apply retroactively regulation according to the "investment return principle." This action of the Commission, moreover, was condoned, though not affirmatively approved, by a majority of the United States Supreme Court; and there were strong dissents on the particular matter in issue here. (See Appendix B, attached hereto)

19. Admitted that, in fixing the prices to be received by independent gas producers according to the "investment return principle", the Commission would be free to use its own judgment, limited only by the "framework established by the courts":

> "Senttor Kerr. There would be nothing to keep the Commission from making an order that would limit his return for his gas to a very low amount after the day had arrived when his entire investment with reasonable return had been recovered, would there?
>
> "Mr. Olds. There would be nothing to stop a Commission from doing probably, or attempting to do, anything, however unreasonable, except the fact that the Commissions operate within the framework established by the courts.

"Senator Kerr. As I understand it the court has approved the principle of the investment return base for fixing the price of gas.

"Mr. Olds. The court has done it and left open to the Commission that kind of regulation which produces an end which is practical in terms of the operation of the particular utility business that is involved.

"Senator Kerr. Have they not endorsed the principle of investment return described by you?

"Mr. Olds. I do not think in specific language that they have endorsed that as the only criteria.

"Senator Kerr. Have they endorsed it as a criteria?

"Mr. Olds. They have accepted it as a criteria in terms of the way in which the Commission has handled specific cases.

"Senator Kerr. Then the amount the producer received whould be up to the judgment of the Commission as either affirmed or changed by the court after his investment had been recovered?

"Mr. Olds. The Commission is free to choose that method of regulation which it thinks is in the public interest, checked by the Courts." (p.322)

It was thus admitted that, under the method of "utility" regulation contemplated and advocated by the Commission majority for application to independent producers and gatherers, the Federal Power Commission would be virtually free to impose its own judgment as to how much a producer would be allowed for his gas. The "Investment Return Principle," as described by Commissioner Olds and Commissioner Buchanan, is synonymous with the Vanishing Rate Base Theory, for after a producer's investment or rate base in a producing property had been fully written off under that theory, he would not be entitled to any further return, other than to cover current operating expenses, on any additional production of gas from such property. Consequently, the application of this theory of regulation to a discovered and non-reproducible resource such as natural gas presents the real prospect of reaching a "zero rate base" and no further return whatever.

More detailed excerpts from and analyses of the testimony of Commissioners Olds and Buchanan on these matters at the hearings on S. 1498 are contained in Appendices A and C, attached hereto. Appendix B also reviews the pertinent facts and circumstances of the Hope case, the true sighificance of which Commissioner Olds misrepresented in his testimony.

<u>Absurdities Resulting from Application of "Investment Return Principle" or "Vanishing Rate Base" to Production and Gathering</u>

It is appropriate to see how such a novel theory of price-fixing for natural gas production, as proposed by a majority of the Federal Power Commission in accordance with their "Investment Return Principle," would actually work out in practice. A few simple illustrations will serve to highlight the absurdities and inconsistencies necessarily inherent in the proposed regulation of arm's length sales by independent producers and gatherers.

<u>Illustration 1.</u> — <u>When two producers have the same discovery cost but one discovers more gas than the other, the price fixed for the gas of one would be higher than for the other.</u>—Each of two gas producers, in the same general area, invests $1,000,000 in searching for and developing natural gas reserves. Producer A comes up with 50 billion cubic feet, but producer B, less successful, finds only 1 billion cubic feet for his efforts and $1,000,000. Under regulation as proposed by Commissioner Olds, producer B would be entitled to get 50 times as much for his gas, as compared with A, simply because it had cost him 50 times as much to find it and get it out of the ground. If not, what criteria, in view of all the many variable and

unpredictable circumstances encountered in such speculative undertakings, would be used under a cost formula of "investment return" to distinguish between "legitimate" and "improvident" explorations?

It thus becomes clear that the basic fallacy of this whole approach lies in its failure to recognize that <u>the value of gas bears no relationship to the cost of finding and producing it</u>. Rather than being "susceptible of regulation on the same principle as is applied to the production properties of an electric utility," the production of gas, because of vastly different conditions, is about the <u>least</u> susceptible to such regulation of any economic activity.

<u>Illustration 2</u>. -- <u>When two producers discover the same amount of gas but one has a higher discovery cost than the other, the price fixed for the gas of one would be higher than for the other</u>.-- As a variation of Illustration 1, above, producers A and B both find 10 billion cubic feet of gas. However, while A found his at 3,000 feet drilling through generally soft formations, neighboring producer B had to drill to 6,000 feet, much of it through hard rock and difficult water conditions. Moreover, B's gas was found to be highly sulphurous or "sour." Because

of these, or perhaps still other, differences in producing conditions B spent $3,000,000 to develop his gas property, whereas A's total outlay was only $1,000,000. Because of the more difficult conditions encountered, B's operating costs also proved to be correspondingly higher than A's.

According to the "investment return principle" as expounded by Commissioner Olds and Commissioner Buchanan, producer B would be entitled to get 3 times as much for the same amount of gas as A is allowed -- if, that is, B could find a purchaser of his gas on such terms. Indeed, some interstate pipe line already connected to B's other wells might well be required to take his high-cost gas on the theory of "dedicated supplies" which Commissioner Olds has advanced.

Illustration 3. "Dry-hole" costs in unproven areas may not be recouped. --In this case, producer A, with an active but depleting producing property subject to price fixing on the "investment return principle," decides to explore elsewhere for additional gas supplies. Not regarding his established area as sufficiently promising for further drilling, he conducts such explorations in a new and distant area which, from preliminary geological examinations, seems more favorable.

Several wells are drilled in this unproven area -- all of them "dry holes" -- at a total outlay of $500,000. The question then would be whether, under the "investment return principle," gas consumers supplied from the established producing property could properly be expected to defray the costs of conducting unsuccessful explorations in a different part of the country wholly unrelated to established operations and which would not, in any case, have benefited those particular consumers. It would be hard to justify such a practice. Yet, the producer would have no other opportunity to recoup such losses, since the returns on his successful operations would have been limited to a 6 percent return on a progressively declining or vanishing rate base.

Illustration 4. -- Practical affect may be to force producer to give his gas away.--Producer A, subject to the "investment return principle," invests $1,000,000 in developing a gas reserve estimated to amount to 50 billion cubic feet. For price-fixing purposes, the regulatory body further estimates that this gas will be produced over a 10-year period and production proceeds according to this anticipated schedule. Each year within that period, the producer is permitted to charge off $100,000 as depletion or depreciation, and the "rate base" is reduced accordingly in determining the amount on which a return of 6 percent may be earned. (To simplify the illustration it is assumed that production is at a constant volume throughout the 10-year period.)

By the sixth year, the depreciated original investment or "rate base" has been reduced to $500,000, on which the allowed return at 6 percent would be $30,000. Spread over his 5 billion cubic feet of gas production in that year, this return would amount to 6 mills ($.006) per thousand cubic feet (M.C.F.). The producer would be allowed this amount, plus his current operating expenses, taxes, etc., but he would receive nothing for the value of his gas as a commodity.

At the end of 10 years the bookkeeping process is completed -- the investment has all been charged to past operations and the rate base has been reduced to zero. The trim mathematics of this procedure would all work out to perfection, provided, that is, the initial estimates and precise calculations are really borne out by what actually happens. In the gas-producing business, however, unlike a "utility operation", such neat results are highly improbable.

(A) <u>If estimate of gas reserve is too low remaining gas would have to be given away when total cost has been recovered but gas still remains</u>. -- If the producer finds, as the end of the tenth year approaches, that he still has a reserve of gas remaining, perhaps 3 or 4 billion cubic feet, adherence to the "investment return principle" would require that he furnish his remaining gas free of any charge, except for operating expenses. There would be no further return on investment because it has already been completely charged to and recovered from past operations.

(B) <u>If estimate of gas reserve is too high and the gas is depleted before total cost is recovered the unrecovered capital is a total loss to the producer</u>. -- The opposite turn of events may likewise happen. Instead of producing on a 10-year basis, as assumed for price-fixing purposes, the producer finds his gas supply exhausted, by virtue of conditions which could not have been predicted, after having produced only 5 billion cubic feet in 5 years. Only half of his original investment has been retired. The other half is lost, for there is no opportunity for its recovery. His gas is gone.

Thus, if the producer's reserve turns out to have been underestimated, he faces the prospect of giving his remaining gas away, except for operating expenses, after the assumed investment-life-period has ended. On the other hand, if the reserve turns out to have been overestimated in the price-fixing process based on the "investment return principle", part of his investment will never be recovered because his gas supply has been exhausted before the regulatory formula has run its methodical course.

<u>Illustration 5. If total cost has been recovered prior to regulation by F.P.C. and producer still has gas he may have no "rate base" and may have to give away his remaining gas when F.P.C. regulation is imposed.</u> -- In this instance, producer A had invested $1,000,000 in his gas-producing property, all of which had been fully recovered from past operations and income prior to the advent of regulation. Then, in a rate proceeding it is found that the producer still has half of his original reserve of 50 billion cubic feet remaining for future production and sale.

In such a case, Commissioners Olds and Buchanan suggested that a departure from the "investment return principle" might be made, so that the producer would be permitted to start over again with one-half of his original investment in the "rate base", or $500,000. This is, however, not the procedure that was adopted in the Hope case. There, with the tacit approval of a majority of the U.S. Supreme Court, the Federal Power Commission ruled out entirely from rate consideration $17,000,000 of gas-producing properties on the ground that this whole amount had been recovered from past income prior to regulation. (See Appendix B, attached hereto.)

Illustration 6. When gas and oil are produced from same wells, oil production may be required to subsidize gas. -- A further complication is presented in all the many cases where oil and gas are produced together in a joint operation. Under such conditions, extremely complex questions of cost allocation would be involved in applying the "investment return principle". Commissioner Buchanan suggested that such allocations would be "arbitrarily" made "as an accounting matter," but he offered no solution for the problem. How would a price-fixing Commission go about the assignment of part of the joint costs to gas, for example, in a situation where a producer, having spent $5,000,000, developed reserves of 25 billion cubic feet of gas and 5 million barrels of oil in the same underground structure? Would the natural-gas production be considered as an incidental by-product for cost allocation purposes? No one could predict what might be done under such conditions. There would be many opportunities for a Commission, concerned primarily with reducing gas prices to a minimum, to load the joint costs heavily on the oil operations and to favor gas. The net result of this would be that consumers of oil products would be required to subsidize consumers of natural gas.

Illustration 7. Price disparity is created between gas sold for interstate transmission and gas sold for intrastate use. -- One further example will emphasize the essentially different conditions applying to interstate and intrastate gas. Producers A and B operate gas-producing properties side by side. Producer A, having contracted to sell his gas to an interstate pipe line, becomes subject to price fixing according to the "investment return principle". As time goes on, his rate base and allowed return decline, so that he is required to deliver his gas to the interstate pipe line first at 4 cents, then 3 cents, and later (when his rate base has all but disappeared) for perhaps 2 cents to cover only his operating expenses. Meanwhile, producer B sells his gas for consumption in an intrastate market at 5, 6, or 7 cents.

The absurd result is that gas which might continue to move into interstate markets would be "priced" by the Commission at only a fraction of the price paid by local intrastate consumers for the same kind of gas produced in the same field or area.

Under these circumstances, it is likewise evident that independent gas producers would avoid further contracts for the sale of gas in interstate markets, wherever other market outlets were available or in prospect. As the consequences of price fixing for interstate gas in conformity with the "investment return principle" and "vanishing rate base" became evident, only the very high-cost gas producers, such as producer B in Illustration 1, above, would continue to contract for the sale of gas for transportation to interstate markets.

The foregoing analysis of the "investment return principle" advocated by the Commission majority recalls the pertinent observation made by Justice Jackson in his dissent in the Hope case:

> "The case before us demonstrates the lack of rational relationship between conventional rate-base formulas and natural gas production and the extremities to which regulating bodies are brought by the effort to rationalize them." (320 U.S. 591, 645 (1944)).

APPENDIX B

The Decision of the U. S. Supreme Court in the Hope Case

In view of Commissioner Olds' advocacy of the "Investment Return Principle" which would result in a Vanishing Rate Base for the independent gas producers; his admission that the Commission, limited only by the tolerance of the courts, would be free to do as it pleased in fixing prices for gas coming from producing properties whose costs had already been recovered from past income; his emphasis upon the *Hope* case as support for his assertions, conclusions and predictions as to what the Commission might do in the indefinite future; and his inaccurate and deceptive statements to the Senate Committee in hearings on H. R. 1498, it is significant to see just what the Commission really did in that case and what the Supreme Court had to say about it.

The following excerpts from the U. S. Supreme Court decision in that case (320 U.S. 591, January 3, 1944), and particularly the dissenting opinions of Justice Reed and Justice Jackson, clearly disclose that *the Commission ruled out completely $17,000,000 of past expenditures in production properties on the ground that the costs thereof had been fully recovered from income by charges to operating* expenses prior to the inception of regulation. On the other hand, the Commission did, as mentioned by Mr. Olds, permit the retention of certain investment outlays on which the Commission considered that "excess" depreciation had previously been charged. In other words, the Commission let past accounting practice, as between charges to capital account and to operating expenses, govern its disposition of the amounts involved; and the Court declined to interfere with the Commission's inconsistent procedures in this matter.

The pertinent passages from the majority decision of the Supreme Court in the Hope case are:

> "Hope's estimate of original cost was about $69,735,000-- approximately $17,000,000 more than the amount found by the Commission. The item of $17,000,000 was made up largely of expenditures which prior to December 31, 1938, were charged to operating expenses. Chief among those expenditures was some $12,600,000 expended in well-drilling prior to 1923. Most of that sum was expended by Hope for labor, use of drilling-rigs, hauling, and similar costs of well-drilling. Prior to 1923 Hope followed the general practice of the natural gas industry and charged the cost of drilling wells to operating expenses. Hope continued that practice until the Public Service Commission of West Virginia in 1923 required it to capitalize such expenditures, as does the Commission under its present Uniform System of Accounts. The Commission refused to add such items to the rate base stating that 'No greater injustice to consumers could be done than to allow items as operating expenses and at a later date include them in the rate base, thereby placing multiple charges against the consumers.' For the same reason the Commission excluded from the rate base about

"$1,600,000 of expenditures on properties which Hope acquired from other utilities, the latter having charged those payments to operating expenses. The Commission disallowed certain other overhead items amounting to over $3,000,000 which also had been previously charged to operating expenses. And it refused to add some $632,000 as interest during construction since no interest was in fact paid. (pp. 598-599)

....

"The Circuit Court of Appeals set aside the order of the Commission for the following reasons ....It concluded that the well-drilling costs and overhead items in the amount of some $17,000,000 should have been included in the rate base. (pp. 599-600)

....

"If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important. (p. 602)

....

"In view of this disposition of the controversy we need not stop to inquire whether the failure of the Commission to add the $17,000,000 of well-drilling and other costs to the rate base was consistent with the prudent investment theory as developed and applied in particular cases. (p. 605)

The dissenting opinion of Justice Reed goes directly to the matter of the treatment given to past expenditures for production facilities already recovered from past income, in these clear terms:

> "<u>But a major error, I think, was committed in the disregard by the Commission of the investment in exploratory operations and other recognized capital costs. These were not considered by the Commission because they were charged to operating expenses by the company at a time when it was unregulated. Congress did not direct the Commission in rate making to deduct from the rate base capital investment which had been recovered during the unregulated period through excess earnings. In my view this part of the investment should no more have been disregarded in the rate base than any other capital investment which previously had been recovered and paid out in dividends or placed in surplus. Even if prudent investment throughout the life of the property is accepted as the formula for figuring the rate base, it seems to me illogical to throw out the admittedly prudent cost of part of the property because the earnings in the unregulated period had been sufficient to return the prudent cost to the investors over and above a reasonable return. What would the answer be under the theory of the Commission and the Court, if the only prudent investment in this utility had been the seventeen million capital charges which are now disallowed</u>? (p. 624)

Justice Jackson's dissent is no less cogent with respect to the matter at issue here:

> "The Commission contends nevertheless that the 'all important' formula for finding a rate base is that of prudent investment. But it excluded from the investment base an amount actuqlly and admittedly invested of some $17,000,000. It did so because it says that the Company recouped these expenditures from customers before the days of regulation from earnings above a fair return. But it would not apply all of such 'excess earnings' to reduce the rate base as one of the Commissioners suggested. The reason for applying excess earnings to reduce the investment base roughly from $69,000,000 to $52,000,000 but refusing to apply them to reduce it from that to some $18,000,000 is not found in a difference in the character of the earnings or in

"their reinvestment. The reason assigned is a difference in bookkeeping treatment many years before the Company was subject to regulation. The $17,000,000, reinvested chiefly in well drilling, was treated on the books as expense. (The Commission now requires that drilling costs be carried to capital account.) The allowed rate base thus actually was determined by the Company's bookkeeping, not its investment. This attributes a significance to formal classification in account keeping that seems inconsistent with rational rate regulation. Of course, the Commission would not and should not allow a rate base to be inflated by bookkeeping which had improperly capitalized expenses. I have doubts about resting public regulation upon any rule that is to be used or not depending on which side it favors." (pp. 643-644)

It is clear that Mr. Olds misrepresented the circumstances and implications of the Hope case, while at the same time he sought to invoke it in support of his advocacy of the "investment return principle" in his testimony before the Senate Subcommittee.

APPENDIX C

Views of Commissioner Thomas Buchanan on the "Investment Return Principle" and Related Matters, as Given in his Testimony at Hearings on S. 1498, June 7, 1949

At the hearings on S. 1498[1/] Commissioner Buchanan appeared for questioning as to his views on the regulation of independent producers and gatherers of natural gas. The essential portions of his testimony, particularly with respect to his exposition of the Investment Return Principle or Vanishing Rate Base Theory, are summarized below. Reference also is made to the Supplemental Statement which he submitted to the Senate Committee on June 17, 1949, in an effort to amend his testimony.

Regulation on Basis of Cost of Production, Under Present Act

Commissioner Buchanan strongly advocated the regulation of independent producers and gatherers on a cost of production basis, under what he regards as clear authority under the present Natural Gas Act. With much evidence of confusion, he gave his interpretation of the "investment return principle" and how it would be applied. He also

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1/ Hearings before a Subcommittee of the Committee on Interstate and Foreign Commerce, U. S. Senate, 81st Cong., 1st sess., on S. 1498, May 17, 18, 24, 26 and 31, and June 7 and 8, 1949.

expressed his view that Order No. 139, under which the Commission has exempted independent producers and gatherers, is a complete nullity.

As to the scope of the present Act, Commissioner Buchanan took the following position:

> "Senator Johnson. Do you agree with Commissioner Olds or Commissioner Draper on whether we should have positive legislation, or in the absence of any legislation, the Commission should go ahead and act?
>
> "Mr. Buchanan. I think the law is very clear as it is. Any doubt that was to be found in what was meant by the Act was clarified by the Supreme Court in the Interstate decision. (Tr. 750)
>
> . . . . .
>
> "Senator Johnson.....You do not agree that that would be wise policy to amend the Act to exclude independents from the control of the Commission?
>
> "Mr. Buchanan. Well, of course, the wisdom is a matter for you. My opinion is that it should not be amended.
>
> "Senator Johnson. To exclude them?
>
> "Mr. Buchanan. To exclude them.
>
> "Senator Johnson. But it should be amended to make it clear that they are included?
>
> "Mr. Buchanan. No, I think that is clear now.
>
> "Senator Johnson. Well, I thought you just stated that you thought amendment would be wise to make it definitely sure and certain.
>
> "Mr. Buchanan. Oh, no; I think this Act is perfectly clear now." (Tr. 769)

Immediately before that, however, Mr. Buchanan had taken the opposite position:

"Senator Johnson. Do you think the Act probably ought to be amended but not to exclude independents, but to make it clear that they are covered?

"Mr. Buchanan. That is right. You will have to amend Section 1(a), if you are going to do the thing properly, because that is the public interest that was found in 1938." (Tr. 768-769)

On the rule adopted in August 1947 by the Commission in Order No. 139, Mr. Buchanan gave the following opinion:

"Senator Johnson. You were not a member of the Commission when Order 139 was written?

"Mr. Buchanan. No, but I have definite opinions of 139.

"Senator Johnson. What are they?

"Mr. Buchanan. I do not think it means a thing, Senator. I think 139 is a complete nullity. I do not think it deceived anybody." (Tr. 750)

In the following testimony Mr. Buchanan made it clear that he would favor regulating gas producers on the basis of "cost of production":

"Senator Kerr. What is the basis that the Commission uses in determining what price to fix for that gas sold by the producer?

"Mr. Buchanan. It would be on the basis of the cost of production.

"Senator Kerr. On the basis of the cost of production?

"Mr. Buchanan. Plus a return on the investment, and the capital necessary." (Tr. 755)

Mr. Buchanan on the "Investment Return Principle"

Mr. Buchanan attempted to expound his view as to how the "investment return principle" would be applied to independent producers and gatherers, particularly as to how price would be fixed by the Commission after the producer's investment had been fully returned. He repeatedly took the position that there could be no problem in that regard because the producer "should" be out of gas when his cost had been fully returned. His confused views and contradictory statements in this matter are noted below:

> "Senator Kerr. When it gets all of its money back, then what price would the Commissioner set for that company?
>
> "Mr. Buchanan. I do not think that would be possible.
>
> . . . . .
>
> "Senator Kerr.....Now, when he has got all of his money back, plus $6\frac{1}{2}$ per cent, then what will the Commission let him receive?
>
> "Mr. Buchanan. At that stage I would say that he ought to be out of gas.
>
> "Senator Kerr. Well, suppose he is not; suppose that the actuality is beyond the omnipotence of your Commission to predetermine, and something happens which you did not expect. That is in the realm of possibility, is it not, Commissioner?
>
> "Mr. Buchanan. I do not know, Senator. You are way beyond me.
>
> . . . . .

"Senator Kerr. You do not think that you could contemplate the possibility of his having gotten his money back, plus a reasonable rate of return?

"Mr. Buchanan. And still have a lot of gas left?

"Senator Kerr. Yes.

"Mr. Buchanan. No.

"Senator Kerr. Or suppose he had a little left, would that be possible?

"Mr. Buchanan. He would still be earning on it.

"Senator Kerr. Would that be possible?

"Mr. Buchanan. It could be, yes.

"Senator Kerr. Then at that time what basis would you use in determining what he would receive?

"Mr. Buchanan. Exactly the same basis as before.

"Senator Kerr. Although he had gotten his money back?

"Mr. Buchanan. No, but you said he had not gotten his money back.

"Senator Kerr. Oh, yes, I said he had gotten his money back, and still had a little gas left. Let us suppose he had got all of his money back, plus 6½ per cent.

"Mr. Buchanan. I do not think the quantity of gas left would be worthy of mention.

. . . . .

"Senator Reed.....Mr. Buchanan, I have a case exactly in point where a gas utility has had its fair return, has depreciated its property clear around, and yet it has a very substantial amount of gas left.

"Senator Kerr. From the same reserves.

"Senator Reed. From the same reserves. Now, I think it is a very fair question.

"Mr. Buchanan. Perhaps you can answer it, Senator Reed; I have never had that experience.

"Senator Reed. If you cannot answer it, that is all right.

"Senator Kerr. You cannot answer it, then?

"Mr. Buchanan. I cannot conceive of such a thing.

"Senator Kerr. You cannot conceive of such a possibility of your Commission's not being able to know 50 years ahead how much gas an area is going to eventually produce?

"Mr. Buchanan. No, I do not think the Commission can figure that at all.

"Senator Kerr. What do you mean they cannot figure? You do not think they can figure how much it will?

"Mr. Buchanan. They make estimates, but perhaps I do not understand your question, Senator.....

"Senator Kerr. Well, I happen to know fields that have produced for 50 years and are still producing.....

"Mr. Buchanan. I think I can recall some myself.

. . . . .

"Senator Kerr. I now ask you if it is possible that your engineers or your Commission would make a mistake.

. . . . .

"Mr. Buchanan. Oh, yes, we all make mistakes, Senator.

"Senator Kerr. Then, they could make a mistake?

"Mr. Buchanan. Yes.

"Senator Kerr. And the man might not get his money back and his reserve be gone, is that possible?

"Mr. Buchanan. That is possible, yes.

"Senator Kerr. Then, is it possible that he might have his money back and still have part of his reserve?

"Mr. Buchanan. Granting the original mistake, yes.

"Senator Kerr. You think that is possible?

"Mr. Buchanan. Yes.

"Senator Kerr. If then the matter were brought before you, what would be the basis that you would use to determine what he would get for his gas thereafter?

"Mr. Buchanan. I would not know, sir.

"Senator Kerr. You have not the remotest idea?

"Mr. Buchanan. I have not the slightest idea." (Tr. 755-761)

Allowance of Operating Expenses Only, After Full Investment Recovered

After the foregoing testimony, which pointed in various directions, Mr. Buchanan finally arrived at the conclusion that a gas producer who had already received a full return of his investment in production properties would thereafter be allowed his operating expenses but no return, in producing additional volumes of gas from the same reserves. His testimony at this point also refers to the matter of allocating costs between gas and oil operations where the two are jointly conducted, with Mr. Buchanan observing that such allocations would be "arbitrary":

"Senator Kerr. What would be the natural result, following your principle that you say you operate under, of getting his money back, plus a reasonable rate of return?

"Mr. Buchanan. He would get at least his operating costs, and a return on his capital.

"Senator Kerr. But he has already got his capital back.

"Mr. Buchanan. His working capital. He would get his operating cost, and a return on his operating capital, working capital.

"Senator Kerr. In other words, then, all that you would be in position to allow him would be his operating costs, would it not, Commissioner?

"Mr. Buchanan. Well, it could be. Granting the original mistake. I do not think the original mistake would happen.

"Senator Kerr. Sir? Well, you said that it could happen.

"Mr. Buchanan. I think that you could -- that is right.

"Senator Kerr. You said that we all make mistakes, did you not?

"Mr. Buchanan. Yes.

"Senator Kerr. And you grant the possibility that even the Federal Power Commission could make a mistake?

"Mr. Buchanan. Oh, yes. It definitely has made mistakes.

"Senator Kerr. All right. Then it wakes up here one day, in the face of the reality, which proves that it was mistaken, and the only thing that you could do would be to actually allow him the operating expense, would you not?

"Mr. Buchanan. That is right.

"Senator Kerr. Now, then, let us say that he is getting his gas from a well that produces oil along with it; and suppose that in a matter of a year he gets the entire investment back from his oil production. Then, what are you going to allow him for his gas?

"Mr. Buchanan. That would not affect the gas at all, not the slightest.

"Senator Kerr. What formula would you use in determining what he would be entitled to?

"Mr. Buchanan. I do not know, Senator; that is purely an accounting matter, and we have--

"Senator Reed. I do not think that you as a member of the Commission.....ought to say that it is purely an accounting matter.

. . . . .

"Senator Kerr. Who determines the matter of allocation?

"Mr. Buchanan. Fundamentally we are advised by our technical staff.

"Senator Kerr. Who determines it?

"Mr. Buchanan. We determine the policy.

. . . . .

"Senator Kerr. Suppose a well came in making an average of a hundred barrels a day allowable of oil, and allowable of 5 million feet a day of gas?

"Mr. Buchanan. Well, I think, Senator Reed will agree that nobody can give you an answer to that statement.

"Senator Kerr. Suppose you fix the specifications to one that you can answer.

"Mr. Buchanan. It would depend entirely -- the values would be allocated entirely upon the costs of producing the two elements, natural gas or the oil.

"Senator Kerr. Well, suppose that the natural gas flowed and brought the oil out with it?

"Mr. Buchanan. Well, it does that; it does that.

"Senator Kerr. Then, how would you allocate it?

"Mr. Buchanan. Still it would be on the basis of the costs of the two.

"Senator Kerr. Suppose it did not cost anything to produce it? Suppose all a man had to do was to just turn a valve, and here it comes.

"Mr. Buchanan. I think that at the wellhead, if that is what you are talking about--

"Senator Kerr. That is where you regulated the price, is it not ?

"Mr. Buchanan. I think that the allocation would be on the actual investment in the well at that time.

"Senator Kerr. Suppose the investment was $100,000.

"Mr. Buchanan. It would be on the basis then of the amount of gas produced as opposed to the amount of oil produced.

"Senator Kerr. Then, what you would do, you would arbitrarily determine what part of the investment you thought should be returned out of gas.

"Mr. Buchanan. Oh, I think it would be an artibrary decision in the end, yes." (Tr. 761-764)

Once again, Mr. Buchanan repeated his conclusion that after a gas producer's investment had been fully recovered he would be allowed only his operating expenses:

"Senator Kerr. But having gotten that part of his investment back, which your Commission in its wisdom or lack of wisdom fixes as being the investment for that gas production, plus a reasonable return, thereafter all that your Commission could allow him under the basis of your formula would be his operating costs.

"Mr. Buchanan. No, no. He would be entitled -- you are supposing now that the cost of the well has been returned?

"Senator Kerr. I am supposing that the cost of that part of it allocated to gas has been returned from gas production.

"Mr. Buchanan. I still insist upon the position that just does not happen.

"Senator Kerr. But you did admit the possibility that it might happen?

"Mr. Buchanan. Oh, yes.

"Senator Kerr. And in that event the only thing that you now can say he would receive would be his cost of operation?

"Mr. Buchanan. If that did not happen, yes." (Tr. 765)

Reversal of Position to Agree with Commissioner Olds

Subsequently Mr. Buchanan reversed his field, agreeing that a gas producer who had already recovered his full investment would be allowed more than simply operating expenses thereafter. Mr. Olds' testimony on this subject having been read back to him (Tr. 772-775), Mr. Buchanan said he agreed with it "absolutely ":

"Senator Myers.....Do you agree with Mr. Olds' views on that particular subject?

"Mr. Buchanan. I think that was absolutely correct. It is much better expressed than I could express it.

"Senator Kerr. You are not telling me that you did not mean what you said a while ago in answer to my question?

"Mr. Buchanan. I think we agree.

"Senator Kerr. But I say, regardless of whether they agree or disagree, you were honest in what you said to me a while ago?

"Mr. Buchanan. Absolutely.

"Senator Kerr. And you knew what you were saying?.....

"Mr. Buchanan. Yes, absolutely.

"Senator Kerr. Sir?

"Mr. Buchanan. Yes.

"Senator Kerr. You did?

"Mr. Buchanan. Yes.

"Senator Kerr. That is all.

"Mr. Buchanan. I think that they both mean the same thing.

"Senator Kerr. Well, whether they do or not, you understood my question and were honest in your answer?

"Mr. Buchanan. That is right." (Tr. 775-776)

Supplemental Statement by Commissioner Buchanan

After the conclusion of the Senate Subcommittee hearings on S. 1498, Mr. Buchanan on June 17, 1949 submitted to the Committee a supplemental statement regarding his testimony. In this statement, among other matters referred to, he repudiated his hearing testimony, as cited above, that only operating expenses would be allowed a gas producer after he had recovered his full investment. This supplemental statement is evidently intended to accommodate his position to that taken by Commissioner Olds in his expressions on the same subject. As noted previously, however, this latter position is directly contrary to the action taken by the Commission in the Hope case, where it ruled out entirely $17,000,000 of past expenditures in gas-producing facilities on the ground that their costs had been fully recovered from past income. (See Appendix B, above.)

Mr. Buchanan's remarks in his supplemental statement on the subject of the investment return principle are as follows:

> "The question of the so-called "vanishing rate base" under the Commission's method of rate regulation was raised by Senator Kerr. The answer to that question is very simple. Even though the producer's entire investment in leases, wells, gathering lines, etc., has been returned to him out of income prior to the assertion of jurisdiction by the Commission over his sales of

natural gas in interstate commerce, nevertheless, when jurisdiction is taken by the Commission an appraisal of the situation is made as of that date. The amount for depletion to be deducted from the producer's original investment in the project is determined by taking the ratio of the gas already produced to the total estimated gas reserves of the producer in the field or fields. For example, if the producer had originally made an investment of $1,000,000 and had produced to the date of the Commission's investigation ¼ of his gas it would be considered for the purpose of rate regulation that he had recovered ¼ of his investment or $250,000. The past would be forgotten and he would be given a fresh start. From then on, the return annually of a portion of his original investment would be upon a depletion basis which would take into consideration his production for the year, the reserves of gas yet remaining to be produced and his unrecovered investment as previously determined. The remaining reserves are recomputed each year, therefore, as was testified by me at the hearings, the situation described by Senator Kerr as a 'mistake,' and the illustration given by Senator Reed could not possibly happen under regulation. In my experience I have never encountered a zero rate base nor have I ever discovered where any regulatory commission had ever used or suggested using a zero rate base."

The foregoing contentions by Commissioner Buchanan, in which he attempts to deny that application of the "Investment Return Principle" to gas production by independent producers would result in a Vanishing Rate Base, are fallacious and misleading for the following reasons, among others:

1. The exact answer to Commissioner Buchanan's attempted denial is given in the dissenting opinion of Justice Reed in the Hope case, with reference to the $17,000,000 which

the Commission had excluded completely, wherein he asked: "What would the answer be under the theory of the Commission and the Court, if the only prudent investment in this utility had been the seventeen million capital charges which are now disallowed?" (See Appendix B, above) The result would, unquestionably, be a zero rate base and, therefore, no further return whatever to the producer for his gas.

2. This would also be the result of the procedure which Commissioner Buchanan recommended in his testimony before the Senate Subcommittee on June 7, 1949, where he repeatedly said that, after a gas producer had fully recovered his investment, any further allowance to him under "utility" regulation would be limited to a coverage of of his operating expenses only, with no recognition whatever of a return or of any value for his gas.

3. Commissioner Buchanan cannot possibly give any reliable assurance that this practice, which is the very essence of the "investment return principle" advocated by the Commission majority, would not be adopted by the Commission in the future. Commissioner Olds admitted in his testimony that the Commission would be free to do as it pleased, except as it might perhaps be checked by the

courts. But a majority of the U. S. Supreme Court in the _Hope_ case did permit the Commission to rule out completely from rate-making consideration $17,000,000 of producing properties -- thus giving effect to the Vanishing Rate Base Theory in that particular case.

4. The most that Commissioner Buchanan actually says in his Supplemental Statement is that, in his opinion, a gas producer's return received "prior to the assertion of jurisdiction" would not be confiscated by retroactive regulation. But the Commission did just that in the _Hope_ case.

5. Furthermore, Commissioner Buchanan avoids any reference to a gas-producing property which _is subject from the beginning of its operation_ to "utility" regulation in accordance with the "investment return principle." Under that theory and procedure, no further return could consistently be allowed after the investment had been entirely written off against past regulated operations, no matter how much gas such producer had left for subsequent production and sale. The rate base would be a flat "zero" with respect to such property or properties, and the

producer, consistent with the Vanishing Rate Base Theory, would be required henceforth to give his gas away, except for the current operating expense of producing it. There is no other possible answer consistent with the "investment return principle" of regulation advocated by the Commission majority.

5. Commissioner Buchanan persists in his Supplemental Statement as he did in his testimony, in contending that the Commission could not make a "mistake" in the future projections necessarily involved in applying the "investment return principle" to gas production. Anyway, he says, corrections and adjustments with respect to reserves and depletion would be "recomputed each year." This is false and misleading, for it would be obviously impossible for the Commission to conduct a rate or price-fixing proceeding for each producer each year, or anything approaching that frequency. Even in its regulation of the interstate pipe lines, relatively small in number, the Commission has found it impossible to review the rates of particular companies more often than once or twice in a decade. If, in addition, independent gas producers were also to be regulated, with all of the complexities

and variables, which would be presented, it is certain that miscalculations and errors of projection and estimate would be seriously cumulative, not self-correcting as Commissioner Buchanan suggests.

Relevant to the testimony of both Commissioners Olds and Buchanan, no more pertinent observation has ever been made regarding the basic impracticality of subjecting gas production to "utility" regulation than the following concise statement by Justice Jackson in this dissenting opinion in the Hope case:

> "The case before us demonstrates the lack of rational relationship between conventional rate-base formulas and natural gas production and the extremities to which regulating bodies are brought by the effort to rationalize them." (320 U.S. 591, 645 (1944))