UNREVISED

A STUDY AND INVESTIGATION OF THE NATIONAL DEFENSE PROGRAM IN ITS RELATION TO SMALL BUSINESS

HEARINGS

BEFORE THE

SELECT COMMITTEE TO CONDUCT A STUDY AND INVESTIGATION OF THE NATIONAL DEFENSE PROGRAM IN ITS RELATION TO SMALL BUSINESS IN THE UNITED STATES

HOUSE OF REPRESENTATIVES

SEVENTY-NINTH CONGRESS

FIRST SESSION

ON

H. Res. 64

A RESOLUTION AUTHORIZING AN INVESTIGATION OF THE NATIONAL DEFENSE PROGRAM IN ITS RELATION TO SMALL BUSINESS

PART 3

POLICY AND PROCEDURES OF OFFICE OF PRICE ADMINISTRATION RELATIVE TO CRUDE OIL PRICING

WASHINGTON, D. C., JUNE 12 AND 13, 1945

Printed for the use of the Select Committee to Conduct a Study and Investigation of the National Defense Program in Its Relation to Small Business in the United States

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SPECIAL COMMITTEE TO CONDUCT A STUDY AND INVESTIGATION OF THE NATIONAL DEFENSE PROGRAM IN ITS RELATION TO SMALL BUSINESS IN THE UNITED STATES

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FINANCIAL PROBLEMS OF SMALL BUSINESS

TUESDAY, JUNE 12, 1945

House of Representatives,
Select Committee on Small Business,
Washington, D. C.

The select committee met, pursuant to notice, at 10 a. m., in room 1011, New House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman (chairman), Howell, Jackson, Hall, and Keogh.

Also present: Dan W. Eastwood, chief investigator; William J. Deegan, Jr., investigator; and C. G. Cambra, investigator, for the select committee.

The Chairman. I would like to insert in the record at this point, the recommendations of our Committee on Small Business that were made December 4, 1944, commencing with the recommendations on page 9 of the report, down to the end on page 10.

(The recommendations referred to are as follows:)

RECOMMENDATIONS

I. The Office of Price Administration should immediately appoint an industry advisory committee to represent the crude-petroleum producers. This committee should be appointed on a Nation-wide basis and the independent producers should be given representation proportionate with their percentage of national production and of number of firms engaged in that business.

II. The Office of Price Administration should immediately initiate a study of the finding, developing, and operating costs of the crude oil producing industry in accordance with the recommendations listed in the above conclusions.

III. The Office of Price Administration should immediately initiate a study of the operating costs of the refiners.

IV. The Office of Price Administration should take greater cognizance of the role of the independent and other producers in the field of exploration and should include amortization of exploration costs as part of the permissible costs used as a basis for calculating price ceilings on crude oil.

V. Because of the impracticability, from a marketing standpoint of granting price increases to individual producers in a given pool at a time when other producers retain lower ceilings, the Office of Price Administration, upon the conclusion of the proposed cost studies, should grant such over-all increases in the price of crude petroleum on a Nation-wide basis as will permit all producers whose operations are conducted in a normal and efficient manner to make a fair profit on their production operations.

VI. A premium price plan for stripper wells should be maintained if such an increase in the over-all price is put into effect, in order to prevent abandonment of those stripper wells whose costs still remained too high, and, also, to continue the flow of their product into essential war and civilian uses.

VII. In order to avoid the necessity of increasing the price of any petroleum product to the consumer, the Office of Price Administration should grant a subsidy to marginal cost refiners whose profits might be adversely affected by any further increase in the ceiling price of crude petroleum.

VIII. The independent producers, through their duly accredited individual representatives, should render full cooperation to the Office of Price Administration in accordance with the rules and regulations of that agency, in the furtherance of the above suggested program.

IX. A time limit of 90 days from date should be set as the maximum period required by the Office of Price Administration to conclude the suggested cost studies. It is assumed that the industry will continue to show its willingness to cooperate in these matters of fact finding.

The CHAIRMAN. I would also like to insert in the record at this point a letter from the chairman of the committee dated March 12, 1945, to Mr. Orville D. Judd, Associate Director of the Fuel Division of the Office of Price Administration, and Mr. Judd's reply of March 24, and also another letter to Mr. Judd of March 28, and Mr. Judd's reply of April 17, 1945.

(The correspondence referred to is as follows:)

MARCH 12, 1945.

Mr. ORVILLE D. JUDD,
Associate Director, Fuel Division, Office of Price Administration,
Washington, D. C.

DEAR MR. JUDD:

* * * * * * *

For the information of this Committee on Small Business, I am wondering if you would be kind enough to supply us the answers to the following questions at your convenience:

Question 1.—Why does OPA decline to give consideration to replacement costs of finding and developing crude oil when considering the need for possible price increases for this product?

Question 2.—What provision have you made to permit the crude oil industry committee or a representative of that committee to have access to the detailed information about to be collected through your crude oil cost study? Will an authorized member of that committee be permitted to work with your staff on the examination, analysis, and interpretation of the detailed cost figures to be reported to you by the producers? If so, please tell us the exact extent to which such a representative will be permitted to participate in this work.

If you will supply us with the answers to these two questions, it is possible that we may be able to assist you in arriving at a more complete understanding with the other interested parties to this study in an informal manner. We are very sympathetic with the burden which this proposed survey places on you and your staff and feel that everything possible should be done by all of us to prevent the industry and its committee from gathering the impression that the Government is not willing to agree to industry requests on matters of procedure as far as is reasonably possible.

With kindest regards,

Sincerely yours,

WRIGHT PATMAN, *Chairman.*

OFFICE OF PRICE ADMINISTRATION,
Washington, D. C., March 24, 1945.

Hon. WRIGHT PATMAN,
Chairman, Select Committee on Small Business,
House of Representatives, Washington, D. C.

DEAR MR. PATMAN: I deeply appreciate your letter of March 12, 1945, in which you indicate your feeling that this Branch has a difficult task to perform and your willingness to aid us in solving some of the difficulties.

The survey on both crude production and refining have become quite involved due to the desires of industry on the one hand to provide information which indicates the need for price relief and the necessity on our part to see that such information and the findings therefrom conform to the standards of the Office.

You ask "Why does OPA decline to give consideration to replacement costs of finding and developing crude oil when considering the need for possible price increases for this product?"

The answer is that we do give full consideration to finding and developing cost but that we do not give such consideration on the basis of estimated reserves found. In other words, we have advised the industry that all costs should be set forth on the proposed questionnaire but that in our determinations we will not use an estimate reserve figure but will use the actual dollars received by the industry for production sold during the same period. As you undoubtedly know, reserve figures are at the best mere estimates. If you will refer to the reserves as set forth by the American Petroleum Institute and the Petroleum Administration for War each year you will find that such figures are ultraconservative and have resulted in crediting to former years a minimum of 1½ billion barrels of crude reserves each year. The conservative basis of industry reporting is certainly satisfactory for the reasons for which it was devised, but it is not factual enough for a price-control agency to make far-reaching decisions involving the price of oil. It is safe to assume on the basis of past experience that the actual reserves found by exploratory efforts in 1944 will not be known to any great degree of accuracy for a period of at least 5 to 10 years in the future. Therefore, this agency does not feel it can pass judgment on oil prices on such an inaccurate basis.

The industry has said in effect that they are selling oil today due to the increased demands of war which it could sell at a later period if such demands were not present. With oil prices today, higher than they have been in the past 16 years and with the feeling on some parts of the industry that postwar prices for oil may be less than today's prices, it is difficult to believe that industry is selling the goods "from its shelves" at less than replacement cost. Again the factors involved are too indeterminate to use as a basis for a price adjustment during the war emergency.

We have advised industry that we will take their expenditures as against their gross return this year and in subsequent years, and if it is found that their net position is not as good as it was in the base period (1936–39) we will grant price increases which will permit that net position to be brought to that level. We have felt that such a position is in accordance with the mandates of Congress.

Your second question is: "What provision have you made to permit the crude oil industry committee or a representative of that committee to have access to the detailed information about to be collected through your crude oil cost study? Will an authorized member of that committee be permitted to work with your staff on the examination, analysis, and interpretation of the detailed cost figures to be reported to you by the producers?"

The answer to the first part of your question is that we have consulted continually with the industry committee as a whole, its subcommittee on the questionnaire form, and Mr. J. V. Brown, secretary of the committee. We have kept them advised as to the exact contents of the form, the names and locations of the industry members to be sampled and the method we intend to employ in making a finding. We have also advised them we will make no changes in any of the returns, in making our compilations, without definite information as to the changes made and the reasons for such changes.

As to the second part of your question, no member of the committee will be permitted to work with our staff on the examination, analysis, and interpretation of the detailed cost figures, although we have agreed to submit to the committee or any authorized member thereof any totals on any divisions of the industry and to advise them as to any methods we employ in making our computations. Our reasons for refusing to give individual return to members of the committee or to permit members of the committee to have access to the forms during compilation is that such information is regarded to be confidential and, therefore, we can only supply totals by segments so that the individual's identity is concealed. From prior experience on other surveys, it has been found that certain members of industry will refuse to disclose the type of information we desire unless they have been assured that such information will be held in strict confidence and used only by this agency in making proper determinations. I doubt seriously that some members of the committee would permit their own returns to become the property of the committee as a whole and I believe, as a whole, the committee is in full sympathy with the stand which we have taken in this respect.

If your understanding is to the contrary or if you are not thoroughly in accord with any of the statements set forth in this letter, I will be most happy to further elaborate on such statements either by letter or by conference as you may desire.

Sincerely,

O. D. JUDD,
Associate Director, Fuel Division.

MARCH 28, 1945.

Mr. O. D. JUDD,
Associate Director, Fuel Division, Office of Price Administration, Washington, D. C.

DEAR MR. JUDD: As indicated in my letter of the 26th, I have had an opportunity to study carefully your letter of March 24 and wish to offer the following comments:

In your letter of March 24 and in answer to a question propounded to you by me as to why your office declined to give consideration to replacement costs of finding and developing crude oil when considering the need for possible price increases, you stated: "The answer is that we do give full consideration to finding and development cost but that we do not give such consideration on the basis of estimated reserves found."

It becomes difficult for me to readily understand this answer and to reconcile the first part of it with the second. You further say that in your determinations "we will not use an estimate reserve figure but will use the actual dollars received by the industry for production sold during the same period." If by this you mean that your construction of replacement costs means only production costs, then you have not actually given any weight to the increase in finding or exploration cost.

The nature of your answer leads me to believe that I may possibly have improperly phrased my first question. What I was particularly interested in was why effect was not separately given to finding or exploration costs; that is, the actual cost of searching for and finding crude oil to replace the oil which is currently being produced. However, since you have indicated that no separate consideration was given to either "finding" or "development," I believe the following remarks will be pertinent in any event.

As I understand the effect of your policy as reflected by this statement, you will consider finding or exploration costs as a part of the total expenditures of the companies and compare that with the total income for the company for the same period, and if there remains a margin of profit, you consider that prices need no adjustment. To me this is not the proper approach to the problem. We all understand that in ordinary times a certain portion of an oil company's income is required to produce the oil that has already been discovered. An additional part of the company's income is devoted to exploration and the finding of new reserves, and a further part to the development of such reserves as may be found. I have been informed and have reason to believe that in the case of many independent producers the production costs as of today are approximately 200 percent of the amount they were in 1941. The cost of developing such new reserves as have been found will vary with the nature and extent of the discoveries but in all cases has materially increased. The total income of the same companies has increased approximately 10 percent, but such increase is due almost entirely to an accelerated rate of production, which only means that these companies are liquidating their assets at an increasing rate. The amount, therefore, that is left for exploration is becoming increasingly less and, if the same continues, will be reduced to nothing. In view of the expressed desire on the part of the President, the Petroleum Administrator for War, and other responsible officials, that exploration should be conducted with increasing vigor calling for the expenditure of larger amounts of money, it is my opinion that a price policy which does not tend in this direction is unsound.

I have received a graph prepared by PAW entitled "Exploratory Drilling, New Reserves Discovered and Production," with which I am sure you are familiar, but in case you have not seen it, I am attaching a copy for your information. From this it will be readily seen that the rate of production since 1934 to date has increased in a more or less uniform line. The number of wildcats drilled per year has likewise increased, but to a greater extent. However, it further indicates that since 1936 the discoveries of new crude-oil reserves have rather rapidly diminished, with the result that today we are each year producing far more crude oil than is being discovered. From testimony that has been furnished our committee, I am inclined to believe that such a trend will continue. From the foregoing, I can only conclude that the cost of finding new reserves is constantly increasing in a rather astounding manner, and unless considerable weight is given to this fact in your deliberations it does not seem that there will be money available to the independent producer to continue his exploratory work.

I believe some confusion has arisen in connection with this matter by reason of the fact that a certain group of the oil industry, generally referred to as integrated companies (those who both refine and produce), have in recent years shown a considerable increase in profits, and since these companies are the best known and most talked about, it has led to the general impression that all of the oil industry is now increasing its earnings in a rather substantial way. From information which I have, I am certain that this is not the case. The profit per barrel made by the independent producer is now considerably less than it was at the time the maximum price of crude oil was established. I am sure you are concerned with the prevention of inflation to the same extent that we all are, and it is not our desire to increase the amount which the consumer must pay for any commodity. However, it is my opinion that if a new ceiling were set for crude oil, the only result of such action on your part would be to permit an adjustment as between the independent producer and the integrated companies. In this connection it seems to me that if you establish new maximum prices for crude oil, the change, if any, that takes place will be gradual and will take place only to the extent that the purchasing companies can afford to increase the price they pay for the crude oil they do not themselves produce. It does not seem to me that the actual price paid for crude oil would immediately increase in all cases, but would increase only gradually and as an economic adjustment which would seek its proper level. I would appreciate it particularly if you would consider this point and advise me as to your opinion.

In another part of your letter you say that oil prices today are higher than they have been in 16 years. I was a little surprised at this since it was my information that the general price for crude oil existing prior to the creation of your office was established and set as the maximum price at which crude oil could thereafter be sold. Of course, I understand that there have been some minor adjustments in local areas and that certain subsidies have been paid for stripper-well production, but I did not believe that these two items together would have been sufficient to raise the general price substantially above that previously paid. In this connection we should not lose sight of what a barrel of oil will buy today with reference to labor as compared to 1941; what a barrel of oil will buy today with reference to footage in digging another well; what a barrel of oil today will buy in material that has to be replaced and purchased for additional development; what a barrel of oil today will buy as to geological and geophysical exploration development.

In connection with the subsidy program, I would appreciate it if you would furnish me information at your convenience indicating the manner in which this is distributed; that is, I would like to have a break-down showing the percentage of the subsidy that is paid to the major companies and their subsidiaries, and the percentage paid to the balance of the industry. It may be difficult for you in some cases to recognize an integrated company's subsidiary, and to the extent that you are not sure, you could indicate such payments in a separate column as distinguished from the balance.

You also indicated in your letter that there is a "feeling" on some parts of the industry that postwar prices for oil may be less than today's prices. Testimony before our Small Business Committee of the House which stands unchallenged, is to the effect that many integrated companies have purchased wells in the East Texas field and in other places at a price out of all proportion if based on present-day allowables and present estimates of reserves as related to present prices, and can be justified only on the ground that the intrinsic value of the oil purchased is in excess of the actual posted price for such oil.

Considerable point is made in your letter of the fact that it is difficult and impractical to estimate crude-oil reserves and therefore you refuse to give any weight to such estimates in fixing crude-oil prices. This seems strange to me in view of the fact that PAW considers and accepts the findings of petroleum engineers as to reserves for the purpose of allocating production over the Nation. Likewise the Securities and Exchange Commission, in permiting sales of securities, and banks in making large loans to oil operators, not only accept these estimates but require them. Why, then, should not OPA accept these accepted standards and practices?

You have further indicated that the basis used by the industry in reporting such reserves was very conservative and for that reason might not be sufficiently factual. However, let me point out for your purpose in fixing prices all you need to consider is the relative position of the industry with respect to reserves during the base period and from that period to the present time. There would seem to be no question but that the estimates will at all times be made on the same basis and therefore furnish a reasonable means of determining the relative position which you must determine under the act.

In summary, I have pointed out to you, I believe, the fact that the consideration that you state you will give to what you call finding and development costs, in effect, will result in no weight whatever being given to any increase in replacement costs; and, in the end, might well result in the liquidation of thousands of independent oil producers, contrary to the Price Control Act and to the desire of Congress in enacting it. * * *

For your information, we are being urged to hold additional public hearings on this matter of crude-oil-pricing policies and to do this immediately. It is our preference to avoid doing this at this time if possible. In the absence of a more satsfactory explanation than the one given in your letter of the 24th, we have no other choice in the matter. Please, therefore, give me as prompt a reply to this letter as you can in the hope that it may serve the purpose of giving us a better understanding of your reasons for opposing consideration of replacement costs, etc.

Sincerely yours,

WRIGHT PATMAN, *Chairman.*

OFFICE OF PRICE ADMINISTRATION,
Washington, D. C., April 17, 1945.

Hon. WRIGHT PATMAN,
House of Representatives, Washington 25, D. C.

DEAR MR. PATMAN: This will acknowledge receipt of your letter of March 28, 1945, in which you request a clarification of my letter of March 24, 1945, * * *

Apparently the following sentence was confusing: "The answer is that we do give full consideration to finding and developing costs but that we do not give such consideration on the basis of estimated reserves found." In this sentence, I attempted to explain that we allow for all costs and in our recent questionnaire to the trade have made provision for the full reporting of such costs. However, I note from a review of the correspondence that I failed to make a definite distinction between the committee's proposed use of replacement costs and our intention to use sustained depletion costs based on the books of the individual operator.

Industry requests that we use operating cost figures in a manner shown by their books but that the finding and development costs which their books show should be disregarded and that we substitute figures calculated on a different basis. For finding costs we are requested to substitute an estimate of the cost of finding oil today, and to apply this cost to every barrel of oil being lifted today, regardless of what was actually spent to find this oil. We are requested to use a similar principle with respect to developmental costs. To grant this request of industry and raise the ceiling prices accordingly would introduce into wartime price control a direct relationship between replacement cost and price which never existed in peacetime. Prices of crude oil were never established or changed in direct and immediate relation to increases or decreases in the replacement cost of oil. In fact, the replacement cost of oil fluctuates greatly depending chiefly on the quantity of oil discovered, which quantity varies materially from year to year. Oil prices advanced as demand increased relative to supply and not because exploratory costs on the basis of estimated reserves had increased.

As you know Congress decided that prices should not be permitted to respond to war-inflated demand but that the Office of Price Administration should control such prices under standards permitting prices which are generally fair and equitable. Our standards do not limit industry profit gained through increased volume of sales but do prevent increases in prices unless industry profits, before taxes and after adjustment for increased investment, fall below peacetime profit levels.

In line with the policy outlined above, I stated in my former letter that we would take industry expense as against their gross return and if it is found that industry's net position is not as good as it was in the base period (1936–39) we will grant price increases which will permit the net position of the industry to be brought to the base period level. The survey now being made should definitely indicate the industry's position in this respect.

As indicated in your letter, some operating costs have undoubtedly increased. Some of these increased costs have been offset by increased production and the amount of increase, if any, will be ascertained by the survey now in progress. If the survey indicates that increased costs do exist, and can be absorbed by the producing industry without reducing their profit below base period levels, then under the standards of this agency no price increase will be warranted. To do otherwise would be to treat the oil industry differently from other industries—either manufacturing or extractive. To permit increases in prices by giving effect to increased labor and material costs, without regard to the ability to absorb would, of course, result in pure cost-plus pricing which would stimulate the cost-price inflationary spiral which the stabilization legislation was intended to prevent.

Your suggestion that an increased ceiling price for oil would not in itself occasion an immediate increase in the price of all oil sold and whatever increase might be occasioned could be absorbed by the integrated segment of the industry, poses for us a new consideration in pricing. We have never attempted to redivide profits between segments of the industry. There have been a few cases where an increase in the price of crude oil was indicated, and where the absorption of this increase, by the purchasers of such oil, was possible without reducing the earnings of such purchasers below peacetime levels. Those increases were granted because special conditions warranted such increases and not because this Office felt that certain profits accruing to one segment should be redivided so that another segment profited by such a division. As our past actions show, we do not think that price increases should be permitted simply because they might be absorbed out of profits at later stages of processing or distribution.

Under generally accepted principles of accounting the amount of profit or loss of any income-producing enterprise is determined by applying against the income earned all of the related costs incurred in producing the income. In determining such related costs the expenditures made for acquisition of assets, to be used in production, are properly includible only as the assets are consumed in the production process.

The information which we have requested in the crude-oil survey now being conducted will enable us to determine these production costs of the reporting companies for the years surveyed. The only possible limitation may be in cases where operators have not kept their books wholly in conformity with generally accepted accounting principles.

The charging of capital assets to production, at amounts required to replace them, be such amounts greater or less than the cost of the assets consumed, is contrary to sound accounting procedure. The practice is not followed by the oil industry itself in its corporate accounting or by any other industry of which our accounting staff has any knowledge. Should you desire to explore this point further our accounting department would be glad to supply you with authoritative accounting references on the subject. As the United States Supreme Court said in the Natural Gas Pipeline Co. case: "There is no constitutional requirement that the owner who embarks in a wasting-asset business of limited life shall receive at the end more than he has put into it."

Strictly speaking, an oil operator does not use the income from production for exploration, finding, or development work. Such work is financed by the capital which the owners and creditors have invested in the project. Out of income the business is reimbursed for the working capital advanced for the payment of operating expenses and for the fixed capital consumed in production. By this procedure the capital is maintained intact and is available for reinvestment in new producing properties.

As long as the investor sustains no loss—which I understand is not being claimed by the oil industry—he is certainly not being liquidated in the ordinary sense of the term. If the owner desires or is required to invest more capital in the business than he had before, the problem is one of capital financing. Certainly the wartime consumer should not be required to provide additional capital funds for the industry in the price he pays for oil.

It would appear that the best proof of what industry will do with respect to exploration under present oil prices is a record of wildcat wells drilled during the past several years. This record definitely indicates increasing activity as shown by the following figures taken from the American Petroleum Institute release dated February 22, 1945

Number of wildcat wells drilled

1937	2,224	1941	3,264
1938	2,638	1942	3,223
1939	2,589	1943	3,512
1940	3,038	1944	3,881

These figures are the more impressive when adequate consideration is given to the fact that shortages of manpower and materials made such a record, during the war years, doubly difficult.

While it is true that fewer large pools have been discovered in recent years, it is equally true that the total of estimated reserves discovered each year plus extensions to known fields and revisions of previous estimates have exceeded production every year except 1943. In that year production exceeded such a total by 18,641,000 barrels.

Estimated total reserves have increased yearly since 1936, with the exception of 1943, and last year showed an increase of approximately 339,000,000 barrels over the preceding year, even after abnormal wartime withdrawals. As a result reserves now total 20,453,231,000 barrels as compared with total 1941 reserves of 19,589,296,000 barrels.

The composite chart indicates the production each year since 1937 together with estimated reserves developed, contrasting such data with the information you supplied.

You indicate there may exist an impression that all segments of the oil industry have fared as well as the integrated companies during the war years. We have never taken the condition of integrated companies as a basis for making over-all industry determinations. In fact, in the survey now in progress, we intend to separate the returns received into four groups; namely, integrated companies, large independents, and others. We intend to determine the status of each of these groups and, if at all possible, provide for specific relief for any segment of the oil industry where such relief is indicated.

In attempting to work along this general line we placed in effect last year, as you know, the premium-payment plan, which permitted premiums to pools where daily production averaged less than 9 barrels per well. Later this plan was revised to include, upon the submission of necessary cost data, high-cost pools whose daily production exceeded 9 barrels per well. I am sorry that, due to the manner in which the plan works, we do not have information as to the breakdown of premium payments so as to show the percentage going to major companies and their subsidiaries and the percentage going to the independent segment of the industry. The plan was so formulated that no direct contact was maintained between the Government and the individual producers and I am informed by the Defense Supplies Corporation, the Agency which makes payments to the first purchasers, that they have no records which would indicate who the individual producers are in the various pools involved.

As indicated in my former letter certain segments of the industry have grave doubts as to whether present prices can be maintained in the immediate postwar years. Individual operators, as well as some officials of the major companies, have expressed the opinion that a floor under petroleum prices might be much more important, in the postwar period, than ceiling prices. They have indicated that their feelings in this respect stem from the fact that the heavy withdrawals by the armed forces will be considerably decreased. Further, automobile use may be restricted because of rubber conditions or lack of cars and, therefore, the use of motor gasoline will not be able to replace the drop in military requirements. They also feel that the manufacturing of oil-burning equipment will not keep pace, during the early phases of reconversion, with the ability of the oil industry to produce.

In connection with the purchases, made by the large companies of producing properties at high prices, it must be borne in mind that a large refinery without adequate crude production is in a very vulnerable position and, therefore, the major companies will pay premium prices for producing properties as a safeguard for their large investments.

In conclusion, permit me to state that we intend to continue to give the oil industry every consideration to which it is entitled. We believe that every segment of the industry should be as free from control as is consistent with the purposes of the antiinflation program. Such purposes require that standards of general applicability be established and adhered to in dealing with all industries. The Petroleum Branch must conform to the standards in general use throughout the Agency. We desire the present survey to permit a factually accurate determination of the fairness and equity of the present maximum prices.

Sincerely yours,

O. D. JUDD,
Associate Director, Fuel Division.

The CHAIRMAN. Mr. Becker.

STATEMENT OF MERLE BECKER, VICE PRESIDENT, W. C. McBRIDE, INC., ST. LOUIS, MO., AND MEMBER OF NATIONAL CRUDE OIL INDUSTRY ADVISORY COMMITTEE OF THE OPA

Mr. BECKER. My name is Merle Becker and I am the vice president of W. C. McBride, Inc., of St. Louis, Mo. Our organization and its predecessor company have been in the business of finding, developing, and producing crude oil for the past 35 years. The founder of our company, William Cullen McBride, operated as an independent for about 20 years prior to incorporating.

We own royalties and producing oil and gas leases in 10 States.

I am also chairman of the subcommittee on cost of production of crude petroleum of the committee on crude oil requirements representing 37 trade associations of the oil industry. I am also a member of the National Crude Oil Industry Advisory Committee of the Office of Price Administration.

On September 20 and 21, 1944, representatives of the crude oil industry appeared before your committee sitting at Austin, Tex., and told you of their problems. Under date of December 4, 1944, the sixth interim report in two parts was issued, one part dealing with the Unfavorable Effect on Present Price Policies, and the other with Trend Toward Monopoly in Crude Production.

Your recommendations in this report, insofar as it deals with the producer, contained the following:

1. The Office of Price Administration should immediately appoint an Industry Advisory Committee to represent the crude petroleum producers. This committee should be appointed on a Nation-wide basis and the independent producers should be given representation proportionate with their percentage of national production and of the number of firms engaged in that business.
2. The Office of Price Administration should immediately initiate a study of the finding, developing, and operating costs of the crude-oil-producing industry in accordance with the recommendations listed in the above conclusions.
3. The Office of Price Administration should take greater cognizance of the role of the independent and other producers in the field of exploration and should include amortization of exploration costs as part of the permissible costs used as a basis for correlating price ceilings on crude oil.
4. The premium price plan for stripper wells should be maintained if such an increase in the over-all price is put into effect in order to prevent abandonment of those stripper wells whose costs still remain too high and also to continue the flow of their production into essential war and civilian uses.
5. The independent producers, through their duly accredited independent representatives, should render full cooperation to the Office of Price Administration in accordance with the rules and regulations of that agency in the furtherance of the above suggested program.
6. A time limit of 90 days from date should be set as the maximum period required by the Office of Price Administration to conclude the suggested cost studies. It is assumed that the industry will continue to show its willingness to cooperate in these matters of fact-finding.

As a result of your recommendations, the National Crude Oil Industry Advisory Committee was appointed on January 3, 1945, and the independent producers have been given proper representation on that committee. A cost study has been initiated, a questionnaire sent to approximately 700 oil producers and the dead line of June 1 has been set for its return to the OPA. More will be said later in the statement about the No. 3 recommendation. The premium price plan for stripper wells has been maintained. The independent producers have rendered full cooperation to the OPA in accordance with your suggestion.

The Office of Price Administration, in appointing the members of the committee to represent the crude petroleum producers, said: "The purpose of this committee will be to aid the Office of Price Administration in determining whether the prices of crude petroleum are generally fair and equitable."

The Committee and the Office of Price Administration agreed that the first step in determining whether or not the price of crude petroleum is fair and equitable is a survey of crude petroleum costs, however, there is a basic difference of opinion as to the method of determining costs and aggregate earnings to be used in fixing petroleum maximum price ceilings. The Office of Price Administration maintains that it is limited by law to the use of bookkeeping profit-and-loss data. The Advisory Committee believes that the replacement costs must be considered and that the law permits it. It has been impossible to reconcile these differences of opinion. The replacement cost theory is a long established accounting practice recognized by practically all agencies of Government and in practically all industries generally referred to as the "last in, first out" method of inventory accounting. Simply stated, this method contemplates the use of the latest inventory costs in arriving at the cost of goods sold. This method is recognized by the Bureau of Internal Revenue for certain cost purposes in determining taxable net incomes. The OPA admits that they use this method in certain industries where replacement costs are readily determinable, however, in all its past production cost surveys it has refused to recognize replacement costs in crude petroleum production, and has now refused to recognize such costs in its proposed survey which it has commenced at the request of the Small Business Committee of the House of Representatives.

It has informed the Petroleum Trade Press that "under its power it can grant increases in ceiling prices only on a showing a hardship based on current operating and inventory costs." While OPA has agreed to include in its survey questionnaire provisions "to obtain data on both historical costs and present discovery costs—OPA officials have warned that they cannot give any consideration to the latter." The Industry Advisory Committee is of the opinion that the costs applicable to each of the three activities, namely finding, developing and producing crude oil, must be considered in connection with the volumes of oil with which they are directly related. The approximate replacement cost per barrel should be determined separately for each of the three activities as outlined below:

1. The total operating costs, including overhead, divided by net production, will disclose production costs per barrel.

2. The total costs of oil wells completed each year, divided by the estimated reserves recoverable from such wells will approximate development costs per barrel on a replacement basis.

3. The total of finding costs incurred by the entire industry for each year divided by the Petroleum Administration for War estimate of new reserves discovered in the same year will furnish a reasonable approximation of finding cost per barrel on a replacement basis.

The sum of the three separate unit costs will give the total cost of finding, developing, and producing crude oil on a current replacement basis.

For more than 80 years price has been the principal factor in determining our petroleum supply. Through the history of the industry in war and in peace these objectives have been accomplished through the normal economics of the industry. Price has been the primary stimulus to encourage search for petroleum reserves. This is the experience on which the industry has been built. Some of the price factors are as follows:

1. The cost of raw material crude oil is basic and the price should be sufficient to cover not only all costs of operating proven oil properties but also the cost of exploring for, discovering and developing new reserves of crude oil to replace the oil currently produced.

2. The price of crude oil affects the ability of stripper wells to continue in operation and to recover the reserves underlying such properties without premature abandonments.

3. Price directly affects the extent of exploration work. the number of new oil-producing areas discovered and the quantity of new proven reserves made available. The price of crude oil in relation to the price of salvage material and equipment has a direct influence to abandon wells.

4. The price of crude oil, if sufficiently high, will serve as a conservation measure by encouraging the use of substitute fuels for less essential purposes.

5. The prices of all other commodities, particularly raw materials, enter into the cost of oil and some equitable relationship must exist between oil prices and other prices if adequate quantities of crude oil are to be made available.

6. The margin above cost should be sufficient to provide for:

(*a*) Funds for the exploration needed to find adequate new reserves.

(*b*) Funds to cover replacement costs.

(*c*) A reserve fund for secondary recovery or other conservation measures.

(*d*) A fair return on borrowed and invested capital taking into consideration the extreme hazards involved in searching for and finding oil.

(*e*) To maintain the industry as a healthy, going concern.

It is impossible to tell exactly what it will cost to replace a barrel of oil during the year of 1945 or in subsequent years, but we do know that venture money cannot be expected to seek an outlet in a business as hazardous as searching for oil unless there is a very substantial margin of profit, much greater than would be necessary in a less hazardous undertaking.

It must be recognized that prices based on historical costs will not provide the necessary incentive for venture money to enter into exploratory effort. To accomplish that purpose it is essential that prices be based on replacement costs.

Statistics indicate a definite upward trend in costs to the extent that present prices are substantially below the cost of replacement.

At no time since 1926 has a price index of crude oil been on a parity with the price index of all commodities or the price index of all raw materials, but it has at all times been subnormal, and since the price of crude oil was frozen by Governmental action in 1941 the price index for all commodities and for all raw materials has increased rapidly.

A price ceiling on crude petroleum should be such as to permit crude oil prices to increase at least to the point that they may be equivalent to the average price index of all raw materials.

Determination of the price which will be sufficient to bring about the desired result can only be made when related to quantities of reserves discovered. If the finding rate is declining, as it has been for the past several years, the additional expenditures required to replace the depleted reserves must be provided out of increased income. As it becomes more and more difficult to find new reserves, the price must be adjusted to the extent required to get the job done. The increasingly poorer discovery record for the past several years is a direct indication that it is becoming more and more difficult to find new oil deposits, particularly in regions in which proven trends have been concentrated. Because of the long period of depressed prices little of the bold exploratory effort has been employed in the industry and favorable prospects have about played out. Prospects which are now considered first class would have been classed as second and third class several years ago. A search has extended to greater drilling depths in recent years. While appreciable quantities of new reserves will be found with greater depths within the present limits of drilling, structures usually are found to be more complex with the increasing depth. The cost of exploring and developing increases and the risk becomes greater so that greater sums of money must be set aside for probable loss.

The price of crude petroleum plays an important part in its production and discovery. It represents something of much more importance than profit as such. Profit, the amount by which returns exceed total outlay, is the measure of economic strength added to the unit. Continuing profit in this sense represents the growing ability to produce. Lack of continued profit robs industry of this all-important capacity. Price is the most important tool of the oil industry. Without it all other tools become useless.

We have repeatedly called attention to various agencies of the Government and to congressional committees of the necessity for having an increase in the price of crude oil. Invariably these committees after hearing the facts have recommended an increase in the ceiling price of crude oil, but these recommendations have fallen upon the deaf ears of governmental agencies. The following is a résumé of the times that the oil industry has testified or called attention to congressional committees and agencies of the necessity for an increase in the price of crude oil:

1. July 26, 1941: A memorandum on the price of crude oil was submitted to the Office of Petroleum Coordinator, now the Petroleum Administration for War, and to the OPA.

2. November 1941: OPA Administrator Leon Henderson advised Mr. Buttram, president of the IPAA, that he would not discuss price with associations.

3. December 2, 1941: Mr. Buttram wrote to Administrator Henderson insisting on the right of associations to discuss the price of crude oil with his office.

4. December 16, 1941: Witnesses appeared before the Senate Committee on Banking and Currency during the hearing on H. R. 5990, which was amended to authorize OPA to confer with associations.

5. July 1942: Subcommittee on Mineral Resources of the Senate Committee on Public Lands and Surveys held hearings in Wyoming, New Mexico, and west Texas. Witnesses testified at all the hearings as to the need for an increase in the price of crude oil.

6. October 1942: Subcommittee on Mineral Resources of the Senate Committee on Public Lands heard witnesses testifying about the price of crude oil.

7. October 22, 1942: Chairman Cole, of the Cole committee, wrote to the President urging a better price for crude oil.

8. November 25, 1942: Witnesses appeared before the petroleum subcommittee of the House Interstate and Foreign Commerce Committee now known as the Lea committee and presented data with regard to supply of petroleum showing a need for price increase.

9. December 4 and 5, 1942: Subcommittee of the Senate, of which Harry S. Truman was chairman, conducted hearings in Oklahoma City and heard testimony regarding price of crude oil.

10. January 18–22, 1943: Special committee headed by Senator Clark of Missouri, conducted hearings on the fuel situation including oil, in Kansas City and Oklahoma City. Many witnesses appeared and testified.

11. February 3, 1943: Petroleum Industry War Council recommended to the Petroleum Administrator for War that the ceiling on crude oil prices be lifted.

12. April 7, 1943: Petroleum Administrator for War Ickes stated that he had recommended to OPA that the ceiling price on crude oil be lifted an unspecified amount.

13. April 13–16, 1943: Select Committee on Small Business, headed by Wright Patman, and the Petroleum Subcommittee, headed by Clarence Lea, conducted hearings on crude oil situation before which many independent producers appeared and testified. Emphasis was placed on need for increase in price. Mr. Ickes also testified that he had recommended lifting the price ceiling an average of 35 cents per barrel.

14. April 26, 1943: Senator Thomas of Oklahoma introduced a resolution providing as follows:

> That it is the sense of the Senate that the Federal agency having control of price ceilings should take immediate action to raise the ceiling price on oil to such a point as will be instrumental in promoting oil exploration, development, discovery, and production of sufficient oil to serve the war effort as well as the necessary domestic needs of our people.

15. May 3, 1943: OPA Administrator Prentiss Brown rejected the PAW request for an increase in crude oil price ceilings and recommended a system of subsidies as an alternative.

16. May 10, 1943: Select Committee on Small Business of the House of Representatives in their report said:

> We recommend that the Federal governmental agencies make effective the price increase recommended in our preliminary report (35 cents per barrel) to the end that immediate capital money be issued the industry to increase production of crude petroleum.

17. May 12, 1943: Congressman Patman of Texas introduced a resolution in the House providing—

> that it is the sense of the House of Representatives that the President—and the Federal agencies having control of price ceilings—should take immediate action to raise the ceiling price of oil at least an average of 35 cents per barrel.

18. June 7, 1943: Congressman Disney of Oklahoma introduced a resolution in the House providing for the transfer of powers and functions formerly conferred on the OPA with reference to crude oil price ceilings to PAW and providing that no price ceiling should be fixed

on crude petroleum or its products below a price equal to the price index of all commodities.

19. June 20–27, 1943: Subcommittee of the House Naval Affairs Committee with Chairman L. Mendel Rivers, of South Carolina, conducted hearings on the crude oil situation in Illinois, Arkansas, Mississippi, Texas, and Louisiana. Many witnesses were provided for these hearings.

20. June 25, 1943: Senate subcommitee of the Committee on Appropriations of which Senator Thomas of Oklahoma is chairman explored the domestic petroleum situation particularly with reference to the remaining undiscovered reserves of petroleum in the United States as well as the current and immediate future supply. Witnesses appeared before this committee and stressed the need for increased price ceilings on crude oil.

21. July 3, 1943: The Special Committee on Petroleum Investigation of the Committee on Interstate and Foreign Commerce, of which Congressman Lea, of California, is chairman, submitted its report to the House with the following observation:

> The importance of price as an incentive and requisite for needed production can scarcely be a matter for debate by men of practical experience.

22. And the committee recommended that PAW be given unified control over problems of Government as to the production, supply, and price ceilings of oil and petroleum products.

23. July 6, 1943: Chairman Rivers, of the subcommittee of the House Naval Affairs Committee, reported to the House that the hearings conducted by his committee had developed.

24. August 7, 1943: OPA rejected Petroleum Administrator for War Ickes' recommendation that crude-oil price ceilings be increased an average of 35 cents per barrel.

25. October 4, 1943: Senator Thomas, of Oklahoma, introduced a bill in the Senate providing for consideration to be given to parity in fixing or establishing prices for crude petroleum or its products. The bill also provided that no ceilings on crude petroleum should be less than 35 cents per barrel above present ceilings.

26. October 6, 1943: More than 100 members of the House of Representatives met to discuss the oil-supply situation, the consumer interest being evidenced by many Congressmen from non-oil-producing States. They decided to discuss the price problem with Judge Fred M. Vinson, Director of the Office of Economic Stabilization, and proceed by the legislative route if relief was not forthcoming from the executive department.

27. October 19, 1943: The Special Committee to Investigate the Fuel Situation in the Middle West, headed by Senator Clark, of Missouri, reported "the committee is definitely of the opinion" that every circumstance justifies an increase in the price of crude oil. The committee doubts whether the increase suggested by Petroleum Administrator for War Ickes of 35 cents per barrel is sufficient to bring the necessary added exploration. The committee is more disposed to the thought that in view of the continued increasing cost prevalent throughout the entire producing oil fields, a minimum of 50 cents per barrel increase should be allowed. In fact the committee believes perhaps a 60 cents increase is necessary.

28. October 1943: A subcommittee of the House Naval Affairs Committee with Congressman Rivers, of South Carolina, as chairman, after several hearings in Washington and throughout oil-producing States, reported—

the immeasurable benefits of petroleum to the war effort, to the civilian population of today and to the generations yet unborn cannot be measured in dollars and cents. We feel therefore that if it is necessary to raise the price of crude oil and refined products to get the increase in the cost of finding, developing, and producing adequate amounts of petroleum, patriotism demands such a course. We should not take a chance on a matter so vital to the economy of our Nation.

The committee further stated—

we are of the opinion that the price ceilings on crude oil should be raised to cover such increased costs immediately and without further delay.

29. October 30, 1943: Fred M. Vinson, Director of the Office of Economic Stabilization, announced its refusal to permit the proposed increase in the price of crude oil.

30. December 13, 1943: The House passed the Disney bill, H. R. 2887, requiring OPA to increase price ceilings for crude petroleum to at least 80 percent of parity. The bill then went to the Senate and was referred to the Banking and Currency Committee.

31. July 6, 1944: Judge Fred M. Vinson, Director of the Office of Economic Stabilization, announced a plan for subsidies to be paid for oil from small wells.

32. July 17, 1944: A Special Senate Committee to Investigate the Fuel Situation in the Middle West met in Kansas City, Mo. A number of independent producers testified regarding the price of crude oil.

33. September 20–21, 1944: The Select Committee on Small Business, with Congressman Wright Patman, of Texas, as chairman, conducted hearings in Austin, Tex. Many oil producers appeared and testified regarding the need for an increase in the price of crude oil.

34. December 4, 1944: An interim report of the Select Committee on Small Business asserted that the price policies of OPA are retarding further exploration for new reserves of crude petroleum by independent producers and that increased exploratory effort is needed to regain the balance between discovery and use of oil.

Since 1941 these independent producers have found their path strewn with obstacles not of their own making. Despite lack of experienced manpower, inability to secure equipment and all other essential materials in volume and in the face of a price policy on the part of the Government which has discouraged rather than encouraged production, this group has maintained a production record which has been one of the outstanding contributions to the war effort. It is to the everlasting credit of this group that many of their numbers have operated at an actual loss of profit, but despite that they have continued to pour into the pipe lines the fuel which is the lifeblood of the war effort.

35. January 2, 1945: The petroleum subcommittee of the House Committee on Interstate and Foreign Commerce submitted its final report under resolution of the Seventy-eighth Congress:

Oil, from the standpoint of its inherent value, is one of the cheapest products that man can buy. This committee has heretofore expressed its approval of proper prices to give the producer of crude oil a reasonable price for his product. We believe that the production of crude is an industry in itself and that it should be placed on a healthy, self-supporting basis in its own right and not to be made dependent upon a better income from the refining, transportation, or distribution phases of the oil industry. In any event from the standpoint of preserving a healthy industry, prices must provide reasonable compensation and have a changing relation in proportion to costs.

36. January 3, 1945: OPA, in response to a request from the Select Committee on Small Business, appointed the National Crude Oil Industry Advisory Committee with 23 members, all of whom were present at the first meeting in Washington, January 18. This committee immediately started work on the form of a questionnaire to be sent to a sampling list of producers.

37. March 14, 1945: Russell B. Brown appeared before the Banking and Currency Committee of the Senate on behalf of the members of the IPAA, seeking relief from an onerous and oppressive crude-oil price structure. The committee at that time had under consideration extension of the Price Stipulation Act.

38. April 7, 1945: Senator O'Mahoney, of Wyoming, chairman of the Special Committee Investigating Petroleum Resources, filed a report with the Senate outlining hearings which the committee would conduct. No. 3 on that list is the independent company.

39. April 1945: Congressman Boren, of Oklahoma, introduced H. R. 2940 to fix the price of crude petroleum and its derivatives and fix a parity formula. This bill is the same as the Disney bill which was passed by the House in December 1943, but died in committee in the Senate.

40. May 17, 1945: Senate Special Committee Investigating Petroleum Reserves, with Senator O'Mahoney as chairman, started hearings.

The purpose of enumerating the times that we have told our story is to emphasize the number of times that recommendations in Congress have fallen upon the deaf ears of governmental agencies, and to give you a reason for the reluctance on the part of a number of operators to fill out and file the questionnaire on costs recently sent to them.

The independent oil producer is a man of patience. Impatient men do not fit into the business of producing oil. There are many setbacks and reverses. The failures and the successes are seldom distributed evenly; sometimes the independent oil producer has to swallow several failures—dry holes—before he tastes a bite of success.

So it was that the independents were equipped with ability to wait on the price-control officials. They realized that these officials were new and inexperienced, that they first had to learn something about oil before they could make decisions. The oilmen were prepared to allow plenty of time. They were also prepared for mistakes. They asked only that mistakes be corrected when they were pointed out.

But 4 years and 40 hearings, and so forth, from the day the oilman settled down to wait, he is beginning to wonder whether patience is a virtue without limit.

Their attitude is that it will be costly and that without a doubt it is just another of these questionnaires that will never result in an increase in the price of crude oil.

The independent companies are not the only ones who are of the opinion that the price of crude oil should be increased or that the expenses involved in finding, developing, and producing crude oil have greatly increased. The following are quotations taken from annual reports of some oil companies to stockholders for 1944.

I have following here, Mr. Chairman, a number of quotations taken from the 1944 reports of major oil companies to their stockholders.

The CHAIRMAN. Briefly, what do the quotations indicate?

Mr. BECKER. They are telling their stockholders that the cost of finding oil is increasing, that they are drawing on their reserves discovered a decade ago and they cannot replace those reserves for the price they are selling them for. They call attention to the fact that the price of crude oil is only 3 cents a barrel higher than it was in 1937 while raw materials have advanced 35 percent and labor a similar amount. That was Humble. The quote from Amerada is relative to present abnormally high drilling expenditures; Phillips says that the Federal subsidy won't do the job; Standard Oil of New Jersey, relative to current costs of discovery substantially higher. The Texas Co. repeats what they said a year ago, that a more equitable price is necessary to stimulate exploratory drilling, and so forth.

The CHAIRMAN. Very well.

Mr. BECKER. The Humble Oil & Refining Co. in its report to the stockholders of April 14, 1945, covering the calendar year of 1944 stated:

> Higher costs are being experienced in replacing the large volue of oil which Humble is producing to meet war demands.
>
> * * * Humble is drawing heavily on its reserves discovered in the preceding decade in order to provide oil for military purposes to the extent that this oil is being replaced; it is at higher costs. This should be taken into account when considering the financial results for the year.
>
> The higher cost of discovering and developing reserves experienced by Humble in 1944 is part of the general trend for the entire industry. The fact that discoveries of new oil are running substantially less than they did during the previous decade while expenditures for exploration and development are now far above that level demonstrates clearly that the industry's replacement cost is greater than the cost of the oil now being produced. The current favorable operating results in the industry are due to high rates of production and the successful finding spree of the 1930's. The petroleum industry will experience substantially higher unit costs of petroleum when output declines from the present abnormal levels and a larger proportion of the total is the high cost oil found now and in the future.
>
> The realization on crude oil continued to be limited by price ceilings to an average of $1.22 per barrel at the well, practically the same as in 1943. The average price realized by Humble last year was only 3 cents per barrel higher than in 1937. This represents a gain of 2.5 percent in crude-oil prices over the past 8 years. In this same period commodity prices generally have advanced 20 percent. Raw materials have advanced 35 percent and the cost of labor has increased in similar proportion.
>
> The future supply of oil for civilian needs and national security is endangered by * * * the continued restriction of prices to prewar levels. Prices currently are at the levels that prevailed in 1937 even though the cost of replacing oil is now much greater. Present prices do not provide sufficient incentive for experienced operators to search for and develop new reserves. Exploration work will have to be expanded even above current levels before new discoveries equal production. This is not likely to occur unless oil prices are raised. The increase required to maintain adequate reserves will be greater if added tax burdens reduce the return to producers. The time to increase prices is now for the relation of supply and demand in the postwar transition period will make it difficult, if not impossible, to secure higher prices. An increase in the price of crude oil with corresponding changes in product prices should be authorized promptly to assist in maintaining adequate petroleum supplies.

This company is the principal producing subsidiary of the largest integrated oil company in the United States, the Standard Oil Co. of New Jersey.

> Amerada Petroleum Corp., April 9, 1945.—* * * present abnormally high drilling expenditures.

Phillips Petroleum Co., March 15, 1945:

Federal subsidy granted August 1, 1944, will provide little, if any, stimulation to costly exploration efforts of the kind upon which this Nation must rely to discover large reserves and to sustain present and anticipated rates of crude oil withdrawal.

Any petroleum enterprise, therefore, which possesses ample natural resources, complete integration, technical ability, and effective organization and management, bids well to achieve successful results over an extended period.

Standard Oil Co. (incorporated in New Jersey):

Current costs of discovery are substantially higher. Replacement of crude oil now being drawn from the ground is of course essential. Continuation of high finding costs, therefore, will make desirable an upward revision of the price of crude to support the exploration required for extensive new discoveries.

Extensive new discoveries of oil will be needed in the postwar years to provide the backlog of resources necessary for national security, for efficient operations and to supply expanded postwar markets.

The Texas Co. and subsidiary companies:

The new oil found in 1944 was only approximately 511,000,000 barrels, or less than one-third of the withdrawals during the year. A substantial part of this new oil was found by deeper drilling in existing fields.

Because of the record demand for petroleum, some of the more important oil fields have been, and continue to be, overproduced, resulting in possible reservoir damage and the eventual loss of oil underground. As the reservoir pressures decrease, production costs will increase due to the necessity of pumping a larger volume of the ultimate oil to be recovered.

It should be recognized that the industry still continues to draw on the backlog of oil reserves discovered and developed at a low cost during the 1930's, and that the reserves so produced are being only partially replaced with new crude oil reserves discovered and produced at much higher cost. The industry is disposing of its inventory in the ground (crude oil reserves) at prices which do not stimulate exploratory drilling on the part of the small independent producer, and are not in keeping with the increased cost of new discoveries.

In view of these conditions, the management repeats its statement made in the 1943 annual report, and reaffirms the following conclusions:

(1) Unless there is developed an entirely new or improved technique for locating deposits of oil, new discoveries will be less frequent and new production will be more costly than in the past.

(2) It is believed that a more equitable price is necessary to stimulate exploratory drilling particularly on the part of the small producer. The number and depth of these exploratory wells must, in our opinion, be increased far beyond that considered normal in the past.

(3) Unless new important reserves are discovered in the United States, this country must become a substantially larger importer of petroleum in order to provide for its military, industrial, and civilian requirements.

The price-control authorities, OPA and OES, are impeding the securing of the maximum needed supply of petroleum for war, industrial, and essential civilian requirements through:

(1) Maintaining crude petroleum price ceilings below a generally fair and equitable level;

(2) Discriminating against the crude petroleum producing industry, particularly the independents;

(3) Fostering and encouraging monopoly by maintaining a situation in petroleum prices favorable to a few large companies and detrimental to thousands of independent oil producers;

(4) Contending that the crude petroleum industry must use 1936–39 as a representative peacetime level as a standard below which current earnings in that industry must fall before upward revision in price ceilings could be allowed; and

(5) Under price control the Price Administration permitted the prices of petroleum products to rise in 1941 and prevented crude prices from rising and then froze crude prices at a depressed level.

The effect of the administration of the Price Control Law is the liquidation of the independent petroleum producer.

The CHAIRMAN. This point reminds me that I heard a while back down in Texas that more than 50 percent of the producers in Texas did not have to pay an income tax last year. Do you have any figures along that line?

Mr. BECKER. No, sir; I do not.

The CHAIRMAN. I wonder if that coincides with the information that you have, or if it could be an exaggerated statement?

Mr. BECKER. I am unable to tell that, but I know that there are a good many that would have no income taxes to pay. That can come about by a number of reasons, however. They could be doing so much development work that they would have no taxable income or their costs could be high enough along with their depletion on their production that they would have no taxable income. (Continuing:) (*b*) The oil we have been producing during the war was found at a time when finding costs were below present finding costs which costs are continuing to increase.

(*c*) This oil found at lower costs is now being exhausted and no provision is allowed to cover replacement of these reserves to provide oil required for future sales.

(*d*) The shortage of material and manpower makes difficult and expensive the operations necessary to maintain supply. Those companies that have large capital from increased earnings under OPA regulations are therefore the first to get the available men and material. The money normally used for this purpose, being our cash receipts, remains on our books and is treated as profits. The fact that we are not spending this money does not dispose of the necessity of such expenditure; it only postpones the time of such expenditure and part of the money must now be paid to the Government as taxes. This means that when these expenditures are required the money for such will not be available.

The responsibility for the future supply of petroleum in the United States must now be assumed by the Congress. The Office of Price Administration has assumed a position directly contrary to further advancement. The efforts of the Petroleum Administrator for War seems lost in administrative frustration. No one is now assuming this important responsibility.

This Committee of the House on Small Business has the opportunity of leadership. Most of the oil producers are small businessmen. You have already sensed our necessities. Your reports have reflected an understanding of our problem and the importance of our cause.

You have attempted to suggest remedies. These remedies have thus far been ignored.

You have suggested a price increase in line with the recommendation of the Petroleum Administrator for War. You have suggested that if subsidies were the only remedy that such program should be simplified and effective, and you have outlined such program on a basis that would work to meet the needs of the producers with much less administrative effort than is involved in the present inadequate program for subsidies on production.

You could now encourage the producers of petroleum if you would insist on one of the following programs:

1. Uniform price increase on crude petroleum in line with the system used by the industry in periods of free economy.

2. Uniform price increase for crude petroleum to be paid by purchasers. If there is no other way of supporting this payment, it could be accomplished in the manner of your seventh recommendation contained on page 9 of the Sixth Interim Report from the Committee on Small Business, December 4, 1944:

> In order to avoid the necessity of increasing the price of any petroleum product to the consumer, the Office of Price Administration should grant a subsidy to marginal cost refiners whose profits might be adversely affected by any further increase in the ceiling price of crude petroleum.

3. Complete withdrawal of price ceilings on crude petroleum, retaining product ceilings where proper.

The CHAIRMAN. Now, Mr. Becker, you state your company has been in business about 35 years?

Mr. BECKER. That is right.

The CHAIRMAN. You are vice president of the McBride Co.?

Mr. BECKER. Yes, sir.

The CHAIRMAN. Are you engaged solely in exploring for oil as an independent producer, or do you have refineries?

Mr. BECKER. We are strictly a producer.

The CHAIRMAN. Just a producer?

Mr. BECKER. No refineries.

The CHAIRMAN. You do not have any distribution?

Mr. BECKER. None at all.

The CHAIRMAN. Strictly a producer?

Mr. BECKER. Yes, sir.

The CHAIRMAN. How many wells did you drill last year?

Mr. BECKER. Last year we drilled fifty-some-odd.

The CHAIRMAN. Fifty-some-odd?

Mr. BECKER. Yes, sir.

The CHAIRMAN. How many 2 years before?

Mr. BECKER. In the seventies.

The CHAIRMAN. In the seventies?

Mr. BECKER. Yes, sir.

The CHAIRMAN. Why did you cut down in 1944 as compared with 1942 and 1943?

Mr. BECKER. Well, there are a number of reasons for it. We had in 1942 and 1943 been drilling a considerable number of wells in Illinois, and the favorable locations were not as good in 1944 so we did not do as much drilling in Illinois at that time. We do try to keep our drilling operations in line with our income.

The CHAIRMAN. How many of these wells were dry out of the 50?

Mr. BECKER. I cannot tell you offhand.

The CHAIRMAN. What is your usual percentage of dry holes?

Mr. BECKER. Our usual percentage of dry holes will run around 25 percent. We do not go out and do much wildcatting.

The CHAIRMAN. If replacement costs were granted, how would that affect the price of crude? I know you recommend a 35-cent per barrel over-all price increase. So did Secretary Ickes. What would be the replacement cost—I mean the increased price per barrel—to make up for replacement costs, if it were allowed?

Mr. BECKER. Well, I am of the opinion, as indicated by my testimony before your committee in Austin last September, and it has not changed much since then, I think the price of crude oil should be increased 63 cents per barrel.

The CHAIRMAN. The make-up replacement costs?

Mr. BECKER. Yes, sir.

The CHAIRMAN. It would require 63 cents increase to give you replacement costs?

Mr. BECKER. Yes, sir.

Mr. EASTWOOD. That was not made up altogether of replacement costs, was it?

Mr. BECKER. Not altogether, but that would give us a proper allowance of profit and replacement costs.

Mr. EASTWOOD. That was broken down in your testimony, as I recall.

The CHAIRMAN. Did you want to ask any questions, Mr. Hall?

Mr. HALL. No, sir.

The CHAIRMAN. Did you want to ask any questions, Mr. Eastwood?

Mr. EASTWOOD. I would like to ask one question. I gathered from Mr. Becker's testimony that our committee had suggested remedies and that the remedies had thus far been ignored. I think, in fairness to the OPA, it should be noted that some of our recommendations have been accepted and acted upon, such as the appointment of the advisory committee.

The CHAIRMAN. Do you have a witness who will testify as to what is being done by the advisory committee?

Mr. EASTWOOD. Yes; we have two witnesses, one is the counsel, Mr. Russell Brown, and the other is the secretary, Mr. James V. Brown. I do not know of the order in which they desire to appear.

Mr. Russell Brown, will you come up now?

The CHAIRMAN. Do you have a prepared statement, Mr. Brown?

Mr. BROWN. Yes, sir; I do.

The CHAIRMAN. Will someone pass them around to the committee and other interested people?

STATEMENT OF RUSSELL B. BROWN, GENERAL COUNSEL, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

Mr. BROWN. My name is Russell B. Brown. I am general counsel for the Independent Petroleum Association of America.

I want to thank you for the consideration you have given me in the many opportunities you have afforded me to appear before this committee and for the courtesies you have extended and the patience with which you have received me.

The CHAIRMAN. Now, suppose we get you identified for the record a little more in detail. In addition to your being general counsel for the Independent Petroleum Association of America, you are also counsel for the advisory committee?

Mr. HALL. By appointment of the association or the OPA?

Mr. BROWN. By appointment of the committee. OPA permits an election and the committee selects its officers, and they then approve them.

Mr. HALL. You were first put on the advisory board, were you?

Mr. BROWN. I am not on the advisory board. The advisory board meets with OPA and selects its officers, chairman, secretary, and counsel, and then that is submitted to the OPA, and unless it is dissapproved——

Mr. HALL. They can take a counsel outside of the advisory committee?

Mr. BROWN. Yes, sir.

Mr. HALL. And you were chosen in that way?

Mr. BROWN. Yes, sir.

Mr. HALL. Thank you.

Mr. BROWN. Your efforts to assist the producers of crude petroleum have been encouraging to many in the industry. Your reports following the Austin hearings brings out very clearly the unfavorable effect of present price policies and the trend toward monopoly in crude-oil production.

The facts and assumptions which you recited in the sixth interim report published December 4, 1944, have not, to my knowledge, been denied or refuted by anyone. The statements made therein are sound. The findings of your committee at that time describe fully the situation as it was and that situation has grown steadily worse. Your recommendaions that OPA appoint an industry advisory committee and the initiation of a study of finding, developing and operating costs of crude oil was constructive.

Independent oil producers were encouraged. That hope soon died, however, and oil producers became discouraged by the numerous announcements by OPA officials.

As a beginning of my contribution to the hearings today, I would like to quote from the first quarterly report of the Office of Price Administration:

> At the time the defense program was launched the petroleum industry was depressed. Production of crude oil in Illinois had been unrestricted and the excess supply had resulted in a weakened price structure throughout the midcontinent area. Under the influence of the defense program the demand for motor fuel and other petroleum products increased at a rapid rate and prices began to rise.

That quotation is on page 150 of the report.

Elsewhere in the report the Director of the OPA established the date of the start of the defense program as May 16, 1940.

The quotation from the report expresses the viewpoint which the Office of Price Administration has had from beginning to end. In its opinion, the cure for the depressed situation was in the improvement of the refined products prices. This recovery did take place but it did not extend to the oil producing division of the industry.

The depression in crude-oil production existed then and it exists now.

Your committee has shown a deep and continuous interest in this matter and in the reports issued has found on the basis of the comprehensive evidence presented that the contentions of the oil men whose activities are confined to the producing division have been sound and reasonable. For the efforts of the committee, these producers are grateful. They are grateful also that the committee is undertaking now to ascertain the reason for the delay in the completion of the cost study recommended by the committee and for the unwillingness of the price officials to recognize certain cost items in their program of price fixing, which items are matters of standard industry accounting.

We in the industry are interested in finding out why industry practices in accounting have been consistently ignored. The statute itself directs that they be followed. In another statement we shall set forth specifically our view as to the departure from the statute which the OPA has consistently practiced with respect to the fixing of prices of crude oil.

It was our hope at the beginning of price control, even prior to the enactment of the statute of 1942, that a fair, open-minded examination of the facts would be undertaken by the Office of Price Administration and Civilian Supply, which was created by the President on April 11, 1941. Even prior to that, policies and programs had been in process of formulation by the Price Stabilization Division of the Council of National Defense.

The producers have been given no opportunity by the OPA or its predecessor agencies to present their case. The production of oil is a national matter. There is a transmission of cause and effect across State boundaries. No recognition of this fact has been given to date under the wartime control of prices; instead, small bits of the producing industry have been studied by the price control staff and small local "adjustments" have been made. Some of these were so small as to be humorous, as, for example, the one in Wyoming permitting a 5-cent-per-barrel raise on the 4 barrels-per-day production in one field. It is unlikely that the 20 cents additional income inspired additional effort.

It would not be possible to state the over-all result of the policy pursued to date more clearly than your committee did in its report of December 4, 1944, when you said:

> * * * Although permitting and admitting an increase in the price of gasoline to the retail customer of 92 cents per barrel, which has been directly reflected in the increased profits of the majors, the Office of Price Administration has granted only almost imperceptible increases to the producer of crude oil. These total approximately 6 cents per barrel as compared with the estimated increase in finding, developing, and production costs of 71.6 cents per barrel.

Within the limits of its consideration of producing costs which the OPA established long ago, I believe they have been quite painstaking. In fact, the meticulous care has accounted for 4 years of time. In the effort to locate decimal points precisely, large questions have gone unseen. One is the disappearance from the industry of many of the independent producers. They have been selling out to the strong companies—to those who recovered from the depression referred to by the first Administrator of OPA by the increase in volume and price of the products they refined and sold.

Mr. HALL. Right there, Mr. Brown. Have you any figures as to how many independents have gone out of business?

Mr. BROWN. It is very difficult to get an exact figure. The figure that has been variously estimated as probably the most accurate, is the reflection of those companies engaged exclusively in the producing of oil as reported by the Treasury Department. That shows 25-percent decrease in the number of filing income-tax returns. Now, there have been various studies made, but it is difficult to get an accurate study.

I think probably Wichita Falls, Tex., was one of the greatest centers of independents in the country, and the boys of that area tell me that it runs considerably more than 25 percent in that area.

Mr. HALL. Does that include those who have failed and those who have sold out to larger companies?

The WITNESS. That is right. They have not all gone broke and gone out of business. Many of them have sold out at a fairly good price. I do not mean to leave that impression. The fact is that we have lost the people though, and that is the point.

Mr. HALL. Yes.

Mr. BROWN (continuing). Twenty-five percent of the oil-producing corporations disappeared from the income-tax records between 1938 and 1942, according to the Treasury Department. I am sure they have not been replaced. Many more went since 1942. Their business obituaries were published in the newspapers of the oil country in the form of announcements of sale.

One explanation of this, in the many explanations the OPA has made, was to the effect that crude-oil prices were so satisfactory that both buyer and seller were indeed to trade with each other. This assertion, should it be made again, should be placed alongside the statement made by Dr. Robert E. Wilson, chairman of the board of the Standard Oil Co. of Indiana, to the stockholders of that company in the annual meeting, June 1. He was quoted by the Associated Press as follows:

> Insofar as these profits (Standard of Indiana, first quarter of 1945) come from crude production, they are to some extent fictitious because we are in effect selling off our shelves goods which cannot be replaced at anything like the previous cost.
>
> The OPA justifies ceiling prices on crude oil on the basis that most producing companies are showing good earnings, but this overlooks the fact that the cost of finding new domestic crude reserves has increased three or four fold during the past decade.

The Standard Oil Co. of Indiana has been one of the largest buyers of producing properties from independents since the war began. It has been protecting its supply of crude oil for its refineries. It was not stimulated by the present price of crude oil to pay the prices for properties it did. Dr. Wilson's statement indicates the exact opposite. It was better business to buy the already discovered and developed producing properties than to pay the price of finding an equivalent amount at the greatly increased costs of discovery. The producer who sold was no better off so far as continuing in the business was concerned. He was in the position of the man who sells his home and replaces it with one that costs more. The only way the oil producer can benefit is to go into another line of business where he can do more with his money, as so many of them have done.

Society loses when this happens, for the producer who sells out and quits the business takes with him a knowledge acquired over the years, through alternating failures and successes in drilling for oil. This knowledge is needed. There is a big job ahead of replacing the reserves so heavily drawn on for this war. They should be replaced in the interest of national security and of an assured supply of oil for restoring and rebuilding our economy. The time is now. War-induced prosperity is beginning to fade and war-time employment is being reduced. The transition period is here.

Your committee is meeting today to weigh judicially the answers to certain points raised by your chairman in his June 6 announcement of these hearings. With that announcement, there was released several letters which were written by him to Mr. Judd, of the OPA, and the replies by Mr. Judd. With your permission, I should like to devote the rest of my statement to some comment on this correspondence.

The letter of March 24 from Mr. Judd states that the survey on both crude production and refining—

have become quite involved due to the desires of the industry on the one hand to provide information which indicates the need of price relief and the necessity on our part to see that such information and the findings therefrom conform to the standards of our office.

Confusion is added by the coupling of production and refining. The studies recommended by your committee were to be separate. Certainly, they could not be joined nor could a conclusion as to producing costs be made contingent upon what a refining survey might show. The commitee on production was formed January 15. The one on refining was organized on April 15. It is our impression that the latter committee decided it should await the result of the crude cost study which is logical, as a refiner's cost is affected by the price of crude. The reverse is not true and there is no warrant for implying that complexity was added to the study because of the refining cost survey.

The second part of the assertion by Mr. Judd may well be noted carefully. The whole trouble for 4 years has been due to the inability of the industry to adapt itself to the standards of the OPA. The statute was and is broad enough, but the standards and procedures of the price agency were cast in a narrow and inflexible mold.

In the reply of Mr. Judd, dated March 24, he assigns as a reason for his unwillingness to believe that the industry is selling its oil below replacement costs the "feeling" in some parts of the industry that postwar prices for crude "may" be less than present prices. To borrow his word, I believe such an intangible factor as that is "indeterminate." The statute directs the OPA to deal in facts and contains no authority for attempting to predict the postwar future.

In the same letter Mr. Judd offers to compare expenditures and gross returns this year "and in subsequent years" and to further compare the results with the base period of 1936–39. This promises nothing except further delay. This year is only half gone. Its results cannot be known until next January. As for the "subsequent years," we are hopeful that the OPA will not have to concern itself with many of them.

The chairman of this committee replied to Mr. Judd's letter of March 24, and his analysis of the several points asserted by Mr. Judd might well serve as the reply of those of us who have been so long engaged in this attempt to present our case to the OPA.

Mr. Judd's next letter to the chairman, dated April 17, clarified one point of confusion contained in his former letter. He did say that the replacement cost figure would not be given weight in the conclusions reached as the result of the current survey. That being a principal point at issue, we now conclude that the OPA's position has thus been definitely announced.

In the second of the two letters from Mr. Judd that were released by your chairman, Mr. Judd asserts further that "Our standards do not limit industry profit gained through increased volume of sales," and so forth. I quote that much merely to say that the majority of the producers represented by the Independent Petroleum Association of America are not in position to escape the operations of the OPA price policy in that manner because they have no increased volume of sales. A few of the large companies account for the national increase in production since war began. This they have been able to do partly because they had a large producing capacity that was not being used and partly because of the purchases of properties from the independents.

Much of this letter is then devoted to a discussion of the theory of accounting—the sort of thing which has occupied so much time in the past 4 years. Typical of what we had contended with in the past is the discussion given by Mr. Judd as to how exploration, finding and development work are conducted. He attaches importance to his statement that "such work is financed by the capital which the owners and creditors have invested in the project."

In other words, it is deficit financing of the finding and development, as imagined by Mr. Judd and his associates. There was a brief period when a considerable number of persons thought that primary capital alone was important and set out to obtain it by selling stock. Some of them, I believe, are still in Federal prisons. Disregarding the brief contribution they made to oil-discovery financing, I believe we may say that income from oil is the principal factor.

A labored distinction on whether an operator borrowed some money and then repaid it out of production or did it some other way is to argue the order of precedence of the chicken and the egg. Had oil exploration of the past been delayed while such metaphysical discussions were conducted, I fear we should have faced the Axis Nations with much less provision for supplying oil when and where needed.

I have been unable to find in the two replies which OPA made to your letters any sound reasoning for the refusal of its price officials to recognize, first, what is fundamental in pricing any commodity, that is the return of all proper costs and a fair margin of profit; and, second, the refusal to abide by the provisions of the Emergency Price Control Act.

I do not need to go into detail on replacement costs, nor shall I attempt to discuss question 2 in your letter to the OPA official. The secretary of the Crude Oil Industry Advisory Committee is here to speak on the committee's activities. And I believe the chairman's replies to Mr. Judd's letters constitute an adequate discussion of the replacement-cost question. Another witness is also prepared to discuss this point.

Many companies, both large and small, are reporting to their stockholders the problem facing oil producers today of replacing reserves which are being rapidly exhausted. The sixth interim report of this committee contained a number of such quotations. I would like to quote the statement of Mr. Reese H. Taylor, president of the Union Oil Co., of California, in his report to shareholders at their annual meeting April 3, 1945:

> The difficulty of increasing reserves through new discoveries alone is stressed by the record of the industry in California last year. During that period 214 wildcat wells were drilled, but only 15 found any oil. These 15 were credited with discovering a reserve of 11,000,000 barrels—less than .4 percent of the oil withdrawn from the State during the year. * * *

Discouragement develops not from the inability to find new oil but from the cost of finding it compared wih present-day sales prices. Today the average barrel of oil sells for $1.02. But by comparison it has been estimated that to find new reserves of 11,000,000 barrels of oil last year the California industry spent around $14,000,000, or at a rate of slighly over $1.25 per barrel. Before the oil is finally recovered this cost will be still higher, for a great number of development wells must be drilled. And drilling and other production costs are so much greater today than they were before the war. Advanced wages, accentuated by overtime, as well as increased costs of tools and materials, account for this rise.

While in 1890 it only cost $2,500 to drill an average well in the California fields—today, because we go much deeper, and use such expensive equipment, it costs almost 26 times as much.

If oil prices were not largely historical in their origin—and in no way realistic under today's operating conditions—adjustments balancing increased costs would have been made long ago. Unfortunately, Government pricing authorities cannot grasp the true situation—or do not wish to recognize present inequities—in spite of the fact that oil is internationally considered one of war's foremost munitions.

In view of the high costs of discovering and producing oil, Union has acquired proved reserves by direct purchase wherever practical. During 1944 such transactions increased our underground supplies by around 24,000,000 barrels. * * *

However, we can't rely on such purchases to meet all our requirements. Therefore, we have expanded exploration and development activities wherever we have felt there is any possibility of finding oil.

But with fair adjustment of prices, Union Oil and the rest of the industry could afford to go farther afield in its search for oil. We could also expand development and research activities to stretch the over-all supply.

OPA in its replies to your committee told you that the industry requests certain data shown by their books be disregarded and that OPA substitute figures calculated on a different basis.

OPA in its costs surveys ignores the books and sets up a formula in determining costs and margin in the production of oil which do not conform with the provision in section 2 (a) of the Emergency Price Control Act which provides:

That no such regulation or order shall contain any provision requiring the determination of costs otherwise than in accordance with established accounting methods.

It has long been an established accounting method on the part of most of the producers of crude petroleum to write off intangible drilling costs. It has equally as long been an established accounting method to compute depletion in accordance with the right given by Congress—that is, percentage depletion—yet OPA ignores the mandate on the amendment inserted last year in the Emergency Price Control Act cited above.

The law was also amended directing the OPA insofar as practicable in adopting price regulation, to advise and consult with representative members of the industry which will be affected by such regulations or order "and shall give consideration to their recommendations." Congress repeated this provisions in the act, indicating it considerated the recommendations of industry advisory committees to OPA should be given proper consideration. So far, the recommendations of the National Crude Oil Industry Advisory Committee, of which I am counsel, with regard to methods of cost finding, have not only been ignored but the industry, the public and your committee has been informed by OPA that it will not consider current replacement costs in determining whether or not an adjustment is necessary in fixing crude petroleum price ceilings.

It is important that OPA be directed to follow the will of Congress. It should be directed to recognize in determining costs, the established methods of accounting in the finding, developing, and production of crude petroleum. The National Crude Oil Industry Advisory Committee is qualified to know what is proper in cost finding for price-fixing purposes in that industry and its recommendations on that subject should not be ignored.

Replacement costs are essential to any continuing business. If a business continues to sell its products below the cost of replacement to that extent the business is being liquidated.

If we are denied replacement costs we are denied the use of the long established "last in and first out" method of accounting used in other industries. This method is recognized by the accounting profession and by Government agencies as sound. If we are required to determine our costs otherwise than in accordance with established accounting methods as provided by law, such as statutory depletion and intangible write-offs, then what method must we employ?

This position of refusal to use the accounting system on which the industry has been built is confusing and attempts to deny the industry the normal method of establishing a base for fair price.

The CHAIRMAN. I wonder if it would be all right, after we hear the next witness, to permit anyone connected with the OPA, Mr. Judd, or anyone selected by him, to interrogate these three gentlemen? Would you like to have that privilege, Mr. Judd, or not? Would you like to wait and make your presentation tomorrow?

Mr. JUDD. Yes, that will be all right.

The CHAIRMAN. All right, suppose we go ahead. Would you like to ask Mr. Russell Brown any questions? I thought we would finish with the three witnesses. Don't you think that would be better?

Mr. Green?

Mr. GREEN. My name is Paul M. Green, OPA Deputy Administrator for Accounting.

Mr. Brown, I have a list of oil companies submitting reports to the SEC. Of 92 companies, only 8 followed percentage depletion methods. All of those reports were made to the SEC, certified to by reputable accounting firms, as being in accordance with accepted accounting practices. It seems to me that that is at variance with your testimony. Would that be any evidence as to practice on sustained depletion accounting in the industry?

Mr. BROWN. I do not see where that varies. Did you find any accounting in any company that does not reflect percentage depletion on the books?

Mr. GREEN. Of 92 companies only 8 used percentage depletion. Of the 8, 6 were very small companies. Two were of a very, very small small size.

Mr. BROWN. Of course, I do not know what the objectives of SEC is. Maybe Mr. Brown would know. Could you come over here? He is an accountant and I am not.

Mr. GREEN. Fine.

The CHAIRMAN. Mr. Brown, if you wish to refer to any of these questions to someone else, that will be satisfactory.

Mr. RUSSELL BROWN. I am not an accountant, but Mr. James Brown is.

The CHAIRMAN. Will you identify yourself for the record?

Mr. JAMES BROWN. My name is James V. Brown, secretary of the National Crude Oil Industry Committee, with offices in Washington, D. C.

Mr. GREEN. You are an accountant, Mr. Brown?

Mr. JAMES BROWN. I was with the Treasury Department as an internal-revenue agent from 1924 to 1929. I have been an oil accountant from 1929 on—rather, long before I went to the Treasury Department. In my work with the Treasury Department I was on natural-resources cases. Does that give you any indication?

Mr. GREEN. Yes; I wanted to ask if you agreed with the witness about the testimony that it was accepted accounting practice in the oil industry to keep the records on percentage depletion?

Mr. JAMES BROWN. I agree.

Mr. GREEN. How would you explain it?

Mr. JAMES BROWN. Referring to your sample of 100 I would say that would be too small a sample to use in classifying the industry as a whole. That 100 is taken from the largest companies in the industry—those who are equipped with offices having accountants trained in the technicalities of sustained depletion as well as statutory depletion. If you go out through the country and examine the books and records of the thousands of independent producers, small producers whose statements do not go to the SEC and whose statements are not published, and who, perhaps, do not have competent accountants, they invariably keep their records on the income depletion basis. That is the only depletion they know. To get the sustained depletion you have got to have engineers. Engineers are costly, and trained accountants are costly. The average producer of petroleum—and there are eighteen to twenty thousand of them according to the Tariff Commission's standards—the bulk of them, do not keep sustained depletion. They do not even know what the answer is on sustained depletion.

Mr. GREEN. In other words, the oil companies that have competent accountants follow sustained depletion?

Mr. JAMES BROWN. They figure it both ways. They put on their public statement the sustained depletion and in their income-tax records the majority of them use statutory depletion.

Mr. GREEN. And you still say we do not follow accepted accounting practice with those companies that have competent accountants and the leading accounting firms certifying that is in accord?

Mr. JAMES BROWN. I am talking about the whole industry.

Mr. GREEN. Could you produce—well, I think I would be safe in saying 1. Could you produce 10 companies out of this 26,000 or whatever number it is that keep their records on replacement cost basis, where any competent accountant has said that it was in accord with accepted accounting practice?

We wish to follow the best accounting practice we can. We are open to conviction. If you can produce out of 26,000 as many as 10 companies, it would be at least a little bit of evidence of the validity of these charges you are making against us. Now, I have these companies from the SEC. The May issue of the Journal of Accountancy sets forth a statement concerning the position I have taken with regard to Mr. Brown's testimony before the other committee. I am perfectly willing to leave the issue with the American Institute of Accountants, probably the highest accounting authority in the land. We welcome any examination of our accounting methods.

Mr. RUSSELL BROWN. If I may make a comment right there, I think you unconsciously put your finger on our difficulty. You go naturally—and I am not finding fault with that—but in your accounting studies, you go naturally to the larger companies. They do carry a sustained depletion accounting constantly because often it is more desirable, particularly when they are buying properties as they are now. The ordinary small group of operators—and I think this comes from a vast experience of going through their accounts—very few of the small operators ever carry sustained depletion. Now, Mr. James Brown here was with the Tariff Commission some time examining books throughout the United States. I do not know what his experience was on that, but I doubt very much if he found many, except the integrated companies, who carried the sustained depletion on their books. I think maybe you have suggested the very trouble we are having and that is why we are inviting you to study the smaller point of view. I think you are probably correct in saying that all of the integrated companies carry also the sustained depletion.

Mr. GREEN. The leading accounting firms in the country certify this is in accordance with the accepted accounting practice. You say we do not do it. We submit Haskins & Sells; Price, Waterhouse; and the 25 biggest accounting firms in the country. You pick them, and we will stand by their method.

Mr. RUSSELL BROWN. Now, the next point you make, if I may comment before Mr. Brown makes a technical answer—that is, as to replacement costs. I know of no occasion in the normal producer's accounting system that would require him to carry a reflection of replacement costs. Yet under a fixed economy he must go back and bring that out and reflect it on the books.

Mr. GREEN. I have no quarrel with you on what your price should be, whether you should have replacement costs, but let's call a spade a spade, and don't come in and attack us on not using accepted accounting practice. Now, in the Internal Revenue Act there are several provisions in favor of the oil companies. One is percentage depletion. Another is the provision that you could write off intangible drilling costs, and a third one is that since you have broken your tie between cost and depletion, the oil companies are permitted to write in an excessive amount of expenses. In other words, when you tie depletion to cost then it makes not too much difference whether you take it this year or next year, and probably does not make any difference to the Internal Revenue. To us it would. When you break this tie and swing over to a percentage depletion basis, then it is certainly to your advantage to throw everything you can in costs, and that is what the oil companies have done. In addition to that, there is still a fourth thing. Where you have a provision that percentage depletion could not be more than 50 percent of income it has been broken down by leases so that you do not have to balance one against the other. So you have four pretty important things there that in my humble opinion are indirect subsidies to the oil industry. I do not care about that. If you are coming to us to attack the accepted accounting methods, I am here to defend myself or any place to defend myself, and I can get support from the highest authority in the land on accepted accounting practice. Now, if it is something that has to be done it is perfectly all right with me. My responsibility is only on accounting. Mr. Judd will talk of the pricing angle. I have all the evidence any committee would look into on whether we do or do not follow accepted accounting practice. We will welcome investigation and submit our case to any authority.

Mr. RUSSELL BROWN. I do not quite understand the purpose of your injecting that—that the oil industry has a favored position.

Mr. GREEN. The purpose was to list four places where you have indirect subsidies.

Mr. RUSSELL BROWN. That is your interpretation.

Mr. GREEN. Yes; it is my interpretation. It would also be the interpretation of leading accounting authorities. I have a letter here with me from the director of research for the American Institute of Accountants in which he specifically covers replacement costs and points out the indirect subsidy nature of these things. That is neither here nor there as far as this case is concerned. All I object to is the oil industry trying to get the same advantages in the procedures of OPA under the accepted accounting practice provision. We are forced by law to follow accepted accounting practice, and before we were forced by law we certainly did it.

Mr. RUSSELL BROWN. The accounting, though, to which you refer is the accounting established by Congress after long and careful study, isn't it?

Mr. GREEN. No; I would not say that. It was established by the Congress as it should have been. It was a deduction method for income-tax purposes; it was not an accounting method for the purpose of cost determination. I will leave that to any accounting authority you may pick.

Mr. RUSSELL BROWN. Let's see. Of course, you indicate a prejudice against our position by stating——

Mr. GREEN. No; I do not.

Mr. RUSSELL BROWN. I think that is our difficulty, because you indicate that prejudice to begin with. You say we are favored. Of course, we do not believe that. We think the result of these accounting systems are the studies Congress has made and found proper. They have reviewed them year after year, after year. The special committee spent months and months studying them back in 1926.

Mr. GREEN. That is right.

Mr. RUSSELL BROWN. And they came out with this and you come in and indicate your prejudice by saying we are in a preferred position.

Mr. GREEN. It is all right with me, if Congress gives you the moon, Mr. Brown. The only thing is that since I am under responsibility to follow accepted accounting practice, I do not want Congress to give you the moon under the cloud of accepted accounting practice. I want the Congress, in support of your request, to look into our accounting practice and trace it down and see how far off base we are. We welcome any investigation Congress wants to make—any committee that you set up—wants to make.

Mr. RUSSELL BROWN. That is why we thought that we should be thoroughly frank. I think we have called a spade a spade. If I have not I meant to call it one and I meant to be fair about it.

Mr. GREEN. That is all I ask. The witness right before you was talking about operating costs. He said "operating costs and depletion." There is an admission that depletion is not operating cost. I just sat there and listened to his statement. In defining profit, he said profit was income less outlay. There agein he included in his profit percentage depletion. Maybe he did not mean to do that. Maybe that was an oversight but twice in his testimony inadvertently he admitted that at least part of percentage depletion was not cost. An examination of the statement will show it.

Mr. RUSSELL BROWN. You could help me and probably clarify where I might misjudge you, if you tell me how the operator who does not get enough money to go back and get another barrel—how does he stay in business under your system?

Mr. GREEN. I do not have any system.

Mr. RUSSELL BROWN. Well, under the one you are supporting. Can you explain how the fellow who sells a barrel of oil for $1, and it cost him $1.25 to get another, how is he going to stay in business?

Mr. GREEN. There are two ways in business to do that—in other businesses, and I think the oil business would be normal. One is to go out and seek additional capital, and the other is to plow back earnings. If I am informed correctly, in the oil industry those earnings are certainly adequate.

Mr. RUSSELL BROWN. You are not correctly informed.

Mr. GREEN. I am sorry.

Mr. RUSSELL BROWN. Now, if he is losing 25 cents a barrel, and he goes to his bank to get money as you suggested, or to sell stock, what sort of position does he have when he goes either to the bank or to the fellow who buys stock and he says, "I am in the business where my oil is bringing me a dollar a barrel. I am selling my goods over the shelf but I must get some more. It is going to cost me $1.25 to get more." Do you think as an investor you would get enthusiastic about that?

Mr. GREEN. Let me counter that, Mr. Brown, with another question. Suppose the replacement cost of oil was less than the oil you now have. Would you still hold the same position?

Mr. RUSSELL BROWN. I do not know. I probably would not even have this price question up.

Mr. GREEN. Why?

Mr. RUSSELL BROWN. I might not need to.

Mr. GREEN. That is right.

Mr. RUSSELL BROWN. But this is a need today. We are talking about factual things. I appreciate this chance to discuss it with you because I have not had that answered yet. I am anxious to get it. That is, the fellow asks me, "How am I going to stay in business if it costs me more to replace my stock than I am getting?"

Mr. GREEN. Technically, that is none of my responsibility. I know that is no answer to your question.

Mr. RUSSELL BROWN. No; that does not help me any.

Mr. GREEN. The two methods, though, which I suggested, are the only ones I know. If the Congress wants to make some special provision to be more liberal with you, to tell OPA to be more liberal with you, I have no objection at all. That is not my problem. But I do have a very deep concern when you attack us on accepted accounting practices.

Mr. RUSSELL BROWN. I do not think it is an attack.

I am only quoting what you say yourself.

Mr. GREEN. Here is a statement by a gentleman by the name of Forasté:

DEPLETION IN THE OIL INDUSTRY

Practically all oil-producing companies in the United States record cost depletion on their corporate books. The 32 companies which cooperated in the survey by completing the questionnaire follow this practice. The 36 companies listed on the New York Stock Exchange, most of which are listed on the questionnaire, all record cost depletion.

Mr. RUSSELL BROWN. I think that is true.

Mr. GREEN. Now, if we are wrong in saying that cost depletion is accepted accounting practice on the basis of what we can find out about the oil industry, what we can find out from published accounting sources, and what we can find out from accounting periodicals, what we can find out from the four large national accounting associations, what we can find out from reports submitted to the SEC, and from accounting authorities, then I think it is your duty to give us some information.

Mr. HALL. Mr. Green, may I ask a question?

Mr. GREEN. Yes, sir.

Mr. HALL. I know nothing about accounting, but from listening to your testimony now, I would take it that the information that you have does come from the bigger companies. In other words, you are speaking about the companies which file reports with SEC.

Mr. GREEN. Most of them are large companies.

Mr. HALL. You are speaking about the Haskins Sells Co.; Price, Waterhouse, and so forth, and they represent, I think, the larger companies.

Mr. GREEN. That is right.

Mr. HALL. Have you, at any time, investigated the accounting system used by these thousands of independents throughout the country?

Mr. GREEN. No.

Mr. HALL. In other words, I am not an accountant, but I do not see how you can appraise this question unless you do know what accounting system some of these thousands use, because certainly Price, Waterhouse in the reports filed with the SEC do not cover the independents. I am speaking as a complete amateur, but I think I am right; don't you?

Mr. GREEN. Yes.

Mr. HALL. How can you answer that question, unless you have investigated it?

Mr. GREEN. I have this statement here, Congressman:

Practically all oil-producing companies in the United States record cost depletion on their books.

Mr. HALL. Who made that statement?

Mr. GREEN. This gentleman, Forasté, who made a study of the oil industry in 1943.

Mr. HALL. I think this gets down to a matter of fact, and it would seem to me it is something easily determined, but I do not believe your answer is the complete answer because you certainly are referring to the larger companies. I am familiar with Price, Waterhouse; and I am familiar with Haskins and Sells; and I am familiar with the type of companies that filed with the SEC. I do not think that answers the question, to my mind at least, Mr. Chairman. I would like to know what the little independent does.

The CHAIRMAN. Suppose we hear Mr. James Brown.

Do you have your testimony prepared, Mr. Brown?

Mr. JAMES BROWN. Yes; I have.

The CHAIRMAN. Suppose we finish up with him?

Mr. JAMES BROWN. I wonder if I might attempt right here to meet the Congressman's question as to what the thousands of independents do. I did not state in my identification that I was with the Tariff Commission when they made their cost survey in 1941 and 1942. That covered 2,500 companies and brought in nearly 15,000 separate returns. I was second in charge of that survey. I saw those returns. I know what those men were doing, from those questionnaires. This Mr. Forasté—his statement I believe covers 32 or 38 companies. Mr. Forasté is with the Standard Oil Co. of New Jersey, if I remember correctly. I do not dispute his figures. There is much information in his report to show that there is conflict in accounting even among those 32 companies, but the 2,500 returns that came from the Tariff Commission show that the practice of the majority is to follow statutory depletion, and write off intangibles.

Mr. EASTWOOD. Mr. Chairman, I have just noted in the introduction that it says it just referred to the 100 large, medium-size, and small companies, and only referred to 100 companies.

Mr. HALL. It seems to me it would be an easy matter to determine. Why argue about it?

The CHAIRMAN. Do you have copies of your testimony available, Mr. Brown?

Mr. JAMES BROWN. Yes, sir.

The CHAIRMAN. You may proceed, Mr. Brown.

STATEMENT OF JAMES V. BROWN, SECRETARY, NATIONAL CRUDE OIL INDUSTRY ADVISORY COMMITTEE

Mr. BROWN. My name is James V. Brown, secretary of the National Crude Oil Industry Advisory Committee. I was elected to that position by the members of the committee at its organizational meeting January 15, 1945. That does not qualify me as a member, but as secretary of the committee. I am also secretary of the Crude Oil Requirements Committee and its subcommittee, made up of representatives of 37 trade associations of the petroleum industry.

On January 3, 1945, Mr. James F. Brownlee, Acting Administrator of the Office of Price Administration, appointed a number of representatives of the oil industry to membership in the National Crude Oil Industry Advisory Committee in accordance with section 2 (a) of the Emergency Price Control Act of 1942, as amended, and in accordance with the rules prescribed in procedural regulations No. 13. On the same date, the then price executive, Petroleum Branch, W. Page Keeton, notified the appointees of a meeting to be held in Washington, January 15, 1945.

Mr. Brownlee in his letter stated:

> The purpose of this committee will be to aid the Office of Price Administration in determining whether the prices of crude petroleum are generally fair and equitable

He further stated that—

The Office of Price Administration is desirous of cooperating with the Committee on Small Business and the industry, and to that end is appointing the necessary committee.

Mr. Keeton in his letter stated the purpose of the first meeting of the committee among others, was to discuss matters relating to the problems raised by the Committee on Small Business of the House of Representatives.

At the meeting held on January 15, all the 23 appointees met with the officials of OPA here in Washington and carried out the necessary organization procedure in setting up this committee. Mr. Sumner T. Pike, Director of Fuel Division; Mr. O. D. Judd, Associate Director, Fuel Division; and Mr. W. Page Keeton, price executive, Petroleum Branch, all of the Office of Price Administration, outlined and discussed the standards of the Office of Price Administration relative to the adjustment of maximum prices on crude oil, pointing out that it is the policy of that Office in establishing price ceilings to take into consideration earnings of the industry in a base period, 1936 to 1939, and compare current earnings of the industry with such base period and to maintain prices at a level which are generally fair and equitable. They further stated that in order that such a determination be made, and to comply with the recommendations of the Committee on Small Business of the House of Representatives and a number of crude-oil producers, a survey of the cost of producing crude petroleum of a representative list of oil producers in the United States would be made, and presented a form or questionnaire for the committee to examine and approve.

The questionnaire followed in general the method used by the United States Tariff Commission in its cost survey which was made under the direction of the Office of Price Administraion in 1941 and 1942. The questionnaire did not provide for bringing out the cost of finding, developing, and producing crude oil on a current replacement basis.

A subcommittee was formed to study the proposed form which OPA submitted. E. P. Potter of the Amarada Petroleum Corp. was appointed chairman of the subcommittee. The other members are A. C. Rubel, of the Union Oil Co. of California; Carl E. Reistle, Jr., of the Humble Oil & Refining Co.; J. P. Coleman, of Wichita Falls, Tex.; W. B. Emery, of the Ohio Oil Co.; Merle Becker, of W. C. McBride, Inc.; Charles Roeser, of Fort Worth, Tex.; were also on that committee, and myself, as secretary.

During the consideration by the full membership of the committee of the type of questionnaire to be used in the survey, the Office of Price Administration was urged to consider a simplified procedure in its proposed survey. The committee recommended that finding costs be determined by agreement between OPA and the industry committee, that a flat figure in cents per barrel be used, based on the experience of the industry, and also the arbitrary figure used in the hardship premium payment plan; namely, 60 cents per barrel covering depletion of leasehold cost, depreciation of tangible equipment, amortization of intangible drilling costs and overhead, be adopted. In addition to the use of these two flat figures, one for finding cost on a replacement basis and the other at 60 cents now used in the hardship premium payment plan, there should be a survey made of a limited number of oil producers covering operating costs only, and that proper weighting of such costs and an allowance for reasonable margin of profit on a national basis should be made, arriving at fair and equitable price ceilings.

Incidentally, that plan is used in the hardship cases, a simple questionnaire, and the committe urged that the same type of questionnaire be used, and that these other elements are difficult, even in the accounting industry, to determine and be agreed upon across the table. We failed to get that plan across.

The committee has not received any assurances that OPA will consider any simplified procedure.

The Subcommittee, after reviewing the OPA questionnaire, reached the conclusion that the form as proposed was not suitable for assembling data that could be properly used in approximating the current actual cost of finding, developing and producing crude petroleum, stating that the procedure proposed would disclose historical cost rather than current actual cost and would indicate current earnings from producing operations which actually are nonexistent if considering in relation to current replacement cost. The committee was definitely of the opinion that the OPA approach to the problem would be both incorrect and misleading.

The Office of Price Administration and the Industry committee were unable to resolve their basic differences of opinion as to the method of determining costs and earnings to be used in fixing petroleum maximum price ceilings. The Office of Price Administration contends it is limited to the use of bookkeeping profit and loss data. The committee believes that replacement costs must be considered and that the law permits it. The committee found it necessary to compromise on a questionnaire which the representatives of the OPA and the industry committee developed so as to furnish both the information desired by OPA and the industry committee. It was not until April 11, 1945, that this form was completed and put in the mails by the Office of Price Administration.

Mr. HALL. When did you start studying this questionaire and begin the preparation of it?

Mr. JAMES BROWN. The subcommittee started on January 15. They met all week.

Mr. HALL. 1945?

Mr. JAMES BROWN. 1945. They met on several occasions in between. We had a meeting in St. Louis, and an OPA accountant was with us.

Mr. HALL. Go ahead.

Mr. JAMES BROWN. Going back to the time of the appointment of the members of the Industry Advisory Committee, I was requested by the Office of Price Administration to submit a list of oil producers who were considered by the industry to be representative both as to volume of production and geographically. The Tulsa office of the Independent Petroleum Association of America prepared 3,000 cards giving the names and addresses of oil producers known to be then in existence. These cards were arranged by States and producing fields within those States. I turned these cards over to Mr. Judd at the January 15 meeting of the Advisory Committee with OPA. At the same time, the National Stripper Well Association furnished approximately 1,000 names. Later, at the request of the Office of Price Administration, I communicated with various local petroleum trade associations throughout the country, obtaining lists of names of producers then in existence in their areas.

This information was all supplied to the Office of Price Administration. OPA made a selection of approximately 700 names which they submitted to me for approval of the Advisory Committee. The list was broken down into geographical sections and sent to members of the Advisory Committee located in these geographic areas. This was done at the request and authorization of the Office of Price Administration. It was not my understanding that the approval of the list was a determination of or guaranty that those names in the list would file the questionnaire. It was found that there were many names that were not known to the members of the committee. Also, that there were a number who were out of business, or had died. These matters were reported to the Office of Price Administration for their selection of substitutes. The committee offered additional names at that time. The final selection was made by OPA.

Mr. Eastwood. It was not a matter of mutual agreement, then?

Mr. James Brown. I would say that I did agree to their selection. Of course, I am not competent to know everybody in the oil business. The men in the field did not know them all, but where there were some names unknown, the girl on the staff there that handled that work felt that they should go out anyway, and I agreed on that procedure. However, we did not know at the time everybody on that list.

I am not entirely familiar with what method was used by that office in the selection of these names. I did learn, however, that only a small portion of them were taken from the cards which were submitted by me at the January 15 meeting, and that the bulk of the names were taken from a Petroleum Register which was then several years old.

That may account for the large number of names later found to be out of business.

Since the mailing of the questionnaire, it has developed that there were still quite a number of names on the list of producers now out of business. It is felt that so much time has elapsed that it would not be advisable to select additional substitutes. My recollection is that there are about a hundred names where no one could be located or the party was dead or we were informed that the person to whom the questionnaire was mailed was now out of business.

Originally, these questionnaires were to be filed on or before May 1, 1945. The time was later extended to June 1, and recently it has been further extended to June 30.

The committee wrote to the oil producers receiving the OPA cost questionnaire on April 11, May 5, May 16, and June 8, urging them to cooperate with the Office of Price Administration to complete and file their questionnaire within the time allotted. Various trade associations have taken other means of urging these people to file through telephone conversations, correspondence, and what not.

I have received many letters giving various reasons for the inability to file, among which I get answers of this nature: "I am not a producer of crude oil"; "out of business since 1940"; "my records simply do not reflect this information"; or "my office force is at a minimum for its every-day requirements. I will not be able to comply with your request"; "we have no crude production"; "owing to sickness and lack of help, we are unable to complete the cost form."

Other reports were, "Have sold out"—there were many of these. Another reports that "the person who kept the records and the information asked for has been in the military services for the past 2 years—there is no one available at present who can supply this information." Another regrets that "lack of experienced personnel and a multitude of detailed work does not permit its preparation." Another states, "The records are not set up in such a manner as to make it possible to get an intelligent report." Another is unable to compute the information desired. Another states that "Partnership was dissolved in 1939." Several report that they are very small producers and do not have any figures or information with which to fill out such a complicated questionnaire. Another states it would be very difficult to go back to 1936 and 1937 for determining operating costs. Many pleaded that it is impossible to fill out the OPA questionnaire with any degree of accuracy.

In short, the general difficulty, as expressed by the many letters which I have received, is the complexity of the form and the lack of personnel. There is also some doubt expressed by many as to the sincerity of OPA in making this survey. I wish to say, in fairness to the OPA there, however, that is not the general opinion of the committee. However, it is one of those feelings on the part of many producers that make it difficult for us to get the questionnaires in.

On May 25, Mr. Judd wrote me as follows:

> It appears advisable to establish the minimum return which this agency considers necessary for factual finding. In view of the fact that the sample has been carefully selected and is numerically small, the percentage of returns on which a finding can be made must of necessity be very high.

Mr. EASTWOOD. How many did you say there were?

Mr. JAMES BROWN. Seven hundred (reading):

> If a higher percentage of returns from such sample is not received, then any finding made will in all probability not disclose a true condition. Because of these facts, we feel that a percentage return of less than 85 percent of the selected sample would require careful determination as to whether any finding made could be considered conclusive. In any event, a materially small percentage return should be regarded as inadequate.

I have transmitted this information to each member of the committee. Most of them have responded and the substance of those responses is that such a percentage is too high for this type of survey, particularly in view of the fact that a substantial percentage of the list has already proven to be useless because of those now out of business or unable to file.

Mr. Judd informed me that his mind is not closed on this percentage but still believes it should be high. The committee does not think that there should be any percentage numerically. The production as represented by those already filed exceeds in my rough calculation more than 60 percent of the total production for the country. By volume they already have in their hands 60 percent of the production of the country.

Ordinarily, that would be an adequate sample. However, this requirement of OPA made it appear advisable to extend the study another 30 days. I believe that within that time all those who intend to file will have done so, and that the returns then in the hands of the OPA should be sufficient for them to commence tabulation. The present position of OPA on the matter of a high percentage of returns is one which has not yet been resolved.

No agreement has been reached as yet as to the method of analysis of interpretation of the tabulations which are to be made from these returns.

The subcommittee in its meeting in St. Louis, February 3, 1945, drew up certain resolutions regarding this survey which were transmitted to OPA. The Committee requested that its representative participate in examining the returns filed in connection with the analysis and interpretation of the data submitted. This bears on the second question in the letter of your chairman to Mr. Judd wherein you ask, "What provision have you made to permit the Crude Oil Industry Committee or a representative of that Committee to have access to the detailed information about to be collected through your Crude Oil Cost Study?"

OPA has consistently refused to permit a representative of the Advisory Committee to examine these returns. It has promised the committee, however, over-all totals taken from the tabulations it proposes to make.

When this study was first contemplated, Mr. Russell Brown and myself discussed with the price executive, the use of a power of attorney to represent oil producers, in accordance with their OPA procedural regulation No. 13. We were informed at that time that we would be permitted to examine any returns for which we furnished a power of attorney. However, when we submitted to Mr. Judd a draft of a proposed letter from the National Crude Oil Advisory Committee, to those producers whose names were included in the survey list submitting a form of power of attorney for execution by those who desired to do so, Mr. Judd, upon advice of his counsel, stated that OPA seriously objected, and that it could not legally authorize the use of such power of attorney. We therefore abandoned the idea. Our purpose was to have some authorized basis for discussion of individual forms with OPA, believing this would make possible the expedition of the study and afford representation to all producers in the review of these returns. My experience with these returns is that many small producers omit some items of cost. OPA has not indicated what allowances it will make where these omissions occur.

If OPA had agreed on the use of a simplified questionnaire for operating expenses only, and indicated a willingness to submit the matter of all other elements of cost for settlement across the table between OPA and the Industry Advisory Committee, the delays which have occurred might have been avoided.

The Committee did recommend such a procedure. There was a precedent in OPA procedure to warrant that action, and as for finding and development costs on a replacement basis, the committee felt that there has existed sufficient data for the determining of an arbitrary figure upon which OPA and the Industry Advisory Committee could agree.

The CHAIRMAN. Mr. Hall, do you want to ask any questions?

Mr. HALL. Mr. Brown, would it be possible to have an accepted method of accounting for small companies which might be different from an accepted method of accounting for the bigger companies?

Mr. JAMES BROWN. It would be, and I find that it is.

Mr. HALL. Would you say that that could be true, too, Mr. Green?

Mr. GREEN. In certain ways, yes. For example, small business under Internal Revenue keeps its accounts on a cash basis. Somewhat larger businesses usually use an accrual basis. As far as cost determinations are concerned, I would disagree. I would disagree wholeheartedly with the statement that you determine cost on this specific item on the basis of percentage depletion which is a percentage of gross income and has absolutely no connection whatever with cost.

Now, maybe that begs your question.

Mr. HALL. I was just wondering whether or not it does answer my question. Have you any knowledge which would indicate that you are right when you say that they do not keep their books in that way?

Mr. GREEN. Yes, sir.

Mr. HALL. What is your information?

Mr. GREEN. We have not examined the books of all these companies, of course.

Mr. HALL. Have you examined the books of any of the earlier companies?

Mr. GREEN. May I call on Mr. Noble here?

Mr. HALL. Surely.

The CHAIRMAN. Identify yourself for the record.

Mr. NOBLE. L. H. Noble, of the OPA. We have, of course, sent out this questionnaire to a good many—most of the companies are the smaller companies. Our national office accountants have not yet visited any of those offices, but in a few instances where they asked for accounting assistance, we have communicated with our field accounting offices and asked them to call on those offices and provide what accounting assistance they need. So that they would have seen the accounts of those particular concerns.

Mr. HALL. What have they found out?

Mr. NOBLE. They have not replied to us, as such. They have assisted these companies in preparing the returns, and as far as we know they have come back. The returns require that the cost be reported on the basis of sustained depletion. As far as I know we have had no objections from the companies with respect to that computation. The reason is, as I understand it, they are required under the income tax laws to make the computation both ways, on the basis of sustained depletion and percentage depletion, and even though they do not have the engineering facilities available as the larger companies do, they enter into some sort of computation because they are required to take the higher of the two methods in any given year.

Mr. HALL. Well, am I right when I say that apparently OPA is not familiar with the cost accounting used by the smaller companies?

Mr. GREEN. To some extent; yes.

Mr. HALL. Well, what did you mean by "to some extent?"

Am I right or am I wrong?

Mr. GREEN. We do not have detailed knowledge as to how the great mass of small companies keep their records.

Mr. HALL. Mr. Chairman, it seems to me that Mr. Green made a fair proposition at the beginning of his testimony. He said he would like to know and he would like to have representatives of the smaller groups tell him how they keep their books.

Mr. GREEN. We would welcome that, Mr. Congressman.

Mr. HALL. It seems to me if we could blend the two colors, green and brown, maybe we could do that.

Mr. JAMES BROWN. I suggest that there is available to the Office of Price Administration a very detailed study made by the United States Tariff Commission at the expense of the OPA and under their direction, and those figures belong to the OPA. There are 15,000 questionnaires lying over in the Tariff Commission Building, and on those questionnaires you will find several thousand of them unable to give sustained depletion. They were unable to give amortization of intangible drilling cost which is required on these forms, and the small businessman does not keep his records that way. He does not know the answer and he did not furnish the answer and nobody supplied it for him.

Mr. EASTWOOD. Mr. Chairman, I would like to insert an observation here. It is my understanding that after we held our hearing on the Southern Pine price complaint a year and a half ago, that OPA agreed in that instance to permit a representative of the producers to examine detailed cost figures, that man being empowered by a power of attorney, I believe—I am not making that as a blunt statement, but I think a Mr. Bower, an accountant for the Southern Pine Association, was permitted to sit with the OPA accountants in examining those, and I think that should be looked into.

The CHAIRMAN. Of course, Mr. Judd and Mr. Green had no connection with the lumber industry.

Mr. EASTWOOD. No; but it was somewhat of a related problem.

Mr. GREEN. We are very happy, Congressman, to have anyone from the industry look into the figures that we have. We are under obligation by law to protect the confidential treatment of the data from the companies. We lean over backward to do that. I can speak only for the Accounting Department. If any representative of any industry has authority from the company, either a letter sent to us or a letter that he carries with him, we are only too glad to have someone sit down and go over the figures with him. Under no other circumstances would we do that without such authorization, simply because we would be violating the law in the protection of confidential data.

Mr. EASTWOOD. I understand from the beginning it was the intention to have Mr. James V. Brown here given that power of attorney by various small firms, and Mr. Judd, upon advice of counsel, according to Mr. Brown's testimony, said that was not possible.

Mr. JUDD. May I comment there?

The CHAIRMAN. Yes.

Mr. JUDD. I am O. D. Judd, Associate Director, Fuel Division, OPA. Mr. Brown's statement is essentially correct. I do not believe there was any legal technicality involved as far as the power of attorney was concerned. We suggested to Mr. Brown at the time he was in, that we did not believe such procedure was advisable nor necessary. I considered it, personally, and probably that should have no part in this hearing, as a reflection upon my integrity, and the promise I made to industry. I promised them definitely that no figure would be changed, that where any question did come up involving change, such change would not be made until the individual submitting the form had been advised and we will stick right by that in every detail. As far as having anyone look at those figures and work with us, I know of no reason why that would hamper our operation. I know of no reason why it is necessary, and I think we will follow the advice of your committee here and what you decide is the proper procedure in your opinion. We have no objection as far as we are concerned—that is, where a power of attorney has been received or necessary permission has been received.

The CHAIRMAN. We have a very important bill on the floor today. It will be necessary for us to recess until tomorrow. Can you be here at 10 o'clock, Mr. Hall?

Mr. HALL. Yes, sir.

The CHAIRMAN. We will resume the hearing then.

Mr. EASTWOOD. I think tomorrow morning, unless the industry has other additional witness, that we will just have Mr. Judd and the OPA.

The CHAIRMAN. That will be all right.

Mr. HALL. I was going to say I think that all comes down to a question of fact. The industry says you do not follow the accepted method of accounting that the smaller companies use. Mr. Green says you do follow the accepted method of accounting, because, as evidence to support himself, he gives us information which, to my mind, only covers the larger companies. Why can't you sit down with the two Mr. Browns and agree upon some kind of a survey to find out what is the accepted method of accounting that the smaller companies use? It seems to me it would be a simple thing to do.

Mr. JUDD. I think that could be done.

Mr. HALL. It would answer all of our questions.

The CHAIRMAN. Suppose between now and tomorrow morning at 10 o'clock you gentlemen get together?

Mr. HALL. Agree upon some plan.

Mr. JUDD. I think it would be well to make a statement as to what the industry generally uses.

The CHAIRMAN. Just agree upon a plan that you can use.

Mr. JUDD. I think from a factual standpoint, sustained depletion certainly is a more basic practice in cost accounting than percentage depletion would be.

The CHAIRMAN. The committee will stand in recess until tomorrow morning at 10 o'clock.

(Whereupon, at 12 noon, a recess was taken until 10 a. m., Wednesday, June 13, 1945.)

FINANCIAL PROBLEMS OF SMALL BUSINESS

WEDNESDAY, JUNE 13, 1945

House of Representatives,
Select Committee on Small Business,
Washington, D. C.

The select committee met, pursuant to notice, at 10 a. m., in room 1011 New House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman (chairman), and Hall.

Also present: Dan W. Eastwood, chief investigator for the select committee.

The Chairman. The committee will please be in order.

Mr. Brown, did you finish your testimony yesterday?

Mr. Russell B. Brown. I have finished my testimony.

The Chairman. Who is the first witness this morning?

Mr. Eastwood. Mr. Fell, of the Independent Petroleum Association.

STATEMENT OF H. B. FELL, EXECUTIVE VICE PRESIDENT, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

Mr. Fell. In connection with the cost study being conducted by the Office of Price Administration, with relation to crude petroleum, as requested by your committee, questionnaires were sent to some 700 corporations, partnerships, and individuals engaged in finding, developing, and producing crude petroleum. It has been reported that the percentage of questionnaires that have been filled out and returned to the Office of Price Administration has been unsatisfactory, and the question has developed as to why all or practically all of the producers who received these questionnaires have not filled them out and sent them in so that the Office of Price Administration might consolidate the information and make the total information available to its Crude Oil Price Advisory Committee, in connection with a determination as to whether or not the Office of Price Administration will grant an over-all increase in the price of crude oil.

From my contacts with producers I have secured the impression that the main reason for many of them not filling out the questionnaires and sending them in, is that effort after effort has been made unsuccessfully through every known means for a period of approximately 4 years to secure an increase in the price of crude oil in the United States without success, and that this has brought about an attitude of hopelessness and futility with reference to any attempt to secure relief through the Office of Price Administration.

This feeling is amplified because of the fact that the Office of Price Administration, through its Oil Section, has stated definitely that it will not consider replacement cost in determining whether an increase in the price of crude oil is justified.

In addition, representatives of the Office of Price Administration have made public statements to the effect that they did not believe that an increase in the price of crude oil would be justified, thus giving the impression to many producers that the case was being prejudged.

Although the Office of Price Administration finally agreed to include figures in the questionnaire which would make it possible to determine replacement cost and to make the information available in total figures to their Industry Advisory Committee, it is recognized that with such information it would then be necessary, on account of the attitude of the Office of Price Administration, with reference to replacement cost, to get legislation enacted by the Congress, directing the Office of Price Administration to increase the price of crude oil.

In view of the fact that legislation of that type introduced by former Congressman Wesley E. Disney, of Oklahoma, was defeated in the last session of Congress, many of the producers believe that it would be very difficult to get such legislation enacted. In fact, the chain of events over the past 4 years has been such as to indicate to many that there is no hope of relief as long as price control under the Office of Price Administration exists.

There are some cases where the producer receiving the questionnaire does not have the information required or asked for in the questionnaire. Several producers receiving questionnaires have stated that their records back in 1936, 1937, 1938, and 1939 were not complete enough to furnish the information requested.

It might be well to mention a few more reasons why many oil producers do not believe there is any hope for a relief through the Office of Price Administration and, therefore, are failing to fill out and send in their questionnaires.

In 1941 the Phillips Petroleum Co. increased the price of crude oil 25 cents per barrel. The Price Administrator requested them to eliminate the increase, which they did. Later they requested permission to make the increase effective and filed information in support of their position. Their request was refused. This all occurred in the face of the fact that the Price Administrator in his annual report stated that the prices for crude oil and the products thereof had been frozen at exceptionally low levels.

The Independent Petroleum Association of America filed a petition to the Office of Price Administration for an increase in the price of crude oil. This was filed in 1941. So far as I know, no hearings were held on the petition nor was any answer made.

Mr. Henderson, the first Price Administrator, appointed crude oil price advisory committees in each of the five districts as outlined by the Petroleum Administrator for War. The personnel of these committees consisted of the individuals who were members of the district production committees of the Petroleum Administration for War, with some additional members. The Office of Price Administration never requested these committees to meet nor organize nor function actively in any manner. Finally the district 2 committee, of which I was a member, requested authority to organize and function.

The committee was organized and I was selected as chairman. I endeavored to get the Office of Price Administration to issue instructions as to what the committee was to do and within what limitations it should function, and to secure clearance from the Justice Department, as had been done by the Petroleum Administration for War with its committees. I was advised something would be done, but nothing ever happened.

This committee met, sent copies of its minutes to the Oil Section of the Office of Price Administration, which were never acknowledged. A representative of the Oil Section of the Office of Price Administration attended the first few meetings of the committee, but had no authority to act for the Office of Price Administration.

Finally, the committee did make some recommendations to the Office of Price Administration, including a recommendation for an increase in the price of crude oil, outlining the reasons for the recommendation. The recommendation was not accepted nor acted upon, to my knowledge, nor was the committee ever requested to meet with the officials of the Oil Section of the Office of Price Administration to discuss the matter.

Insofar as I know, the committees in the other districts were never even organized. Apparently it was not the desire nor wish of the Office of Price Administration that the committees function.

A study of the cost of producing oil was made by the Tariff Commission under the direction of the Office of Price Administration, notwithstanding the fact that the Office of Price Administration was going to make a determination, based on the report of the Tariff Commission's study. It would seem that in order to be free from any possible bias that the study should have been made entirely free from any direction or control by the Office of Price Administration. A report by a subcommittee on crude oil of the Cost and Price Adjustment Committee of the Petroleum Industry War Council, early in 1942, showed that an analysis and projection of the cost study conducted by the Tariff Commission indicated definitely that an increase in price was justified. This report was made available to the Office of Price Administration, but no favorable action resulted.

It should also be stressed that an increase in the price of crude oil has been recommended by the Petroleum Industry War Council, by the Petroleum Administrator for War, by the Interstate Oil Compact Commission, by the National Conference of Regulatory Bodies, by oil and gas associations throughout the Nation, by Governors of oil-producing States, by oil regulatory bodies, and by congressional committees who have studied and are familiar with conditions within the petroleum industry.

In other words, every agency or organization that has knowledge of and is thoroughly familiar with production of crude oil has recommended a substantial increase in the price of crude oil, but notwithstanding the volume of testimony, the recommendations that have been made, the data and studies that have accompanied these recommendations, the Office of Price Administration has continued to refuse to grant an over-all increase in the price of crude oil.

All of these factors have combined to make the average oil producer feel that there is no hope for a price increase through the Office of Price Administration. He feels he has been discriminated against.

He filled out the questionnaires sent out by the Tariff Commission when they made their study, but nothing developed as a result of that study, nor was any consideration given to a thorough analysis of the figures contained in the Tariff Commission report which indicated that oil producers are operating at a loss.

Producers continue to receive forms with requests for quarterly financial reports, which, if filled out, would not give a true picture of the present cost of finding, developing, and producing oil. In addition to this, similar forms are received for annual reports. The multitude of forms and questionnaires received, added to the other points mentioned, is an important factor in the question involved.

I do not say that the producers are justified in not filling out the recent questionnaire sent out by the Office of Price Administration to a selected list. I am definitely of the opinion that they should fill them out and send them in, but I am merely stating what I have found to be and believe to be the reason why many have not done so.

Mr. JUDD. We appointed a National Refining Advisory Committee in accordance with the recommendations of the Small Business Committee of the House of Representatives. This committee has tendered to us a report which they have asked that we tender to this committee for insertion in the record. We have not had time to study the report nor to make any finding on the various facts set forth. We are tendering it only on the basis that the advisory committee so requested.

(The report referred to is as follows:)

MEMORANDUM REGARDING REFINING OPERATIONS AND EARNINGS IN RELATION TO CRUDE OIL PRICES

Prepared by National Industry Refiners' Advisory Committee, June 6, 1945

This committee has been asked to advise with you on the question of whether in the event of a general crude oil price increase refined product prices should also be increased, or whether refining companies' profits generally are sufficiently great that they could absorb a crude oil price increase, with some exceptions which might be handled by subsidies.

These questions, we believe, arise in part as a result of a report on crude oil production problems made in December 1944 by the Patman Committee on Small Business, of the House of Representatives, which report, among other things, recommended that—

(a) OPA should immediately initiate a study of finding, developing, and operating costs of crude oil producing industry by a sampling process, giving due recognition to integrated and independent operating conditions.

(b) Because of the impracticability from a marketing standpoint, of granting price increases to individual producers in a given pool at a time when other producers retain lower ceilings, OPA, upon the conclusion of the proposed cost studies, should grant such over-all increases in the price of crude oil on a Nation-wide basis as would permit all producers, whose operations are conducted in a normal and efficient manner, to make a fair profit on their production operations.

(c) OPA should grant a subsidy to marginal cost refiners whose profits might be adversely affected by any further increase in the ceiling price of crude petroleum in order to avoid the necessity of increasing the price of petroleum products to the consumer.

On December 4, 1944, the Committee on Small Business of the House of Representatives recommended to the Committee of the Whole House that the Office of Price Administration appoint an industry advisory committee to represent crude petroleum producers. This committee was subsequently appointed to assist the OPA in matters pertaining to refined product prices.

Careful consideration has been given to these recommendations insofar as the refining branch of the business is concerned, and this memorandum is directed in particular toward bringing forth and clarifying these phases.

OVER-ALL EARNINGS OF INTEGRATED UNITS NOT A FAIR BASIS TO JUDGE REFINERS' ABILITY TO ABSORB A CRUDE OIL PRICE INCREASE

The ability of refiners to absorb proposed crude oil price increases and the consequences which would result from any such attempt cannot properly be judged by the over-all corporate profits of integrated companies having refinery and other operations. A study made of all the refiners operating in this country shows that a majority of them are small plants, many, if not most of which depend mainly upon earnings solely from refinery operations. As will be seen from the summary below, 202 out of a total of 396, or more than 50 percent of the refineries in the United States (as listed in the Oil and Gas Journal of March 31, 1945) are of less than 5,000 barrels daily capacity:

Crude-oil capacity:	*Number of refineries*
Less than 3,000 barrels daily	145
3,000 to 5,000 barrels daily	56
5,000 to 10,000 barrels daily	79
10,000 to 20,000 barrels daily	45
20,000 to 50,000 barrels daily	46
More than 50,000 barrels daily	25
Total	396

While it is true that a large percentage of refining capacity is in the hands of integrated companies, the great majority of refineries in number are of the small nonintegrated type. There would seem to be every reason, therefore, why refining should be considered as an entity in itself.

So far as integrated companies are concerned, the earnings of such companies reflect many factors—nonoperating income, income from production, refining, transportation and marketing, plus a large variety of sideline activities, varying from production and distribution of farm implements and supplies to shipbuilding. The distribution of side-line activities reflects the initiative and resourcefulness of individual management and should not have any bearing on whether or not that particular organization is making adequate profits to absorb an increase in the price of crude oil. Profits from transportation and marketing, especially where all products are sold under fixed ceiling prices, do not bear on ability to absorb a crude price increase. Nonoperating income as a part of over-all earnings reflects not only the current policies of management and government, but, to a large extent, the historical policies followed over a period of years. Policies adopted in prior years reflect actions taken during a competitive economy and have no bearing on actions taken during an economy of governmentally limited prices.

Sales of petroleum products to civilians are made at prices controlled by the government through the Office of Price Administration. Civilian demand for principal petroleum products is controlled through rationing. Control of prices and volume limits profits from this source of sales revenue to standards judged as fair and in keeping with national well-being by the Office of Price Administration.

Prices secured from the sale of both ordinary and special petroleum products for use by the armed forces, as well as products sold to manufacturers of materials for the armed forces, are all subject to renegotiation. The reasonableness of profits originating from this source is judged by the margin on the products themselves, plus the trend of profits on sales in total. This segment of profits has either already received the stamp of Government approval through renegotiation or is still subject to renegotiation.

Returns from transporting on the inland waterways or on the Great Lakes are subject to ceiling rates approved by the Office of Price Administration. Dividends received from crude oil pipe line operations are limited by the consent decree of December 23, 1941.

Truly, profits from many phases of integration in the petroleum industry are now limited or controlled by policies set forth by one department or another of the Federal Government. To increase the price of crude oil and to adopt the thesis that the over-all profits of refining companies are adequate to absorb the increased cost would be a denial of the fairness that has guided the Office of Price Administration in fixing price ceilings in the past; and in addition such an action by the Office of Price Administration would nullify the actions taken by other govermental bodies charged with responsibility for determining the reasonableness of prices and profits in various other operations.

One other warning must be called to attention if over-all profits were to be used as a guide as to ability to absorb an increased cost of crude oil. An unsound decision on prices of a raw product would drastically affect output long before an over-all earnings statement were even available. Either the earnings of an organization would be seriously threatened or the output of critically needed petroleum products during a war economy would be seriously affected if action were based on this standard of judgment without any actual guide of greater validity being applied. Refinery throughput would be limited to that portion which remains profitable after taking into consideration price or cost actions taken by the Office of Price Administration.

SUBSIDIZING REFINERIES PRESENTS IMPOSSIBLE OBSTACLES

The House Committee on Small Business has suggested that the way to handle a crude price increase without increasing product prices might be to give a subsidy to refiners whose profits were inadequate to absorb the increases in price without difficulty.

Your committee is unanimous in its belief that a subsidy to refiners would not be feasible.

This opinion is not based upon any of the general objections which can be made to practically all subsidy arrangements—e. g., reduced efficiency, unfair discrimination, discouragement to individual initiative in favor of reliance on Government support, opportunity for laziness and careless business practices, and many other abuses. The exigencies of war do not invalidate these general and historic objections to subsidies but do cause them to be disregarded.

Your attention is called rather to specific factors which, in our opinion, make any refinery subsidy attempt not only impractical and undesirable, but dangerous and destructive to the over-all purposes to be achieved.

Meeting the war requirements for finished petroleum products is regarded as the primary responsibility of the petroleum industry. Refineries are operating near capacity and many refining units are being employed even though of older, less economical design to provide an output meeting the petroleum supply program. If the continued operation of marginal, or submarginal units, were to be further jeopardized by an increase in the cost of crude oil without an upward revision of ceiling prices and a subsidy depended upon to keep such units in operation, certain extreme problems would be presented.

(*a*) The basis for subsidy payment and the extent of the payment would have to be predetermined and announced in advance and be such that any refiner could know in advance exactly what subsidy would ensue from running a particular crude, making a specific product, or operating in a certain way, and the subsidy would have to be adequate if continued operations at necessary levels were to be assured—many refiners could not operate for an extended period of time upon their own resources, depending upon the uncertainties of a Government audit and the possibility of subsidy payment at some later date to determine their ultimate profit or loss position. Predetermination of a subsidy for the operation of a plant as complicated as a refinery, or marginal units of a refinery, however, is believed to present insurmountable obstacles.

(*b*) Marginal operating units that would be made submarginal by an increase in the cost of crude oil might be an entire refining company with more than one plant; or it might be a single plant owned by an independent or by an integrated company; or might represent a marginal unit installation at a particular refinery. A considerable amount of refinery-operating equipment in the country today is in operation only in order to meet the supply program, and must be retained in operation as long as present finished product requirements continue. It is not believed that a general subsidy plan for refiners could be formulated which would be sufficiently elastic in its application to apply to companies, to individual refineries, and to individual units of articular refineries. Each marginal unit presents unique characteristics defying generalization.

(*c*) There is a wide variety of crude oils. A refinery may be a good profit producer as long as it operated on a given crude from given production sources. A decline of production of this preferred crude may necessitate processing a substitute crude which can readily shift the profit position of the plant to marginal or submarginal position. It would be impossible to draft a subsidy plan which would recognize changing characteristics of crude oil streams.

(*d*) Petroleum refining cost accounting is characterized by a lack of standardization of procedures. The differences in practice reflect varying efforts to adopt the cost-accounting procedure suitable for management guide of an industry, characterized by many problems of a joint cost nature and of other unique conditions affecting the operations of the multitude of refinery units. How could a subsidy plan be applied to different refinery units where profit determination is predicated upon totally different methods of accounting?

(e) Refinery margins or profits are influenced both by raw material and operating costs and by variation in the proportions of the various finished products made, each product having a different ceiling price or value, and its production being determined in many cases by directives from the Petroleum Administration for War. If a subsidy were made applicable to refinery operations designed to maintain profits on a parity with those secured in a normal competitive situation, its application would have to be sufficiently elastic to recognize variations in yields of finished products. Ways of meeting this requirement cannot be foreseen when product yields are a function of the type of crude processed, the type of equipment, market requirements, Government directives, and the polices of management.

The above reasons for regarding a subsidy to refiners as impractical are ample, but there are others of equal importance, such, for example, as the distortions which a subsidy to refiners would tend to produce. If the subsidy were given to all refiners whose profits were adversely affected and especially if such determination were made not on the basis of refinery operations, but on the over-all earnings of the particular company, then unless adequate safeguards were devised (and we do not believe this to be possible), there would be a direct invitation to all sorts of costly practices in every phase of the business, including the highly competitive field of distribution and marketing. Under these conditions the malignant effects of a subsidy would tend to spread about each subsidized plant as inflammation encircles a wound.

If sales were made at less than ceiling prices by a subsidized operator, would the Office of Price Administration undertake to determine whether such subceiling price was reasonably necessary under the existing market conditions (as it might well be) or whether it constituted an unwarranted abuse and that deduction should be made from the subsidy payment?

Would the Office of Price Administration endeavor to determine whether the full selling, delivery, or other expense incurred was necessary or whether some special service performed for a good dealer, such as improving a driveway, installing new or larger tanks, or like services was a legitimate marketing item or was an abuse traceable to a subsidy?

These objections may seem unreal or unimportant to some academic observers, but they will be instantly understood by anyone familiar with the oil industry, its operations and its economics. The problem of working out a subsidy arrangement that would be workable under the many complicated factors which characterize refinery operations not only presents a hopeless task, but, if attempted, would introduce strife and dissention in an industry now functioning smoothly and meeting its war responsibilites. Indeed, the difficulties would grow more serious, for as the postwar period draws nearer the competitive struggle of refiners to hold or obtain marketing outlets will intensify.

WE DARE NOT LOSE REFINERY PRODUCTION

Refineries in the United States are operating and must continue to operate at a level which is more than a million barrels per day higher than before the war. The Committee on Petroleum Economics of the PIWC, based on military and essential civilian demands and supply and transportation facilities, has recently projected crude-oil runs to United States refineries for 1945 at 4.743,000 barrels daily. This compares with actual runs of 3,535,000 barrels daily in 1940. The 1945 projected figure represents the full utilization of practically all cracking capacity in the industry and all but a small amount of topping capacity which is not advantageously located. This maximum refinery production must be achieved if military and essential civilian needs of the United Nations are to be supplied; and even with this high level of refinery operations, it is estimated that stocks of refined products will be further decreased in 1945, having already been decreased by approximately 50.000,000 barrels since the beginning of the war. The latest PAW forecast as to the situation after VE-day calls for the same maximum capacity operation so long as the war in the Pacific continues.

The increse in runs of over 1,000,000 barrels per day, which has been necessary over peacetime operations to meet war demands, has only been achieved by refiners running crude oil of progressively increasing cost in relatively high-cost marginal equipment, and in many cases the high-cost marginal crude being run is of less favorable refining value. If a general increase should occur in the price of crude oil without a corresponding increase in the price of products, it is these marginal high-cost crude supplies and marginal high-cost processing units which would be dropped, resulting in a shut-down of the very operations by which it has been possible for the United States refining industry to achieve the increased runs, without which it would not be possible to meet the heavily increased military demands when at the same time maintaining supplies for civilian use.

To illustrate the critical levels at which the industry is having to operate because of greatly increased military demands, a 5-percent loss in crude runs would mean a loss in refinery production of about 235,000 barrels per day. Since military demands must be protected at all costs, such reduction in refinery production would have to be reflected in reduced civilian supply. If the 235,000 barrels per day reduction were reflected in gasoline, it would mean the elimination of approximately 40 percent of all United States passengar-car gasoline supply. If reflected against the production of distillate fuels, it would mean the elimination of approximately 70 percent of all distillate fuel-oil supplies for home heating.

In the face of this situation, it is clear that anything that would materially detract from the full maximum utilization of available United States refining capacity would lead to extremely serious consequences in the form of break-down of the essential civilian economy, or failure to meet full military needs.

With the above factors in mind, the question of the effect of a rise in the price of crude oil on refinery operations can be approached.

REFINERS' MARGIN INADEQUATE TO ABSORB CRUDE PRICE INCREASE

Ample published data exist to establish clearly the inability of the refiner to absorb an increased crude oil cost out of margins which are steadily shrinking because of rising cost of processing products sold at prices frozen as of October 1941. The Bureau of Mines for many years has published monthly data for crude runs and finished product production for various refinery areas in the United States. Platt's Oilgram and other publications have reported posted prices for various refined products for many years. In addition, there are published transportation rates for most pipe-line movements and gathering operations. Much information has also been obtained with regard to refinery operating costs.

Analysis of such information clearly establishes that many refiners could not stand any increase in crude-oil prices without an immediate reduction in refinery operations unless the higher crude costs were offset by correspondingly increased product prices.

INFORMATION AS TO CURRENT REFINERY EARNINGS SUBJECT TO QUALIFICATION FOR RENEGOTIATION AND WAR CONDITIONS

Current refinery operating figures will not give a real basis for judging the ability of refiners to absorb a crude-oil price increase in the future. There are three reasons for this, all relating to the current production of petroleum products for the armed services or other Government agencies and for sale to war plants.

In the first place, all such sales are subject to renegotiation. Such renegotiation is not yet finished for the year 1943 and obviously will not be completed for 1944 or for 1945 for a long time in the future. Thus any data secured as to the current financial results of refineries making products for the armed forces or other Government agencies or for war plant use would necessarily have to be regarded as preliminary and subject to adjustment downward on account of future price renegotiation.

Such renegotiation is on the basis of permitting profits on the products involved which will be no more than are reasonable in the light of all the facts and considering the expensive capital installations and other special factors and risk involved. Since this is the case, there would seem to be no basis for assuming that after such renegotiation there would be any profits left arising from such sales that refiners could properly be asked to devote to the absorption of a crude-oil price increase. For many, if not the majority of refiners, the sales which are subject to renegotiation constitute a very substantial proportion of the total sales, and hence this factor is one which cannot be overlooked or passed over as being of little importance in considering the results of information from refiners as to their current operations before renegotiation.

In the second place, information regarding current operations involving large-scale manufacture of products for the war effort will fail to give any indication of the more normal operating situations which refiners will be facing when the war is over, both as to the volume of operation and the type of products being made. As has already been pointed out, it is generally expected that refinery runs will decline by 15 or 20 percent as soon as the war is over; and this in itself will create an entirely different situation since volume is a very important element in per-barrel refining costs, and such costs per barrel are bound to increase substantially, if not drastically, when the volume declines at the end of the war.

In the third place, sales of high-value military products will largely terminate with the end of the war, and any increase in the average revenue per barrel which refiners may now be obtaining as the result of the manufacture of such special products, will have disappeared and the expensive new capital facilities which were created for the manufacture of such products will be usable only for the manufacture of ordinary motor gasoline and other civilian products.

For these reasons, the refiners' ability to absorb an increase in crude oil price must be judged on the basis of normal type of operation rather than from a questionnaire reporting 1944 conditions. An approach to the question of how present profits on such normal refining operations compare with prewar levels can be had by examining the differential between the income from such products (at refinery price levels) and the cost of crude oil delivered to the refinery over a period of time for representative refining areas in the country. Studies for two such areas are summarized in a later section of this report along with certain other studies that have been made. Before discussing the results of these studies, however, we desire to call attention more specifically to some of the factors that have been and still are operating to increase the refiner's cost and reduce his profit margin.

CRUDE COSTS HAVE INCREASED

The average delivered cost of crude oil for practically every refiner is higher today than it was in 1941. A number of individual crude oil price increases have been granted by OPA with no corresponding provision for increased product prices, and whereas in peacetime crude oil supplies were plentiful and a substantial volume of crude oil, particularly in new fields, was sold to refiners at below the posted price, under today's wartime conditions the full posted price is being paid in practically all cases. Crude oil sources abnormally distant must be resorted to today with increased transportation costs to the refiner and many of the new and more distant crudes are of inferior refining value.

REFINERY OPERATING COSTS HAVE INCREASED

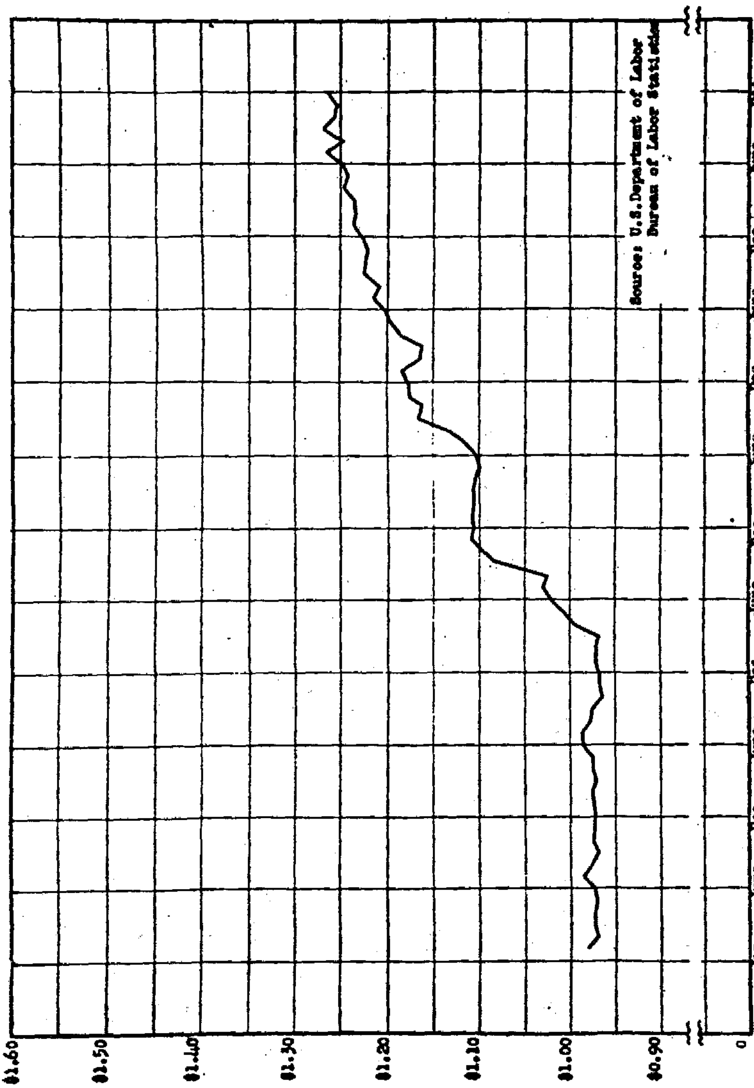
Refinery costs have shown substantial increases over prewar levels, and this trend toward higher costs has become more pronounced in each successive period up to the present time. A number of factors have contributed to this trend.

Average hourly wage rates in the petroleum industry, according to the United States Bureau of Labor Statistics, have increased by more than 30 percent since 1941, due to increased hourly rates and to overtime payments. The trend is shown in chart I.

Further, lower productive capacity per man-hour has resulted from generally decreased efficiency, traceable to disruption of normal personnel. The high standards of efficiency which the industry had come to accept without question have been impossible to maintain by reason of depletion of forces by the armed services and extensive use of women replacements and other untrained workers. This, together with the fact that much new equipment of a highly complicated nature has been installed and old processes have been subjected to radical changes, has meant that much time and money have had to be spent in training workers. Furthermore, by reason of very high labor turn-over heavy training expenses continue to be encountered.

What is true of wage costs is true of practically every other expense—costs of repairs and maintenance have constantly increased. This is due in part to high labor costs, since labor constitutes a substantial portion of maintenance costs; also because capacity operations have necessitated operating old equipment that normally would be retired and replaced; and because the stress of pushing plants to capacity has caused abnormally high maintenance on certain units. Moreover, in many cases it has been impossible to obtain high-quality materials and refiners have had to resort to substitutes having shorter operating

CHART 1—AVERAGE HOURLY EARNINGS—PETROLEUM REFINING



life; and to obtain materials of any kind involves great difficulty and expense due to labor shortages, priorities, expediting efforts required, etc. It has also been necessary in many cases to have maintenance work done by outside contractors at higher costs than if work were done by a refiner's own maintenance crews.

Because of shortages of manpower and materials it has been impossible for many refiners to keep up with the wear and tear which has occurred. For a number of refiners this is now beginning to show up in increasing numbers of costly emergency shut-downs, and the difficulty of getting manpower and materials is resulting in many cases in prolongation of the shut-down period. In addition to the element of higher cost for the work that is done, the refining industry therefore is in fact incurring a hidden cost in deferred maintenance that is not being reflected on the books. In other words, wear and tear is occurring more rapidly than is being taken care of. This is particularly true in cases where sour crude is now being run and where additional corrosion is occurring even though it may not have reached a critical point. This whole matter of deferred maintenance is bound to be a serious factor since cost of repairs, when too long delayed, tends to become excessive as against what preventive maintenance would have cost. Here is another example of how today's conditions are laying up additional costs which ought in reality to be charged against today's operations but which are not.

Refiners are indeed facing many special problems in the postwar period. It is expected that as soon as the wars are over refinery runs will be reduced by 15 to 20 percent, or somewhere in the neighborhood of 1,000,000 barrels per day. Under these conditions there undoubtedly will be great pressure upon refinery margins. For those refiners who have invested large sums in new equipment during the war, there will also be the problem of utilizing and paying for these facilities in the early postwar years, and the problem of laying up other capacity not yet fully depreciated. And yet, even though there will be excess capacity as a whole, there will still be a strong pressure on many refiners to install new refining facilities immediately after the war. Refiners not having the latest equipment will be at a competitive disadvantage so far as quality factors are concerned, hence even in the face of excess refining capacity generally, many refiners will feel compelled to build new facilities, thereby adding still further to the excess.

These are all factors growing out of the war situation. The developments of today will burden the morrow with extra costs for premature obsolescence, carrying charges on idle capacity, and the like. These items ought to be charged against wartime profits, but because they are not the type of costs which are provided for in ordinary accounting procedures, they are not being charged today. If, however, full provision were made for all of these costs, it would constitute a very substantial charge against present refinery profits.

The point has also been made by several members that the factor of replacement cost which is receiving considerable attention in relation to crude oil costs is also involved in refinery operations. Practically no refinery in the United States, except one wholly constructed during the war, could possibly be replaced for anything like the amount of money that it originally cost. Based on considerable information obtained on this point, it appears that the average cost of typical refinery capital items is today more than 50 percent greater than in the years just prior to the war, and if the comparisons were made with costs for the early thirties the disparity would be even greater. Depreciation charges, however, are based upon historic capital costs and such depreciation charges are certainly not being accumulated on a basis which would permit the replacement of the items being depreciated on the basis of today's replacement costs.

Without, however, taking into consideration these cost factors which are not being reflected on the books but only the factors which are so reflected, we believe it can be said with safety that the average refiner making ordinary products is getting a lower profit per barrel today, even before deduction of income taxes, than he was in 1941.

The full impact of these various increased cost factors will only be felt when the war is over. It will not be possible for refiners to reduce either direct operating expenses or overhead charges in the postwar period at anything like the rate at which crude oil runs are destined to decline. Only then will the true import of these increased cost factors, on a per-barrel basis, be fully realized.

SUMMARY OF INFORMATION ALREADY AVAILABLE ON REFINERY PROFIT MARGINS

As already stated, considerable information is available on refining margins and profits from Government and industry data and from special studies that have been conducted, the results of which have been made available to us. Four such studies are summarized here, to wit:

(a) Midcontinent refinery margin index.

(b) Gulf coast refiners' margin:

(c) Analysis made by special subcommittee of the PIWC for districts 2, 3, and 4.

(d) Special study covering 14 refineries in Michigan.

These are considered in the order listed:

MIDCONTINENT REFINERY INDEX

For a number of years prior to 1942 the National Petroleum News published what it called a refinery index, which measured the difference between the well price of 36 gravity midcontinent crude oil and the wholesale value of the refined products typically manufactured from such crude by typical refiners in the midcontinent area, as reported to the United States Bureau of Mines. The publication of this series was suspended in 1942 (when crude oil and product prices were frozen), but our committee has had the figures brought up to date on the same basis. The complete data from the National Petroleum News and the later calculations above referred to are contained in appendix A.

A comparison of refinery margin levels for the years 1936–39, representing a period of freedom of price movement, and those existing under the period of a fixed price economy, causes attention to be focused on certain significant features. From 1936 through 1939, the refinery margins averaged 52.5 cents per barrel. (This is not the refinery profit; it is simply the difference between the wholesale value of the normal type midcontinent refined products from a barrel of crude and the price of midcontinent crude at the well—it is, therefore, simply an index of the amount available to the midcontinent refiner out of which to get his crude from the well to the refinery, process it, and obtain a profit, if any. Obviously, as shown later, the transportation and refining costs leave a relatively small part of this total for profit even before income taxes.)

During 1938 there was a mild depression generally and the oil industry experienced substantial reductions of inventory values which invalidate the use of that 1 year as typical of operations under conditions of freedom of price movement, as compared with years of fixed price operating conditions. Both product and crude-oil prices had declined late in 1938 due to adverse business conditions and also flush production in Illinois. The average index for the years 1936, 1937, and 1939, which are much more nearly comparable with present conditions, was 65.3 cents per barrel. By 1941, conditions had improved and both product and crude-oil prices increased early in that year to approximately the levels of 1937.

The freezing of prices in October of 1941 would indicate that the refinery margin as reflected by the index was established at about 70 cents per barrel, but this average margin was based on a peacetime flow of finished products from the refineries, which failed to meet the needs of a war economy. Production of lower-value products, such as distillate fuels, heavy fuel oil, and still gas, had to be increased, whereas the yield of gasoline had to be reduced. For the midcontinent refinery area under review, the yield of distillate fuels increased from 10.52 percent in 1941 to 14.36 percent in 1944; residual fuel oil and gas from 25.66 to 27.43 percent; while gasoline yields declined from 51.47 percent in 1941 to 44.94 percent in 1944. The indicated reduction in the index by the end of 1944 to approximately 58 cents per barrel, therefore, represents adjustments of yields at refineries to meet the needs of a war economy.

The present refinery margin of 58 cents per barrel is the total amount available to the refiner to pay the cost of transporting the barrel of crude from the well to the refinery, the processing and other cost incurred at the refinery to convert the raw product to finished material, meeting interest obligations, and all overhead incident to the plant before returning a profit. Complete cost data for these various functions have been submitted to the committee by five midcontinent refiners so that the adequacy of the refinery margin indicated by the index may be evaluated. The cost of moving the crude from the well to the refinery averaged 10.888 cents per barrel. This was checked against crude movement via common carrier pipe line from known crude sources to specific refineries in the Oklahoma-Kansas area and was believed to be completely representative. The average direct manufacturing expense per barrel of crude at these same plants was found to be 22.381 cents per barrel. The average general expense represented by the average depreciation charges, taxes (other than income taxes), insurance, refinery sales cost, interest on investment (if actually paid), and office expense incident to the operation of the plant was found to average 14.214 cents per barrel. Total expense from refinery receipt to disposition of product at the refinery gate, therefore, averaged 36.595 per barrel. This cost, too, was checked against several additional refineries and against known processing payments among refiners and was found to be representative. Deducting 10.888 cents per barrel for transportation and 22.381 cents per barrel for direct manufacturing cost and 14.214 cents per barrel for general expense indicates that the refinery profit before income taxes at the close of 1944 was reduced to 10.517 cents per barrel. This is the amount of profit that may be regarded as available from ordinary normal refinery operation for income taxes, dividends, and reserves.

It is recognized that some refiners have been able to make more favorable combinations of products through specializing in aviation gasolines and components or other war products, the profits from which, however, as previously pointed out, are subject to renegotiation as are the prices received for various other products. On the other hand, it must also be recognized that many refiners have been unable to achieve the average yield on motor gasoline and have extended the average yield of residual fuel, resulting in net margins even below those indicated above. These marginal refiners or marginal units of other refineries must be maintained in operation to meet present abnormal war demand.

GULF COAST REFINERY MARGIN

Calculations for a number of years have also been obtained regarding the refiners' margin on the Gulf coast, similar to those reported above for the midcontinent. The margin in this case is determined by calculating the value of the major products—gasoline, kerosene, distillates, and fuel oil—on the basis of the low quotations of Platt's Oilgram for Gulf coast prices and applying the same to the yields of the various products. From this is deducted the delivered cost of a mixture of East Texas and West Texas crude in the proportions representative of the operations involved, together with the estimated cost of getting the crude to the refineries, based on published pipe-line tariff rates and other transportation factors. This index, therefore, indicated the amount per barrel available for the refinery operation and for profit thereon. A detailed description of the calculations will be found in appendix B.

The figures for the last 10 years for such refinery margin before deducting refinery operating and overhead expenses are as follows:

	Cents		Cents
1935	43.7	1940	35.7
1936	47.5	1941	38.3
1937	49.6	1942	32.4
1938	22.4	1943	39.0
1939	41.3	1944	40.5

It is to be pointed out that these figures are before any deductions for either direct or general refining expenses. Such expenses for Gulf coast refineries being in the range of 30 to 35 cents per barrel leave a very small profit indeed on the normal Gulf coast refinery operation.

It will be noted from these figures that the margin on the Gulf coast has been definitely lower during the war period than for the years 1936, 1937, and 1939. The year 1938 cannot be considered as representative because that year was even more of a depression year for Gulf coast refiners than for interior refiners, due to the greater sensitiveness of Gulf coast refined product prices to the disturbances which occurred in the world markets with the opening of the war.

As in the case of the midcontinent index, the Gulf coast index does not reflect the additional earnings which some refiners undoubtedly have been able to achieve through manufacture of aviation gasoline or components, and other special war products. Again, such sales, of course, are subject not only to additional expense, but to renegotiation, and it is felt that the only proper way to judge the ability of refiners generally to absorb a crude oil price increase is on the basis of the ordinary normal refinery operations to which all refiners must expect to return.

PIWC STUDY COVERING 51 REFINERIES

In the latter part of 1944 the Petroleum Industry War Council appointed a special subcommittee to obtain information on refinery profits. The resulting report is quoted in full in appendix C hereof, and was based upon reports for 51 refineries, widely scattered throughout the areas referred to, which during the period covered by the study, namely, January 1, 1944, to October 1, 1944, had daily average runs to stills of 267,736 barrels per day. For these refineries the average net income, before income taxes and renegotiation, was shown to be 19.22 cents per barrel of crude oil run, and the report stated further that "some refineries estimate that the net realization after taxes would be 10 cents a barrel, while other estimates remain as low as 4 cents per barrel.

The reports for the 51 plants covered by the special PIWC study included the earnings from all sales that were made of products to military or other government agencies and any other special sources of income which these refineries may have had during the period in question, whereas the midcontinent and Gulf coast margins referred to above were on the basis of ordinary or normal products. The average profit, including that on war or special products, of 19.26 cents a barrel, was a preliminary figure prior to renegotiation on war and other products used directly in the war effort. It is obvious that these refiners did not have a final profit margin sufficient to enable them to absorb a crude oil price increase. The figures are also for a period the middle of which was approximately 1 year ago, and since that time there have been further increases in refinery operating expenses.

STUDY COVERING 14 MICHIGAN REFINERIES

The most up-to-date report which has been made available is a study which has been recently made by the independent refiners of Michigan. The study covered 14 refineries in Michigan, most all of which were operated by companies having practically no other business than refining, as evidenced by the fact that over 99 percent of the total output was reported to have been sold on an f. o. b. refinery basis. The period covered was the last 3 months of 1944 and the first 3 months of 1945.

The 14 refineries involved had average daily crude oil runs during the period of 43,900 barrels daily. Their profits before deducting income taxes and before any renegotiation allowances ranged from less than nothing up to 28 cents a barrel, and for the entire group averaged 18.76 cents a barrel. The report states that after estimated income taxes the average was 7.60 cents, and only one out of the 14 refineries made over 10 cents a barrel after income taxes.

The results for these Michigan refiners, almost all of which are nonintegrated, tie in closely with the other studies reported here and indicate that in Michigan, as in other areas, the refiners could not be expected to absorb proposed crude oil price increases. The text of the Michigan report, quoted in full in appendix D hereof, contains many other interesting and pertinent statements.

DISCRIMINATION AGAINST REFINING BRANCH

The oil industry has been able to meet so magnificiently the unusual demands placed upon it during the war because of the harmonious relations that have existed within the industry during this critical period. Only through confidence and good will could there have been the cooperation that has existed among the various members of the industry and between the industry and the Government agencies which have had the responsibility for directing the war effort of the petroleum industry. The success of these Government agencies has been due far less to authority or power of coercion than to these factors of confidence, good will, and cooperation, without which the industry's contribution to winning the war would have been greatly impaired.

Nothing, however, could be better calculated to stir up bitterness, strife, and dissension within the industry and between the industry and the Government than for a Government agency arbitrarily to take away a large segment of the revenue and the livilihood from one branch of the industry and to pass it over to another branch.

And as between various refiners, the effect would, of course, be most unequal. A refining company that produced as much crude oil as it refined would not be affected either way, since what it lost by the refinery absorption it would gain from the increased price of crude oil—it would simply lose the benefit of any crude price rise. The company which produced more crude oil than it refined would gain a benefit to the extent of the excess of its production over its refinery runs. A refinery that produced only a part of its crude requirements would be penalized to the extent that its refinery runs exceeded its crude oil production, and a refinery that had no crude oil production at all would be penalized 100 percent. Such action if taken by the OPA or any other Government agency would therefore constitute an unfair discrimination (varying according to the degree of crude oil integration) against all refiners whose refinery runs were greater than their crude oil production.

Crude oil is not sold as such direct to consumers. It must be processed and the revenue derived from the finished products must be adequate to maintain a continued flow of crude oil to refiners and maintain refineries in operation to process this raw product to finished products for ultimate consumption. Any effort to shift profits from one segment of the industry to another would bring about serious maladjustments within the industry, jeopardize its ability to meet war requirements, reduce the flow of products to civilian consumers, put certain refiners out of business, reduce profits of others, and stir up strife and dissension within the industry and between it and the Government.

In the minds of practically all members of the industry who have studied the matter, and of the members of Government and advisory agencies most concerned with oil matters, that is, the Petroleum Administration for War and the Petroleum Industry War Council, there has never been any question but that petroleum product prices should be increased in connection with any increase in crude oil prices. This is evidenced by resolutions passed and statements made by trade associations, responsible individuals, and the Petroleum Administrator for War.

SUMMARY AND CONCLUSIONS

1. The ability of refineries to absorb proposed crude-oil price increases and the consequences which would attend any such attempt cannot properly be judged by the over-all corporate profits of companies having refinery and other operations. There are hundreds of refining companies who have no material sources of revenue other than refining. As for integrated companies having production, transportation, marketing, or other activities, each of such operations involves large investment and risk taking, and there is no reason why the proper and legitimate revenues from such activities should be diverted to the absorption of refinery losses brought about by arbitrary Government action. Moreover, the revenues from these other branches in almost all cases are subject to or limited by the action of various other Government agencies and hence have already passed the test of reasonableness.

2. A subsidy to refiners is not practicable. Refining is an extremely complex operation with constant technical changes, and the determination of profits is subject to many factors which would make it practically impossible to design or administer any equitable subsidy arrangement, and if based on over-all profits such subsidy would lead to many abuses.

3. Refinery runs at present record-high levels are urgently needed to meet combined military and essential civilian requirements, and this will continue to be the case so long as the war continues in the Pacific or elsewhere. But a crude-oil price increase with no increase in product prices would not only eliminate some refiners entirely, but would reduce the operations of almost all others, because practically all refineries are running a certain amount of marginal crude (i. e., crude which delivers to the refinery at such a high cost as to leave little if any profit) which even a small increase in cost would turn into a definite loss. Any reductions in refinery operations would be very detrimental to the war effort and the civilian economy, and subsidies could not be relied upon to solve the problem.

4. Refining profit margins are not sufficient to absorb crude-oil price increases that have been proposed. This conclusion is clearly evident from information that is available from published data and special studies which are presented and analyzed in this report. Current profits' reports on refinery operations which include the output of products for military or other Government or war-plant use cannot be regarded as fair measures of refiners' ability to absorb crude-oil price increases because—

(*a*) Sales of products to armed forces or other Government agencies and war plants are subject to renegotiation which will adjust the final prices received to such amounts as will leave only a fair and reasonable profit.

(*b*) War products involve extraordinary capital costs and taking of risks which justify reasonable earnings.

(c) The manufacture of such products is a temporary source of revenue which will disappear when the war is over and refinery runs decline by from 15 to 20 percent.

For all these reasons the ability of refiners to absorb a crude-oil price increase should be considered primarily in terms of normal rather than war products, and in terms of the increased costs of refinery operations which have occurred. Such costs of operation have increased for several reasons:

(a) Delivered crude-oil costs have increased due to various individual advances granted by OPA, and because of higher delivery costs of more distant crude required to keep refineries running.

(b) Refinery operating expenses have increased. Average wage costs are up over 30 percent, while efficiency of the labor force has decreased due to an increase in the proportion of new and inexperienced workers and other factors. Materials, supplies, and maintenance costs have similarly increased—and even so, much maintenance is not being done and deferred costs, not reflected in present accounts, will be the future result. Capital replacement costs are also higher by 50 percent, or more than the average of prewar historic costs on which present depreciation rates are based, and this constitutes another hidden factor not reflected in present costs.

The real impact of increased refinery costs will only be felt when the war is over and runs decline far more rapidly than refinery expenses can be reduced.

5. Analyses of four studies of refinery margins and earnings (covering, respectively, refinery operations in the midcontinent area; similar operations in the Gulf coast area; a special analysis of 51 refineries in districts 2, 3, and 4; and a special study covering 14 refineries in Michigan) all indicate that the earnings from normal refinery operations under today's conditions are lower than at the outset of the war, reasonable in relation to historic levels, and not sufficient to permit absorption of proposed crude oil price increases.

6. An increase in the crude-oil price without a commensurate and simultaneous increase in product prices would constitute gross discrimination against the refining branch and would stir up strife, dissension, and distrust within the industry where harmony, good will, and confidence now exist. Practically all representatives of the industry and of petroleum agencies in the Government who have studied the matter have expressed the view that product prices should be increased in connection with crude price increases.

7. In conclusion it must be emphasized that the refining branch of the oil industry is in itself a great industry, highly technical in its operation and enormously important to our national interest. It represents a tremendous capital investment and constantly requires a large, new flow of capital into it for purposes of replacement, technological improvements, and new construction. It is an industry which is facing many difficult problems and adjustments both now and in the postwar period.

To assume that it is not necessary for a great enterprise such as petroleum refining to obtain a profit out of its own operations, rather than be dependent upon revenues from other branches of the industry to carry it along, is not only to overlook the fact that hundreds of refineries have no other activities than refining, but to overlook the vital importance of the refining process in the operations of the oil industry as a whole. Refining must not be deprived of the means of standing on its own feet.

8. On the basis of the information presented in this study and for all the reasons set forth therein, the conclusion seems inescapable that any upward adjustment of crude oil prices would have to be accompanied by a commensurate and simultaneous increase in refined product prices. The suggestion that a general crude price increase could be absorbed by integrated refiners and runs maintained by subsidy to marginal refiners (as suggested by the House Committee on Small Business) is devoid of realistic appreciation of elementary economics of the oil business and irresponsible as to the effects that would result on the civilian economy and the vital supply of petroleum products to the armed forces.

APPENDIX

Appendix A

National Petroleum News Refinery Index

The course of the midcontinent refiner's margin, in cents per barrel of crude processed, since 1928. The figures on which the chart is based are given in table 1.

Refiner's Margin in 1938 Not at "Lowest" Level

(By M. G. Van Voorhis, National Petroleum News staff writer)

The midcontinent refiner's margin—his return from running a barrel of crude through his stills, based on posted price of crude and current market value of the yields—has reached lower levels than in 1938 in five recent years, as is shown in the accompanying graph and tables.

However, offsetting these low spots in past years have been periods when the margin built up to profitable levels. The study of the trend of the refiner's margin in the midcontinent is possible now through a computation of National Petroleum New's refinery index back through 1928, although National Petroleum News has been publishing this margin, or index, only since 1935. It appears the first issue of each month in the market section.

The accompanying article not only discusses the trend of this margin but it also shows the change in yields of principal products at midcontinent refineries since 1928, both in percent and in gallons.

> The slight discrepancies in the refinery index as carried in table 1 as compared with table 3 are due to the fact that the index in table 1 is based on average prices prevailing during the entire month; and those indices given in table 3 are based on the Oilgram's first published prices of the month. The two sets of figures in table 3 are the result of two bases of yield computation.—Editor.

The National Petroleum News Refinery Index, published monthly in National Petroleum News during the past 3 years as an indication of the average return or refiner's "margin" from refining a barrel of midcontinent crude, has been recalculated with refinements of method by months since January 1928, and is presented in the accompanying chart and table 1. The latest refinery index was published in the July 6 issue, page 41.

The refiner's "margin" is the difference between the value at current market prices of all the products derived from the barrel of crude oil and the cost of the barrel of crude. The term "index" is the "margin" as computed by the method described in this article. This is the figure which has been published monthly in National Petroleum News.

This figure includes the costs of transporting the barrel of crude oil from the well to the refinery, storing the products and it includes sales advertising and overhead costs as well as the refiner's profit. It has been estimated that 55 cents a barrel would approximately cover the average costs of handling and processing and that the average refiner's profit would be roughly approximated by the level of the index above or below this figure.

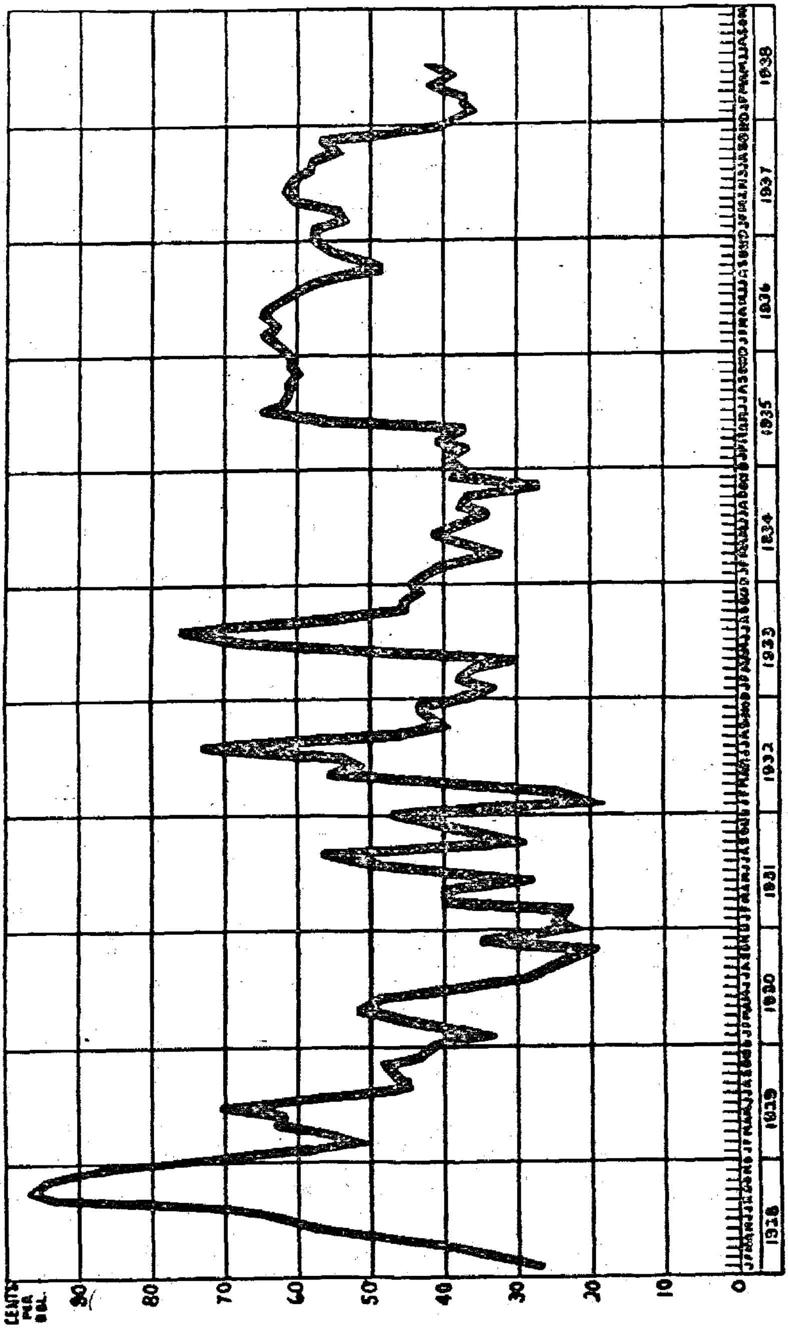

CENTS PER BBL.
90
80
70
60
50
40
30
20
10
0
1928
1929
1930
1931
1932
1933
1934
1935
1936
1937
1938

TABLE 1.—*Recapitulation of the Refinery Index which has been published as a monthly feature of National Petroleum News since August 1935 and figured back through 1928* [1]

Month	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
January	$0.27	$0.58	$0.33	$0.24	$0.18	$0.33	$0.42	$0.40	$0.63	$0.58	$0.36
February	.33	.50	.40	.23	.24	.38	.39	.37	.65	.53	.37
March	.38	.55	.47	.40	.37	.36	.32	.41	.63	.54	.37
April	.48	.63	.52	.40	.56	.30	.36	.37	.65	.60	.42
May	.58	.62	.49	.28	.51	.51	.41	.57	.64	.62	.38
June	.62	.71	.38	.40	.54	.69	.37	.65	.62	.61	.42
July	.70	.59	.28	.51	.73	.76	.34	.62	.60	.58	-------
August	.93	.45	.26	.57	.46	.55	.38	.61	.56	.58	-------
September	.97	.47	.22	.29	.39	.45	.37	.61	.48	.55	-------
October	.95	.48	.19	.36	.41	.45	.27	.60	.50	.57	-------
November	.88	.43	.35	.42	.43	.43	.39	.61	.55	.44	-------
December	.74	.41	.21	.47	.36	.44	.38	.61	.58	.39	-------
Average	.65	.54	.34	.38	.43	.47	.37	.57	.59	.55	-------

[1] The figures appearing in the above table differ somewhat from the figures published monthly in the National Petroleum News Refinery Index, the causes of the differences being explained in the accompanying article.

(The margin between the cost of 36 gravity Mid-Continent crude and the current selling prices of the products made from it are the basis for this index.)

Four major products are segregated in computing the index and a few lesser products totaling under 3 percent of the total are grouped under the head of "specialties." Gasoline, of course, leads in volume by a wide margin and is followed by heavy fuel oil and still gas, heating oil, and gas oil, and kerosene. Lubricating oil and wax are included with heating oils. Specialties include asphalt, road oil, and coke.

Volume of crude going into these products and yield of the products have been compiled from figures published by the United States Bureau of Mines in its monthly petroleum statement and annual summaries for the districts of Oklahoma, Kansas, and Missouri; Texas Inland; and Arkansas and Louisiana Inland. Other districts were omitted because of the impossibility of segregating the amounts of Mid-Continent crude refined by plants in such areas.

The accompanying chart shows the 2-year period following the introduction of the index in 1935 to have been roughly equivalent to 1929 in refiner's margins while the present relatively low level is above depths reached in 5 preceding years.

Computations for the new chart differ in a few particulars from the index as computed during the past 3 years.[1] However, the general trend is closely comparable by either method. The main distinction is that the new figures have been computed on the basis of average monthly prices rather than "first-of-the-month" prices. The National Petroleum News index will continue to be computed on the latter basis, since it gives a more up-to-date figure while the monthly average gives a fairer history of the index.

Stricter attention to details has been observed in the preparation of the accompanying chart. Rather than using the same yield figures over the 10 years, yields were computed for each year from annual statistics. The variation of these yields is shown in table 2. The effect of these variations, when applied to the computation of the National Petroleum News Refinery Index is to raise the index figures roughly 1.5 cents above each preceding year since 1934. In 1937 and 1938 the revised yields give indices about 8 percent above those which have been published previously and about 4 cents higher. This gives a brighter aspect to the low levels which have shown up in the last few months.

The error is not as serious as this wide variation makes it appear when it is considered that the recalculation is merely a means of correcting the "pitch" of the "tune" which has been affected only by a gradual and continuous "flatting" as the result of being "played" without the "accompaniment" of yield revisions.

[1] A large share of credit for the preparation of the statistics presented in this article goes to the statistical department of Standard Oil Co., of Ohio, and paricularly to Sidney A. Swensrud and A. T. Beall, who worked with National Petroleum News in preparing the method of computaion and did most of the actual calculations.

TABLE 2.—*Percentage yields of petroleum products in 3 Mid-Continent districts in which the National Petroleum News Refinery Index is based and corresponding recovery in gallons per barrel*

PERCENT RECOVERY

	Gasoline	Kerosene	Gas and oil	Fuel oil still gas	Specialties	Miscellaneous loss, etc.
1928	43.38	7.59	8.09	35.09	1.07	4.78
1929	42.95	6.90	8.52	35.10	1.28	5.25
1930	47.18	6.16	7.90	30.79	1.91	6.06
1931	48.85	5.68	10.02	28.41	2.17	4.87
1932	50.17	6.10	9.02	27.72	2.32	4.67
1933	49.64	6.27	8.71	28.72	2.07	4.59
1934	50.02	6.26	9.06	27.79	2.32	4.55
1935	50.24	6.49	9.82	28.23	2.02	3.20
1936	50.37	5.69	10.72	28.47	2.24	2.51
1937	51.29	5.78	10.82	26.49	2.29	3.33

GALLONS RECOVERY PER BARREL OF CRUDE RUN

	Gasoline	Kerosene	Gas and oil	Fuel oil still gas	Specialties	Miscellaneous loss, etc.
1928	18.22	3.19	3.40	14.74	0.50	1.95
1929	18.04	2.90	3.58	14.74	.54	2.20
1930	19.82	2.59	3.32	12.93	.80	2.54
1931	20.52	2.39	4.21	11.93	.91	2.04
1932	21.07	2.56	3.79	11.64	.97	1.97
1933	20.85	2.63	3.70	12.06	.87	1.89
1934	21.01	2.63	3.81	11.67	.97	1.91
1935	21.10	2.73	4.12	11.86	.85	1.34
1936	21.16	2.39	4.50	11.96	.94	1.05
1937	21.54	2.43	4.54	11.13	.96	1.40

It is impractical to keep the index strictly up to date with respect to yields since the annual figures are not available often for many months after the time of computation of the index and monthly figures are too variable for the purpose. A running summation of several months is a possibility but involves extensive computations for each index figure.

Although the tabulated yields show slight variation from 1932 to 1936, the necessity for varying the yield figures in computations of the index before 1932 is more obvious. Table 3 shows the refinery index as computed by 1934 yields compared with indices computed by yields of the corresponding years. Figures for 1938 are computed by 1934 and 1937 yields. Gasoline yield has by far the most weight in the index as may be judged from the fact that the return on each of the other three leading products is from one-sixth to one-thirteenth as great.

TABLE 3.—*National Petroleum News Refinery Index as computed with the index computed on the basis of yields for the corresponding years since 1934*

Date, 1934	Index (1934 yields)	Date, 1935	Index by 1934 yields	Index by 1935 yields	Date, 1936	Index by 1934 yields	Index by 1936 yields	Date, 1937	Index by 1934 yields	Index by 1937 yields	Date, 1938	Index by 1934 yields	Index by 1937 yields
Jan. 2	50.6	Jan. 2	38.4	40.3	Jan. 2	59.9	62.5	Jan. 4	56.1	60.3	Jan. 3	32.8	36.5
Feb. 5	47.2	Feb. 4	37.7	39.6	Feb. 4	61.0	64.0	Feb. 1	47.8	52.1	Feb. 1	33.0	36.7
Mar. 7	41.1	Mar. 4	34.3	36.4	Mar. 2	58.4	61.1	Mar. 1	50.2	55.0	Mar. 1	32.2	35.8
Apr. 4	37.1	Apr. 1	44.8	46.9	Apr. 1	62.4	65.2	Apr. 1	55.4	59.6	Apr. 4	39.0	42.7
May 2	46.6	May 6	54.5	56.6	May 1	62.7	65.7	May 3	58.2	62.3	May 2	37.6	41.1
June 4	45.7	June 5	64.1	66.2	June 1	60.7	63.7	June 1	57.9	62.0	June 1	31.4	34.8
July 2	36.3	July 1	61.6	63.7	July 1	58.5	61.2	July 1	55.1	59.2	July 1		
Aug. 1	44.1	Aug. 5	59.5	61.5	Aug. 3	56.5	59.2	Aug. 2	54.9	59.1			
Sept. 4	36.5	Sept. 3	60.1	62.2	Sept. 1	47.9	50.5	Sept. 1	55.2	59.5			
Oct. 1	37.6	Oct. 1	58.5	60.6	Oct. 1	45.7	49.4	Oct. 1	55.3	59.6			
Nov. 5	38.7	Nov. 4	58.9	61.0	Nov. 1	50.1	52.8	Nov. 1	44.8	48.8			
Dec. 3	41.8	Dec. 2	58.6	61.0	Dec. 1	55.0	58.0	Dec. 1	39.8	43.6			

Another refinement is allowance in crude runs for unfinished rerun (net). This made a noticeable difference in fractional percentages of yields. In other respects the computations are identical. Natural gasoline was deducted from gasoline yields as before. Table 4 gives an example of the calculation for 1936:

TABLE 4.—*Crude yields—1936*

	1,000 barrels	Percent
Crude runs to stills	206,522	
Unfinished reruns (net)	[1] −1,533	
Net runs	204,989	100.00
Gasoline output	114,614	
Natural gasoline	[1] −11,357	
Net gasoline output	103,257	50.37
Kerosene	11,688	5.69
Heating and gas oils and lube oils	21,842	
Wax, at 273 pounds per barrel	126	
Total heating and gas oils	21,968	10.72
Fuel oil and still gas	58,357	28.47
Specialties:		
Road oil	1,088	
Coke (300 200 ton, at 5 barrels per ton)	1,501	
Asphalt (364 500, at 5½ barrels per ton)	2,005	
Total specialties	4,594	2.24
Total accounted for		97.49
Miscellaneous, shortage, etc		2.51

The next step was to price these products. In all instances, except that of specialties the figures used were the monthly quotation from the Oil Price Handbook, as follows:

Gasoline: Average weekly lows for the month for regular gasoline in Oklahoma (now 70–72 octane).

Kerosene: Monthly average for Oklahoma 41–43 grade kerosene.

Gas heating oils: Monthly average for Oklahoma 38–40 straw (average of No. 1 White and No. 1 Straw since 1935).

Heavy fuel oil: Monthly average for Oklahoma 14–16.

For specialties it was impractical to determine monthly prices. Yearly determinations for asphalt and road oil were based upon figures published by the Bureau of Mines in the Minerals Yearbook. An average of $3 per ton for coke was taken as the most reasonable approximation for the period. These figures are admittedly inaccurate but the inaccuracies would have less than 1 cent's influence upon the final index.

TABLE 5.—*Specialties return (1945)*

Product	Present yield	Per barrel price	Realization
Asphalt	0.527	$1.50	0.0079
Coke	.745	[1] 3.00×2	.0045
Road oil	.750	.94	.0071
Total	2.002		.0195

[1] Per ton price converted to per barrel at rate of 5 barrels per ton.

An average price per gallon is then found by multiplying the total yield of specialties (2.022 percent) by 42 gallons to obtain the gallons involved and dividing the realization ($0.0195) by this figure thus:

$$\text{Average price in 1935} = \frac{0.0195}{.02022 \times 42} = \$.0230$$

Table 6 gives the computation for the month of July 1936, involving the final steps of determining the index. The crude cost is the well price for 36°–36.9° Oklahoma crude by the Stanolind Crude Purchasing Co. as shown in the Oil Price Handbook.

It is again necessary to emphasize that this index is not an accurate representation of any single refinery but, as an average for a group, it is significant to the whole industry.

TABLE 6.—*An example of computation of index for July 1936*

Product	Percent yield [1]	Gallons output per barrel of crude	Price per gallon	Realization
Gasoline	50.37	21.16	$0.06000	$1.2696
Kerosene	5.69	2.39	.035625	.0851
Gas-heating oils	10.72	4.50	.031094	.1399
Fuel oil—still gas	28.47	11.96	.015179	.1815
Specialties	2.24	.94	[2].0230	.0216
Miscellaneous loss, etc	2.51	1.05		
Realization	100.00	42.00		1.6977
Price 36° gravity Mid-Continent crude				1.10
Refiners' margin (index)				.5977

[1] From table 4.
[2] 1935 price (1936 not available).

Annual summary of Mid-Continent refinery index, 1928–44

PRODUCT YIELDS

Year	Percent of crude-oil run						Gallons per barrel of crude-oil run					
	Gasoline	Kerosene	Gas oil [1]	Fuel oil and still gas	Specialties [2]	Miscellaneous and loss	Gasoline	Kerosene	Gas oil [1]	Fuel oil and still gas	Specialties [2]	Miscellaneous and loss
1928	43.38	7.59	8.09	35.09	1.07	4.78	18.22	3.19	3.40	14.74	0.50	1.95
1929	42.95	6.90	8.52	35.10	1.28	5.25	18.04	2.90	3.58	14.74	.54	2.20
1930	47.18	6.16	7.90	30.79	1.91	6.06	19.82	2.59	3.32	12.93	.80	2.54
1931	48.85	5.68	10.02	28.41	2.17	4.87	20.52	2.39	4.21	11.93	.91	2.04
1932	50.17	6.10	9.02	27.72	2.32	4.67	21.07	2.56	3.79	11.64	.97	1.97
1933	49.64	6.27	8.71	28.72	2.07	4.59	20.85	2.63	3.70	12.06	.87	1.89
1934	50.02	6.26	9.06	27.79	2.32	4.55	21.01	2.63	3.81	11.67	.97	1.91
1935	50.24	6.49	9.82	28.23	2.02	3.20	21.10	2.73	4.12	11.86	.85	1.34
1936	50.37	5.69	10.72	28.47	2.24	2.51	21.16	2.39	4.50	11.96	.94	1.05
1937	51.29	5.78	10.82	26.49	2.29	3.33	21.54	2.43	4.54	11.13	.96	1.40
1938	52.21	5.96	10.59	25.97	3.15	2.12	21.93	2.50	4.45	10.91	1.32	.89
1939	52.73	6.15	9.48	24.82	3.46	3.36	22.15	2.58	3.98	10.43	1.45	1.41
1940	51.25	6.27	9.81	25.29	3.23	4.15	21.53	2.63	4.12	10.62	1.36	1.74
1941	51.47	6.06	10.52	25.66	3.57	2.72	21.62	2.54	4.42	10.78	1.50	1.14
1942	45.90	6.36	14.13	26.68	3.83	3.10	19.28	2.67	5.93	11.21	1.61	1.30
1943	42.61	6.28	14.25	29.77	4.10	2.99	17.90	2.64	3.99	12.50	1.72	1.25
1944	44.94	6.08	14.36	27.43	3.57	3.62	18.88	2.55	6.03	11.52	1.50	1.52

[1] Including lubricating oil and wax.
[2] Specialties include asphalt, road oil, and coke.

	Oklahoma refinery tank-car prices (cents per gallon)				Wholesale value of refined products versus crude-oil price (dollars per barrel of crude oil)		
	Gasoline (regular grade)	Kerosene (41°-43° gravity water white)	Gas oil (34°-40° gravity, No. 1 White and Straw, No. 2 Straw)	Fuel oil (14°-16° gravity)	Total value of products	Price of 36° gravity Mid-continent crude at the well	Refinery index
1928	7.82	5.26	3.09	1.53	1.96	1.31	0.65
1929	7.59	5.47	3.76	1.29	1 91	1.37	.54
1930	6.03	3.77	3.15	1.25	1.57	1.23	.34
1931	3.58	2.47	2.01	.70	1.01	.63	.38
1932	4.52	3.24	2.53	.85	1.30	.87	.43
1933	3.81	2.92	2.48	1.00	1.09	.62	.47
1934	4.60	3.35	2.80	1.55	1.37	1.00	.37
1935	5.28	3.57	3.14	1.58	1.57	1.00	.57
1936	5.86	3.69	3.31	1.55	1.69	1.10	.59
1937	5.81	4.17	3.83	1.93	1.76	1.21	.55
1938	5.00	4.19	3.86	1.80	1.62	1.18	.44
1939	4.84	3.97	3.42	1.73	1.54	1.02	.52
1940	4.60	4.04	3.51	2.01	1.51	1.02	.49
1941	5.44	4.41	3.77	2.18	1.73	1.12	.61
1942	5.76	4.46	3.87	2.26	1.77	1.17	.60
1943	5.92	4.42	3.89	2.31	1.75	1.17	.58
1944	5.95	4.38	3.63	2.31	1.77	1.17	.60

Source: 1928-38, National Petroleum News, edition of July 13, 1938; 1938-41, Platt's Oil Price Handbook, 1941 edition; 1942-44, computed using same methods employed by National Petroleum News in calculation of refinery index.

Summary of Mid-Continent refinery index, by months, 1928-44

	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944
Jan	$0.27	$0.58	$0.33	$0.24	$0.18	$0.33	$0.42	$0.40	$0.63	$0.58	$0.36	$0.37	$0.50	$0.48	$0.65	$0.57	$0.61
Feb	.33	.50	.40	.23	.24	.38	.39	.37	.65	.53	.37	.36	.48	.46	.64	.57	.61
Mar	.38	.55	.47	.40	.37	.36	.32	.41	.63	.54	.37	.42	.43	.46	.55	.57	.61
Apr	.48	.63	.52	.40	.56	.30	.36	.37	.65	.60	.42	.47	.48	.46	.53	.57	.61
May	.58	.62	.49	.28	.51	.51	.41	.57	.64	.62	.38	.50	.53	.58	.54	.57	.61
June	.62	.71	.38	.40	.54	.69	.37	.65	.62	.61	.42	.52	.53	.65	.58	.57	.61
July	.70	.59	.28	.51	.73	.76	.34	.62	.60	.58	.50	.55	.53	.68	.60	.57	.61
Aug	.93	.45	.26	.57	.46	.55	.38	.61	.56	.58	.50	.55	.50	.71	.62	.58	.60
Sept	.97	.47	.22	.29	.39	.45	.37	.61	.48	.55	43	.60	.50	.71	.63	.59	.58
Oct	.95	.48	.19	.36	.41	.45	.27	.60	.50	.57	40	.63	50	71	63	58	.58
Nov	.88	.43	.35	.42	.43	43	.39	.61	.55	.44	.49	.63	.47	.71	.63	.58	.58
Dec	.74	.41	.21	.47	.36	.44	.38	.61	.58	.39	.47	.60	.48	.71	.63	.58	.58
Year	.65	.54	.34	.38	.43	.47	.37	.57	.59	.55	.44	.52	.49	.61	.60	.58	.60

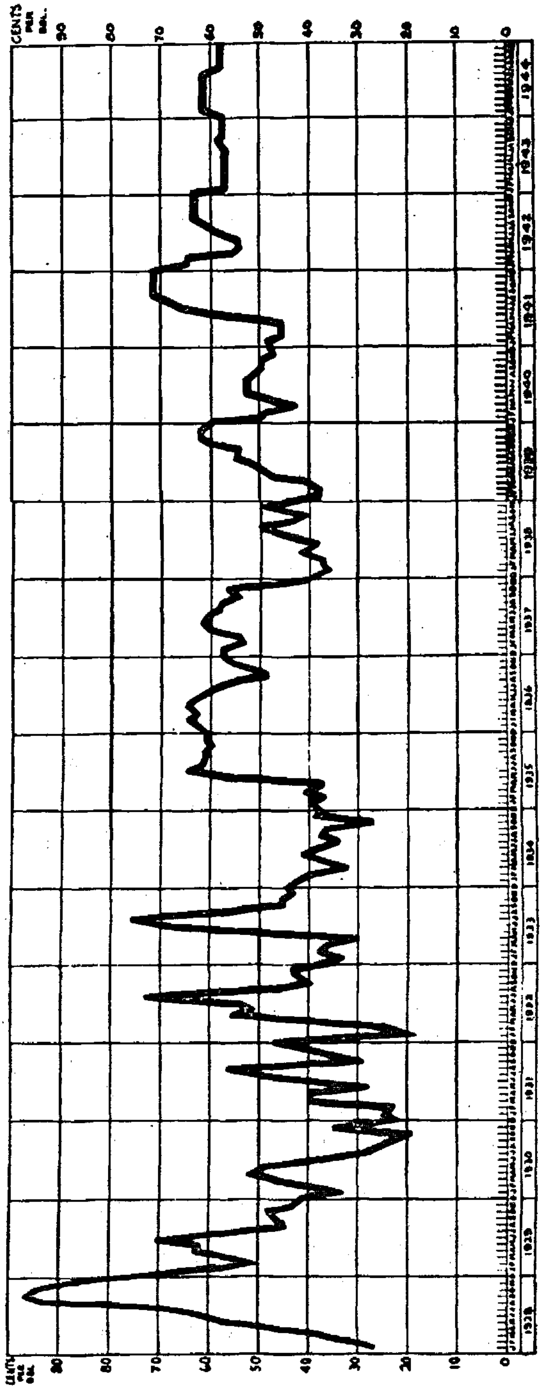
Source: 1928-38, National Petroleum News Edition of July 13, 1938; 1938-41, Platt's Oil Price Handbook, 1941 edition; 1942-44, computed using same methods employed by National Petroleum News in calculation of refinery index.

Appendix B

VARIATION IN THE AVERAGE GULF COAST REFINERS' MARGIN FOR THE PERIOD JANUARY 1, 1934, TO APRIL 1, 1945, INCLUSIVE

There is attached hereto a chart representing an estimate, covering the period 1934 to 1944 and the first quarter of 1945, inclusive, of the margin available to a Gulf coast refiner, between income from products sold and cost of crude delivered to the refinery, to cover refining costs, including fuel burned. Prices for the major products (gasoline, kerosene, distillates, and fuel oil) are taken at the low of Platt's Oilgram. Certain assumptions are made as detailed on the chart, such as reflecting the cost of crude in terms of a mixture of East and West Texas crude in the proportions necessary to yield the products produced; also aviation gasoline is reflected at motor gasoline value, since prices for aviation gasoline are subject to renegotiation and the estimate is intended to reflect the situation of a refiner producing only the major civilian products. It is believed that the basis used is sufficiently representative to provide an adequate basis of comparison for illustra-

REFINERY INDEX



ing the effect of changes over the period in question for this type of refining operation.

Yearly averages of the Gulf coast refiners' margin as reflected by the chart are as follows in cents per barrel:

	Cents		Cents
1934	47.1	1940	35.7
1935	45.7	1941	38.3
1936	47.5	1942	32.4
1937	49.6	1943	39.0
1938	22.4	1944	40.5
1939	41.3	First quarter, 1945	37.4

	Cents per barrel
Prewar average, 1934–41	40.95
War average, 1942–44	37.30
Average, 1936–39	40.20

It is thus clear that during the first 3 years of the war the Gulf coast refiners' margin has been less than the prewar average and the 1944 margin was very close to the prewar margin, the margin for the first quarter of 1945 being several cents per barrel lower. To measure the variation in refining profits it would be necessary to know average refining costs for the individual years, which are not available. It is well recognized, however, that labor and material costs have increased during the war.f Conversely, the effect of higher throughputs is to decrease costs per barrel, although this naturally increases expenses for repairs and maintenance. In view of these balancing factors, it is a reasonable assumption that costs per barrel have not greatly changed, and it would not appear that the average Gulf coast refiners' operations for the production of the major normal products are yielding a return materially different from prewar peacetime operations. Such prewar profit did not extend 5 to 10 cents per barrel, which is obviously of an order smaller in magnitude than any general crude price increase that has been proposed.

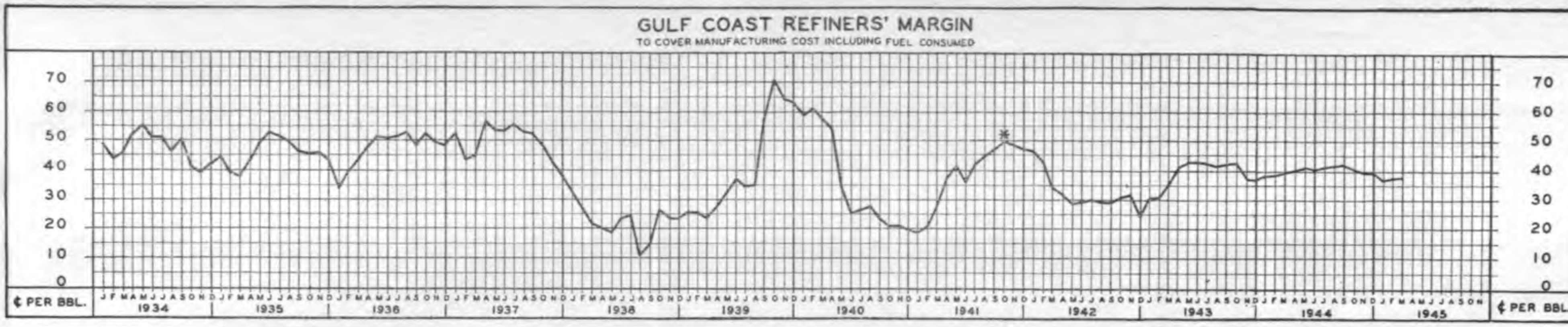
NOTE.—This chart presents the latest estimate of the margin available to Gulf-coast refiners, to cover refining costs, including fuel consumed in operations, for the period 1934 to date. The margin has been taken as the difference between the total realizations on prime refinery products and the cost of crude processed for these products. (Aviation gasoline has been included at motor gasoline realization.) The product realizations are combined in the ratio of the monthly domestic demand (total demand beginning October 1941, because of security limitations on published data) as reported by the Bureau of Mines for the eastern seaboard area, including the east coast, total Texas, Louisiana, and Arkansas. The crude price used is the average price delivered at a Gulf refinery at full scheduled transportation rates for that gravity of crude required to meet the demand for products in each month.

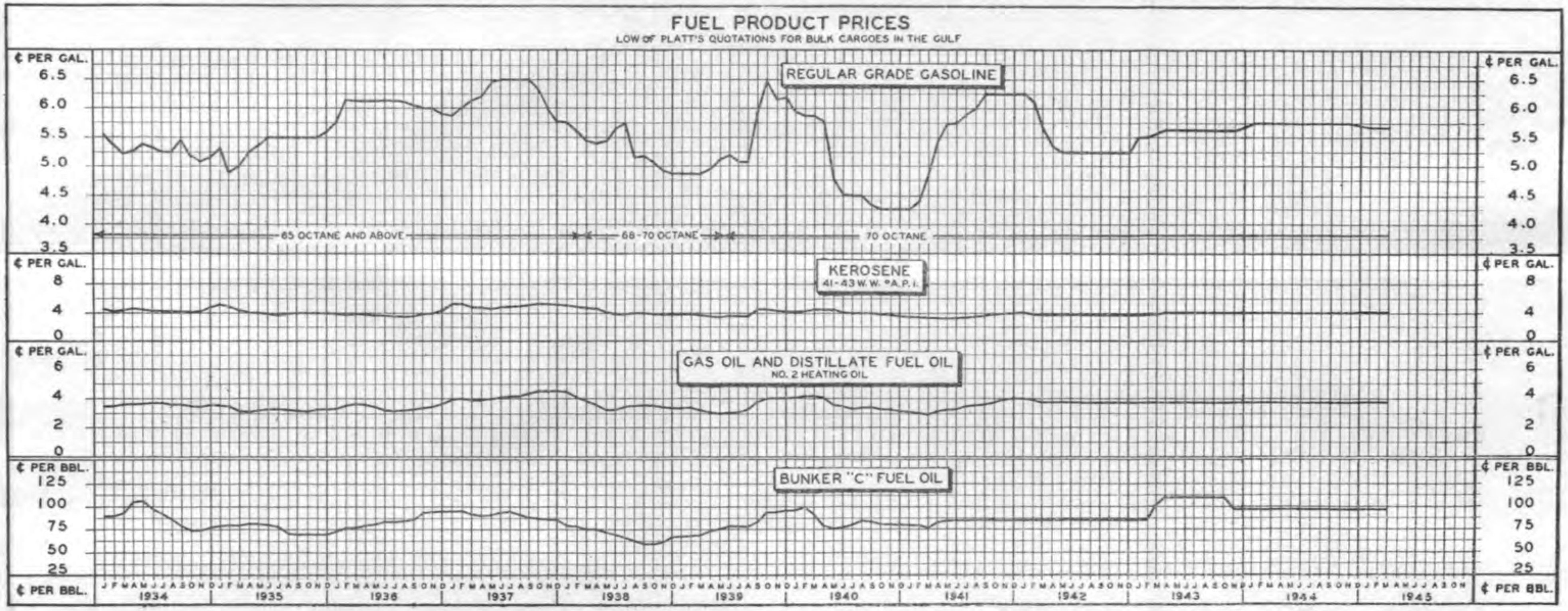
Product prices are shown with the price scale for each product adjusted for the average yield of this product over the period so that the curves as drawn indicate directly the approximate effect of the price changes in any product on the margin curve. The average of East and West Texas crude prices at the wells is shown as being indicative of changes in crude price levels. The transportation to the Gulf at tariff rates and other charges on these crudes are also shown to indicate the delivered cost at a Gulf-coast refinery.

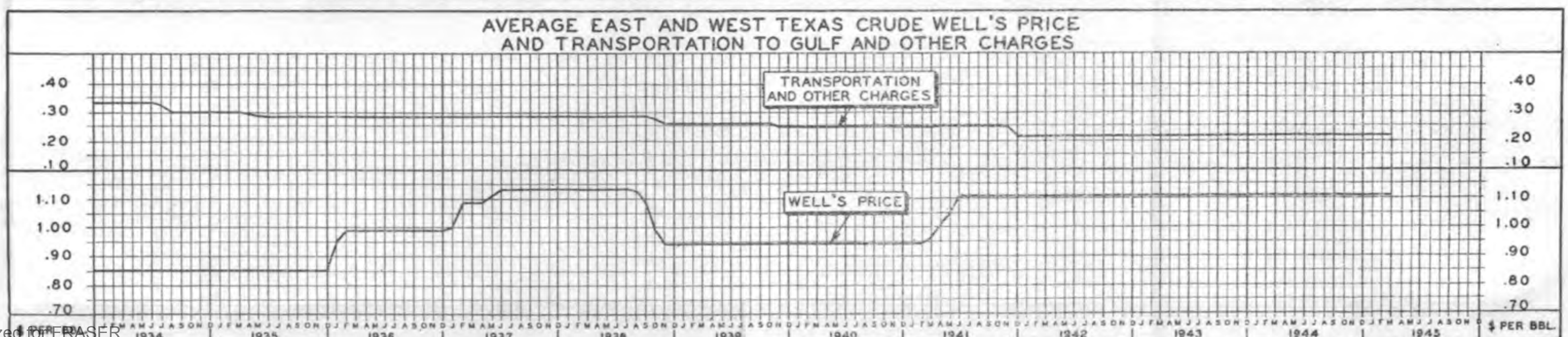
APPENDIX

This committee, appointed by the Chairman of the Petroleum Industry War Council to study the economic conditions of the small refiner, commonly referred to as the independent refiner, has undertaken a geographically representative survey. It was deemed important to obtain as broad a view as possible of the present situation and therefore the data were obtained from refiners throughout a large area.

The statistics which are set forth below for your information and consideration represent a good cross section of the operations of the small, nonintegrated companies:


GULF COAST REFINERS' MARGIN
TO COVER MANUFACTURING COST INCLUDING FUEL CONSUMED
¢ PER BBL.
1934
1935
1936
1937
1938
1939
1940
1941
1942
1943
1944
1945


FUEL PRODUCT PRICES
LOW OF PLATT'S QUOTATIONS FOR BULK CARGOES IN THE GULF
¢ PER GAL.
REGULAR GRADE GASOLINE
65 OCTANE AND ABOVE
68-70 OCTANE
70 OCTANE
KEROSENE
41-43 W. W. °A. P. I.
GAS OIL AND DISTILLATE FUEL OIL
NO. 2 HEATING OIL
¢ PER BBL.
BUNKER "C" FUEL OIL
1934
1935
1936
1937
1938
1939
1940
1941
1942
1943
1944
1945


AVERAGE EAST AND WEST TEXAS CRUDE WELL'S PRICE
AND TRANSPORTATION TO GULF AND OTHER CHARGES
TRANSPORTATION
AND OTHER CHARGES
WELL'S PRICE
$ PER BBL.
1934
1935
1936
1937
1938
1939
1940
1941
1942
1943
1944
1945

District	Number of plants	Rated capacity barrels per day		Crude processed	Daily average processed	Total taxes before income taxes	
		Crude	Cracking			Dollars	Per barrel
							Cents
2	28	167.600	58,750	33,691,240	124,377	6,354.505	18.86
3	17	164,800	46,300	33,299.081	127,587	6,687,569	20.08
4	6	18,150	4,950	4,480,242	15,772	728,180	16.25
Total	51	350,550	110,000	71,470,563	267,736	13,770,254	19.26

The survey, from which the above data were compiled, was made through the 15 States where refinery operations are carried on, with reports coming from refineries located in the Petroleum Administration for War districts 2, 3, and 4. some of the companies included in the survey have skimming plants only. However, the majority have both skimming and cracking plants.

Your committee recognizes the fact that many factors confront the refiner which are beyond his immediate control and which make his operations vastly more costly, such as increased labor charges, material costs, shortages in operating materials, use of substitute materials, and the like. The demands of the military forces for specific materials or products often make it imperative that the refiner engage in refinery practices and operations which cut down his yields and which do not permit him to obtain the highest return from his operations. This is directly reflected in smaller net realizations. This has been a very real burden to the independent refiner, but one which he has carried willingly during the war period.

The statistics compiled for your committee's report represent operations for the period January 1, 1944, to October 1, 1944. The daily rated crude capacity of the reporting companies represented in this survey is 350,650 barrels per day, while the daily average runs to stills represent 267,736 barrels per day, as set forth in the table above. The total net realization for these companies, before taxes, was $13,770,254, which makes a per barrel return of 19.26 cents before taxes. Some refiners estimated that the net realization, after taxes, would be 10 cents per barrel, while other refiner estimates ran as low as 4 cents per barrel.

The difference between the rated capacity and the actual daily runs to stills was 82,814 barrels. The refiners were unable to run to maximum capacity because of their inability to obtain an adequate supply of crude, while transportation and storage facilities at times presented very real problems.

The refinery operations reflected in this survey are truly representative of all the refiners in this area who are independents and who have the same operating difficulties. From the net realization shown above, it is readily seen that the refiners in this area are operating on a very small margin of profit. This margin may be narrowed further in those companies which hold contracts subject to renegotiation.

Appendix D

As a result of recent discussion of crude oil and product prices, various Michigan refiners have felt it advisable to make a survey of the independent refiners in Michigan to determine the answers to the two questions brought up by the Patman committee in Congress on the matter of crude oil price, viz:

1. The ability of the refiner to absorb a 35-cent per barrel crude advance.
2. The payment of a subsidy to the marginal refiner who is unable to absorb the proposed crude-oil advance.

We feel that this Michigan report is typical of the independent refining industry throughout the country insofar as the operations of these companies are almost entirely refining. More than 99.6 percent of the products sold at these refineries are sold on a refinery wholesale price basis, which leads us to the conclusion that the Michigan refining industry is a single line operation and actually reflects the refiners' ability to absorb any crude advance.

We submitted questionnaires to the 15 independent refiners in Michigan and received a response from 14. The results of this questionnaire are shown as a composite on the attached statement.

These refiners actually processed 43,901 barrels of crude daily during this period, which is more than 90 percent of the total crude run by the independent refiners in this area. We will analyze and make certain conclusions from the information presented on the questionnaire which answers will be listed below:

1. The first question to be answered, of course, is, Can the refining industry absorb a 35-cent per barrel crude advance?

The attached analysis shows that the average gross profit before taxes of the Michigan independent refining industry was 18.764 cents per barrel for the 6 months ended March 31, 1945. After taxes this figure was reduced to 7.60 cents per barrel (best estimate). The conclusion is, of course, obvious. Only 1 out of 14 refiners reporting made more than 10 cents per barrel after taxes (best estimate). Eight out of fourteen refiners made less than the average 18.76 cents per barrel before taxes. It is apparent from the above figures that the profits of independent refiners are very small and certainly they are in no position to absorb any crude-oil advance. Even this small profit is artificial and is the result of the following factors:

(*a*) They are operating in a period of maximum market demand during wartime. This has created an artificial relationship between supply and demand. The result is reflected in the market price of all products.

We must not overlook the very distinct possibility that with the partial end of hostilities a surplus of petroleum products will exist. This surplus will result in a competitive condition which will decrease the netbacks of the refiners considerably and will mean that the independent refining industry may lose the small profit position it had during the war. It is historical that a small surplus can ruin a price structure and it is obvious that the loss of the military demand may create this condition immediately at the end of hostilities.

(*b*) Approximately 6.5 percent of the crude oil purchased by Michigan refiners is compensable crude. With the partial end of hostilities, this compensation may be dropped or this compensable crude may no longer be available. This would result in a large drop in the refiners' profits as a curtailment of this throughput would increase the refinery cost per barrel. Actually a drop of 6.5 percent in throughput would more nearly equal a 20- to 30-percent drop in profit per barrel before taxes. The refining industry in this country is running at a rate of 20 to 25 percent over its prewar capacity and it is reasonable to assume that there will be a corresponding decline in the postwar period. A decline of 20 to 25 percent in the refining throughput of the independent refiners in Michigan would result in the elimination of most of their profits.

(*c*) Independent refineries are not being adequately maintained due to their inability to obtain proper equipment and materials during wartime. There is no way possible to build up reserves for this contingency and the refiners must pay for this inadequate maintenance during the postwar period. Their plants are becoming obsolete due to the new wartime developments. The small independent refiner has not been able to build up necessary reserves for these developments out of the small net profits that he has after payment of taxes. We cannot overlook this point because in the competitive period that will take place in the postwar era the independent refining industry will be at a very serious disadvantage and it is unfortunate that their net-profit position during the war did not allow them to build up reserves for this contingency.

As an illustration, may we point out that the total combined net profits for these 14 Michigan refiners is approximately $600,000, which would not even pay the cost of one 3,000-barrel catalytic cracking plant.

(*d*) Most independent refiners in this area sold to independent gasoline distributors and maintained very few stations and outlets themselves. During the wartime a great many of these distributors became war casualties and in the postwar period the independent refiner is faced with the job of rebuilding these markets.

At present, the military and major companies are the main purchasers of independently manufactured gasoline. It is only fair to assume that in the postwar period major companies will market their own gasoline as heretofore. This will mean that the independents will be forced to start from scratch to find new outlets for their manufactured gasoline. It is unfortunate that the small amount of net profit available to refiners during this period will not allow them to build up the necessary reserves for this contingency.

With these facts, we must come to the following conclusions:

(1) The refiner is unable to absorb any crude oil advance.

(2) His present profit position does not allow him adequate profit or reserves to face the problems of the postwar period.

(3) The profits that he has realized are to a great extent artificial.

2. The Patman committee suggested that—if the crude-oil advance could not be absorbed then the payment of a subsidy might be made to the marginal refiner.

Listed below are our reasons for opposing payment of a subsidy to the refiner:

1. There is no yardstick that can be employed to measure a fair subsidy. Refiners' profits vary from day to day, depending upon the amount of crude that they process, the type of products that they manufacture, market conditions, type of crude processed, location of available crude supplies, and many other considerations which change from day to day. These many considerations would make it impossible to determine a fair basis for a subsidy.

2. A subsidy on refining capacity would put the independent refiner in a precarious position after the war. With the ending of hostilities the incentive for payment of a refiners' subsidy would no longer be present but the refiner would be faced with the high price of crude oil and the inevitable decline in finished market prices. These two would create a condition that might spell the finish of the independent refiner.

For example, if the subsidy to refiners would be lifted the refiner would be in a position where he is paying more for crude oil than his finished products would bring. At the same time he would be faced with a dropping demand on finished products which would result in a far greater loss. The refiner would be unable to obtain relief until after a long period when economic adjustments would take place in the price of the products. This interim period might extend for 6 months to a year during which time the independent refiner would either be out of business or faced with such loss that his financial structure would be impaired.

3. Small independent refiners are not in a position to carry on during the period when they are waiting for subsidy payments from the Government.

For example, we have refiners in our area who have been badly hurt because they have not been able to receive their compensation on crude oil for a period of several months.

Obviously, it would be difficult to administer a selective subsidy to refiners. Elaborate audits would be necessary. Thereupon, the rate of subsidy would have to be decided for each refiner. There would be further delay in processing applications and in the meanwhile, many small refiners would be shut down awaiting replenishment of their exhausted working capital. Finally, could a selective refiner's subsidy be administered with justice?

4. May we suggest as an alternate a further enlargement of the subsidy on crude oil which is in effect at the present time and would only need to be enlarged to bring about the desired results.

Our analysis leads us to the following conclusions:

a. 1. The refiner is unable to absorb any crude advance.

b. Subsidy to refiners is selective and difficult to administer.

c. A crude-oil advance can be made by subsidy without any difficulty by payment direct to producers.

Submitted by composite tabulation, 14 refiners:

Michigan refiners questionnaire on operations, for period Oct. 1, 1944, through Mar. 31, 1945

1. Total invested capital (net worth)	$9,143,647.40
(a) Total assets as of Mar. 31, 1945	$13,318,564.47
2. Net profit before taxes	$1,491,048.86
3. Net profit after taxes (best estimate as to taxes)	$603,963.79
4. Percentage of net profit (after taxes) to invested capital	6.605
5. Total barrels throughput for period (43,901 barrels per day)	7,946,115
6. Per barrel profit before taxes (cents)	18.76
7. Per barrel profit after taxes (cents)	7.60
8. Are your operations almost entirely refining? Yes, 14.	
(a) What percentage of your sales (best estimate) are on a f. o. b. refinery wholesale basis?	99.6
(b) What percentage of your sales (best estimate) are on tank wagon and retail level?	.4
9. Total barrels compensable crude processed during period	519,514
10. Are these profits figures before any renegotiation? Yes, 14. Are you about to obtain ceiling prices on all refined products? No, 14.	

STATEMENT OF PAUL M. GREEN, DEPUTY ADMINISTRATOR FOR ACCOUNTING, OFFICE OF PRICE ADMINISTRATION

Mr. GREEN. Mr. Chairman, I have no prepared statement. I do have with me copies of a rather extensive statement that I made on these same points to the Senate Banking and Currency Committee.

Now, if that would be useful in any way, I would be glad to give it to the committee.

The CHAIRMAN. Suppose you give the clerk your statement and we can insert the parts that are germane.

(The statement referred to is as follows:)

STATEMENT OF PAUL M. GREEN, DEPUTY ADMINISTRATOR FOR ACCOUNTING OF THE OFFICE OF PRICE ADMINISTRATION, BEFORE THE SENATE BANKING AND CURRENCY COMMITTEE ON THE ADMINISTRATION OF THE "ACCOUNTING METHODS" PROVISO AND THE AMENDMENT PROPOSED BY THE NATIONAL COAL ASSOCIATION

The Office of Price Administration has been charged by the National Coal Association with disregarding the mandate of the Congress embodied in the "accounting methods" proviso to section 2 (a) of the Emergency Price Control Act.

When Senator Wagner reported the present act to the Senate he remarked that the amendment imposed "a salutary limitation on the Administrator's discretion by denying him authority to prescribe the use of accounting methods conflicting with those methods generally established in the accounting profession." However, it had been consistent policy and procedure from the very beginning to follow accepted accounting practice in our determination of costs even though it was not until June of 1944 that it was made mandatory under the act.

Our accounting staff operates independently of all the other departments and is charged with the responsibility for maintaining recognized accounting standards, policies, and procedures. We have always striven to employ for your accounting staff the best and most professionally qualified accountants we could find. They have been drawn from the ranks of the public accounting profession, private industry, and Government. Many of them are members of the country's leading accounting organizations, and they participate in and follow with keen interest the day-by-day developments in accounting concepts, standards, and techniques.

WHAT ARE "ESTABLISHED ACCOUNTING METHODS"?

A basic question raised by the coal association's criticism is: What are established accounting methods? We maintain that established accounting methods comprise those accounting principles which have been generally adopted by recognized professional accounting bodies and leading practitioners for determining or stating economic facts in monetary terms. These principles or conventions have been evolved out of years of experience and research in the fields of commerce, industry, and finance. They are still evolving. Though there are points today on which accounting authorities may differ, it can be stated safely that there is general agreement in the profession with respect to most fundamental issues. And these principles or methods have been widely accepted by businessmen in determining the results of their operations, in preparing their reports to stockholders and management, and in preparing financial statements to be used in the sale of their securities.

We have, in all of our accounting work, sought to determine and employ "established accounting methods." We have not, however, felt that a particular method of accounting became an "established method" merely because it was used by a given company or because its use was permitted for a specialized purpose such as the Federal tax law. Instead, the accounting methods followed by a company are measured against the body of generally accepted accounting principles and methods followed or endorsed by the recognized professional accounting societies, leading practitioners, and companies.

These accepted principles or "established methods" have found expression in bulletins published by leading accounting organizations, such as the American Institute of Accountants, in the professional journals, and in texts and reference treatises on the subject. In a practical way they are to be found in the statements of business corporations certified by independent certified public accountants as having been prepared "in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year." Accounting methods thus established are the ones which we consider we should follow if we are to arrive at accurate accounting determinations which will permit the establishment and maintenance of generally fair and equitable prices as required by the Act. Where the accounting methods of a company are contrary to these generally accepted accounting principles, we have not considered them to be "established accounting mehods."

WHY OPA USES THE "SUSTAINED DEPLETION" METHOD

The first specific charge of deviation from established accounting methods leveled at us by the National Coal Association is our rejection of the so-called percentage method of computing depletion in cost determination for extractive industries and the requirement in its place of the so-called sustained depletion method.

To clarify the terms used here, I wish to explain sustained depletion and percentage depletion. Sustained depletion is computed as follows: First, the cost basis of the coal deposit is determined. This is then divided by the number of tons available as determined by the best possible engineering estimates. The resulting figure is the depletion to be charged to each ton mined. We, and accountants generally, believe this method sets forth cost as nearly as it can be determined.

Percentage depletion is computed by taking an arbitrary percentage of the gross income of the properties. In the case of coal mines the statutory rate is 5 percent of gross income, after a few specified deductions. The highest of the statutory rates is the 27½-percent rate prescribed for oil and gas wells. Percentage depletion may be taken indefinitely, even after the cost of a property has been fully written off. However, the deduction may not exceed 50 percent of the tax net income for the year, determined without benefit of the depletion deduction. Therefore, the method results in no depletion charge whatsoever if the mine using it has no tax net income before depletion. Accountants believe this method to be unrealistic and unsound for cost determination, whatever its merits may be as a measure of tax deduction.

Percentage depletion has not been adopted for general corporate accounting and cost-determination purposes except in the case of a few companies. The reason is clear. By regular use of percentage depletion a company could charge to income as depletion more than it paid for the depleting asset. But it seems impossible to us that a company can have costs in an amount exceeding what it paid. Yet this is precisely what happens once the aggregate amount of depletion, on the percentage method, exceeds the price paid by the company for the mineral deposit it owns. These considerations were recognized by the United States Supreme Court in the recent Natural Gas Pipeline rate case in which Chief Justice Stone said:

"The Constitution does not require that the owner who embarks in a wasting-asset business of limited life shall receive at the end more than he has put into it. We need not now consider whether, as the Government urges, there can in no circumstances be a constitutional requirement that the amortization base be the reproduction value rather than the actual cost of the property devoted to a regulated business. Cf. *United Railways* v. *West* (230 U. S. 234, 265, 50 S. Ct. 123, 130, 74 L. Ed. 390). It is enough that here the business by hypothesis will end in 1954, and that the amortization base, computed at cost and including property already retired, will be completely restored by 1954 by the annual amortization allowances. As the Commission declared: 'The amounts of amortization are recognized and treated as operating expenses. Operating expenses are stated on the basis of cost. * * * We refuse to make an allowance of amortization in excess of costs. *To do so would not be the computation of a proper expense, but instead the allowance of additional profit over and above a fair return. Manifestly such an additional return would unjustly penalize consumers.*' "[1]

Many companies which claim percentage depletion for tax purposes do not follow it in their own corporate statements. Since it is not generally accepted as an accurate determination of actual cost by either the accounting profession or the industries involved, it could not be relied on in forming a realistic evaluation of an industry's need for a price increase. Sustained depletion, on the other hand, is generally employed by the coal-mining industry for other than

[1] *Federal Power Commission et al.* v. *Natural Gas Pipeline Co.* (315 U. S. 575, 593 (1942)). [Italics added.]

tax purposes, and is generally recommended by authoritative writers on cost accounting as the appropriate method to be used by the extractive industries. It is clear that no new accounting practice has been thrust on the industry.

In substantiation of our statements as to the relative standing of the two methods, we submit exhibit A setting forth quotations from leading accounting authorities on the subject of depletion, and Exhibit B reporting the treatment of depletion as shown in the certified financial statements of 24 leading coal companies filed with the Securities and Exchange Commission. Every one of these 24 companies chose to employ the sustained depletion method in making their annual reports, even though some used percentage depletion for tax purposes.

THE AMORTIZATION OF EMERGENCY FACILITIES

The second alleged departure from established accounting methods claimed by the National Coal Association concerns our method of accounting for amortization of emergency facilities. In our opinion, the fact that for tax purposes the cost of property acquired under certificates of necessity may be fully deducted from gross income over a 5-year period does not mean that the useful life of such assets may not actually extend for a greater or lesser period.

Established accounting concepts require that the cost of assets used in production should be allocated on some equitable basis to the output of the facility. Conventional accounting practice therefore demands that depreciation be computed with respect to the useful life of the asset and not with respect to an arbitrary period of time established for other purposes.

If it can be reasonably established that certain emergency facilities will have a useful life of less than 5 years, this office accepts for cost purposes a rate in excess of 20 percent. If it is reasonable to expect that the facility will be used and useful for a longer period, a rate lower than 20 percent will be required. In other words the rate used will be established by the circumstances of the case.

Departure from the 5-year rate either by the company concerned or by OPA is not in any sense a reflection on the opinion of the authorities granting the certificate of necessity. Such certificates do not mean that the authorities granting them have found that the facilities will be used or useful for exactly 5 years. The issuance of the certificate is exclusively a recognition of the fact that the proposed addition is essential to the war effort and as such should be granted the necessary priorities and allocations to construct it. To further stimulate war plant expansion, the Congress granted the added right of 100 percent deduction of the cost of such facilities, including land, over a 5-year period in computing income-tax payments.

I may point out in passing that the War Department follows the same policies and principles of accounting in regard to depletion, depreciation, and amortization as does the Office of Price Administration. To formalize the existing policy of the procurement agencies with respect to amortization, the Office of Contract Settlement is, I understand, about to release an accounting policy memorandum which rules out the inclusion of 5-year amortization simply because there is a certificate of necessity. This memorandum will be binding on the War, Navy, and Treasury Departments and the Maritime Commission in the settlement of terminated war contracts.

THE COAL ASSOCIATION'S PROPOSED AMENDMENT

The National Coal Association has proposed that the following proviso be added by amendment to the accounting methods proviso:

"*Provided further*, That determined costs for purposes of such regulations or orders shall include, but not be limited to, deductions from gross income recognized by the Bureau of Internal Revenue for Federal income tax purposes."

This amendment would not require the use of established accounting methods in any sense of the term. For example, as we have shown, the method of computing depletion cost which we now follow and which the National Coal Association now attacks is the one followed by the coal companies themselves. The association does not even propose that Federal income tax accounting be the basis for OPA accounting. They propose that, in computing costs for pricing purposes, industry be permitted to include deductions from gross revenue recognized for Federal income tax purposes. But they would not limit industry to such items. The proposed amendment would authorize the industry to take advantage of any specialized accounting methods developed by the Congress to meet the peculiar needs and problems of Federal income taxation. However, it would not require the industry to observe any of the countervailing safeguards which the Congress may have provided since the determination of cost is specifically not to be limited to items deductible for tax purposes. Thus industry would be authorized to ignore the tax law whenever it could find an established accounting method more advantageous to it.

The chief effect of such an amendment in many cases would be to inflate costs for price determinations far beyond those recognized by any system of accounting and out of all relationship to facts.

So to relate the stabilization legislation to income tax law would embarrass the administration of both. Clearly the stability of the price structure would be threatened if effect had to be given to frequent changes in the statutory concepts and judicial inerpretations of income for tax purposes.

The two basic problems should not be confused. Tax laws have many objectives to achieve through the definition of gross and net income which are distinct from the objectives of the accountant in portraying as accurately as possible the actual costs incurred in the production and distribution of goods and services. I am confident that the leaders of the accounting profession would be unanimous in maintaining that cost accounting and its established methods should not be predicated upon income-tax legislation.

Exhibit A

STATEMENTS BY ACCOUNTING AUTHORITIES ON ACCOUNTING FOR DEPLETION IN EXTRACTIVE INDUSTRIES

Paton and Littleton, An Introduction to Corporate Accounting Standards (published by the American Accounting Association in 1940), page 91:

"Depletion, like depreciation, should be determined objectively, as a cost of revenues, without reference to effect upon net income. In lieu of an independent computation in terms of cost and estimated content, the policy of using an arbitrary percentage of sales as a depeltion charge should be accepted only where conditions are such as to make satisfactory determination on the standard basis out of the question."

R. H. Montgomery, C. P. A., of Lybrand, Ross Bros. & Montgomery, and counsellor at law, Financial Handbook (second edition, 1937), page 383:

"Wasting assets are those property investments which are used up in the course of operations. Examples are mining investments of all kinds, gravel deposits, clay deposits, timberlands, stone quarries, and oil fields. These assets differ from investments in buildings and machinery in that they cannot be replaced or renewed; they are converted from fixed property investments into stock in trade and sold as product.

"The shrinkage in value of wasting assets is called depletion, as distinguished from depreciation. Like the latter, it is a cost of production, but it is a part of the material cost rather than the overhead. It is necessary to provide for this depletion or loss in the value of the fixed investment so that as the property is exhausted the capital invested in the company will be protected. This is accomplished by means of a depletion allowance, which is handled similarly to the depreciation allowance. As coal is removed from a mine a charge is made against operations or costs, and the amount is credited to the depletion allowance. The amount of the depletion to be provided is based upon the probable output from the wasting property, and the cost of the property less the residual value it will have after the natural reserve is exhausted. For example, a coal mine will be estimated to contain a certain number of tons of coal. The cost less the residual value should be written off on the basis of the average cost per ton of recoverable coal. Cost as here used is intended to include purchase cost plus any carrying charges capitalized to the time mining operations are begun."

Charles B. Couchman, The Balance Sheet, pages 48 and 49 (published under the auspices of the American Institute of Accountants. The Century Co., New York, N. Y., 1924):

"5–2. In some assets which are of a tangible nature the actual asset itself or at least the ownership thereof passes away during the period of use. Such assets are known as wasting assets, and the continuous decrease in value is referred to as depletion. Common illustrations coming under this classification are timberlands, mines, oil lands, and development lands. As these assets are developed and as the sales are made, each sale transfers title to a certain portion of these assets. Some of the assets which made the timberland valuable pass from the ownership of the company with each sale of timber. Similarly, in each of the other illustrations, a portion more or less great, of the asset itself passes from the ownership of the company with every sale of the company's product.

"It is quite customary to effect this transfer not at the time of sale but at the time when the product is prepared for sale. To illustrate: With every ton of coal that is mined the estimated amount of asset value is transferred from the asset of coal mines to the current asset of coal ready for sale. The result is that the passing from permanent asset value to the current inventory asset or, a step further, to the profit-and-loss account, is in proportion to the quantity of product rather than in the ratio of the passing of time. The estimated amount of coal which the land will produce is calculated prior to the beginning of operations. The cost of the land divided by the estimated number of units gives the amount by which the asset is depleted with each unit removed."

H. A. Finney, C. P. A., Principles of Accounting 1942, page 298:

"*Depletion methods.*—Depletion is usually computed by dividing the cost of the wasting asset by the estimated number of tons, barrels, thousand feet, or other units in the asset, thus determining a unit depletion charge. The total depletion charge for each period is then computed by multiplying the unit charge by the number of units coverted during the period from a fixed nature into merchandise."

Accountant's Handbook, third edition, 1943 (edited by W. A. Paton), page 630:

"It is almost universal practice to measure periodic depletion on the basis of the relation of the amount of the commercial output for the period to the total estimated commercial content of the property. Kester (Advanced Accounting) describes the process about as follows:

"'First, a unit depletion charge is established by dividing the capital invested in the wasting property by the total number of units it is estimated will be extracted during the life of the property. The second step is to multiply the unit charge by the number of units extracted during the period. The result is the depletion charge for that period.'

"For example, a tract of coal land is purchased at a cost of $1,000,000, of which the amount of $100,000 is considered to represent the residual land cost and $900,000 the cost of the wasting resource. The total commercial content of the deposit is estimated at 3,000,000 tons. With these conditions, the unit depletion charge is $900,000/3,000,000, or 30 cents per ton. In the first year the recoverable amount mined is 500,000 tons. The depletion charge for the year is accordingly $150,000.

"A distinction should be drawn between the total depletion charge for the year and the amount of such charge applicable to the income statement. If, in the example just given, the amount of coal sold and delivered totals 450,000 tons, and the unsold inventory on hand at the mine and breaker totals 50,000 tons, the depletion charge included in inventory is $15,000 and the amount applicable to sales, $135,000 (assuming a single homogeneous class of product)."

Exhibit B

TREATMENT OF DEPLETION IN THE FINANCIAL STATEMENTS OF 24 COAL COMPANIES AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION

This exhibit summarizes the depletion policies followed by 24 coal companies as disclosed in the most recent statements filed by such companies with the Securities and Exchange Commission pursuant to the requirements of the Securities Exchange Act of 1934. The group consists of companies whose major activity is coal mining and comprises substantially all such companies filing with the SEC.

Financial statements of all of these companies are certified by independent public accountants as being "in conformity with generally accepted accounting principles and practices."

In every case the depletion reflected in the statements filed with the SEC is actual sustained depletion, taken on a straight-line or tonnage-output basis. In no case is depletion taken based on the percentage depletion method allowed for tax purposes. The following table summarizes the situation:

Name of company	Certifying accountant	Method of depletion used in reports to SEC
1. The American Coal Co. of Allegany County, New York, N. Y.	Ernst & Ernst	Sustained.
2. Ayrshire Patoka Collieries Corp., Indianapolis, Ind.	Arthur Young & Co	Do.
3. Eastern Gas & Fuel Associates, 250 Stuart St., Boston, Mass.	do	Do.
4. The Elk Horn Coal Corp., Cincinnati, Ohio	Ernst & Ernst	Do.
5. The M. A. Hanna Co., Cleveland, Ohio	do	Do.
6. The Hatfield-Campbell Creek Coal Co., Union Trust Bldg., Cincinnati, Ohio.	Haskins & Sells	Do.
7. The Hudson Coal Co., 230 Park Ave., New York, N. Y.	do	Do.
8. Island Creek Coal Co., 75 Federal St., Boston, Mass.	Barrow, Wade, Guthrie & Co.	Do.
9. The Lehigh Coal & Navigation Co., Philadelphia, Pa.	Lybrand, Ross Bros. & Montgomery.	Do.
10. The Lehigh Valley Coal Co., Wilkes-Barre, Pa.	do	Do.
11. Lehigh Valley Coal Corp., Wilmington, Del	do	Do.
12. The New River Co., Mount Hope, W. Va.	Ernst & Ernst	Do.
13. The Pacific Coast Co., 2106 Smith Tower, Seattle, Wash.	Price, Waterhouse & Co	Do.
14. Peabody Coal Co., 231 South La Salle St., Chicago, Ill.	Arthur Andersen & Co	Do.
15. Pennsylvania Coal & Coke Corp., Grand Central Terminal Bldg., New York.	Anchin, Block & Anchin	Do.
16. The Philadelphia & Reading Coal & Iron Co., Philadelphia, Pa.	Haskins & Sells	Do.
17. The Pittston Co., 77 River St., Hoboken, N. J.	Eppler & Co	Do.
18. Pond Creek Pocahontas Co., 75 Federal St., Boston, Mass.	Barrow, Wade, Guthrie & Co.	Do.
19. St. Louis, Rocky Mountain & Pacific Co., Raton, N. Mex.	Peat, Marwick, Mitchell & Co.	Do.
20. Truax-Traer Coal Co., 8 South Michigan Ave., Chicago, Ill.	Arthur Andersen & Co	Do.
21. The United Electric Coal Cos., 307 North Michigan Ave., Chicago, Ill.	Haskins & Sells	Do.
22. Virginia Iron, Coal & Coke Co., Roanoke, Va.	A. M. Pullen & Co	Do.
23. Westmoreland, Inc., Philadelphia, Pa.	John Heins & Co	Do.
24. West Virginia Coal & Coke Corp., 705 Atlas Bank Bldg., Cincinnati, Ohio.	Arthur Andersen & Co	Do.

An effort was also made to determine the methods employed by these companies in calculating depletion for Federal tax purposes. Owing to the shortage of time, no information could be obtained as to 16 of the 24 companies. Of the remaining 8, 2 used sustained depletion both in their tax returns in the year examined and in their reports to the SEC. However, 6 in the year examined used sustained depletion in reports to the SEC but took percentage depletion for tax purposes.

A supplement to this exhibit, consisting of quotations from the financial statements of these companies, will be filed when the mimeographing of the material is completed.

Supplement to Exhibit B

QUOTATIONS FROM FINANCIAL STATEMENTS FILED WITH SEC BY 24 LEADING COAL COMPANIES

1. The American Coal Co. of Allegany County, New York, N. Y.; certifying accountants, Ernst & Ernst.

> NOTE E.—The provision for taxes on income reflects a deduction for depletion, based on a percentage of income (as permitted by the Internal Revenue Code), which exceeds by approximately $148,000.00 the charge made for depletion in the accounts.

Policy as to depreciation, depletion, amortization, and maintenance and repairs: Depletion of coal seams owned in fee is provided for at the fixed rate of $0.025 per ton which rate has been in effect since 1920 and, as far as the present executives know, was in effect prior thereto.

Provision for depletion of West Virginia leaseholds has been computed in accordance with the registrant's past practice on the basis of fixed amounts per ton estimated to fully amortize the asset amounts by the time the mineable coal in the properties has been exhausted. During 1942 a redetermination of the tons of recoverable coal in the seams of one of the leased properties was made. The effect on operating results for the year, because of the consequent change in the charge for depletion, was not significant.

2. Ayrshire Patoka Collieries Corp., Indianapolis, Ind., certifying accountants, Arthur Young & Co.

5. Policy with respect to depreciation, depletion, amortization, maintenance, and repairs, etc.:

(*a*) Depreciation, depletion and amortization: The policy followed with respect to provision for depreciation, depletion, and amortization is to charge off the cost of ordinary depreciable property, developed coal lands, and general development over the recoverable tonnage at each location. The provision is based on coal mined each year after determination of a per-ton rate by dividing the net book value of the particular property item by the estimated available tonnage. Trucks and trailers, considered to have a shorter useful life than other mine properties, have been depreciated on a straight percentage basis of 20 percent per year. Furniture and other equipment, which is used at all mines, is being depreciated at various rates from 6 to 25 percent per year. Facilities certified for amortization are being amortized over a period of 60 months from date of completion.

3. Eastern Gas and Fuel Associates, Boston, Mass.; certifying accountants, Arthur Young & Co.

The provisions for depreciation and depletion of the commercial and coal-mining properties for the year 1943, as in the previous year, are based generally on the estimated life of the properties, including in the case of coal reserves (owned in fee and held under leasehold), provision for depletion and amortization of development cost on the basis of coal production. Included in such amortization of development costs is the amortization of "premium account" of $10,463,478.54 (not allocated by mines) on a straight-line basis over a period of approximately 41 years from December 31, 1943.

4. The Elk Horn Coal Corp., Cincinnati, Ohio; certifying accountants, Ernst & Ernst:

Policy as to depreciation, depletion, and amortization; the depreciation policy followed by the corporation is to provide amounts for depreciation computed at rates considered adequate to amortize the cost of such assets over their useful lives. Depletion of coal lands is computed on a tonnage basis by using depletion rates accepted by the Bureau of Internal Revenue as shown in revenue agent's report dated November 23, 1923. Leasehold equity and option to repurchase is being amortized over the life of the lease with Western Pocahontas Corp. (12 years from March 25, 1937).

5. The M. A. Hanna Co., Cleveland, Ohio; certifying accountants, Ernst & Ernst:

NOTE E.—Depreciation, depletion, maintenance, retirements, etc.: The depreciation policy of the companies is to provide out of earnings amounts considered to be sufficient to offset the amounts at which depreciable assets are carried, during the estimated life of the properties. Provision for depletion and amortization of coal and ore properties is made out of earnings on a tonnage basis, set on the estimate of expected extraction. Because of variations in the estimated lives of properties and equipment applicable to the various mines and other operations, it is not practicable to state the rates used in computing the amounts of depreciation, depletion, and amortization.

6. The Hatfield-Campbell Creek Coal Co., Cincinnati, Ohio; certifying accountants, Haskins & Sells.

Depletion policy: Depletion is based on estimates of the recoverable tonnage of coal. Such provisions are made through charges against operations and credits to reserves.

7. The Hudson Coal Co., New York, N. Y.; certifying accountants, Haskins & Sells.

(1) During the year ended December 31, 1943, the company continued its previous policy with respect to depletion and depreciation.

The provision for depletion is based on rates per ton, applied to coal tonnage produced during the year, from coal lands and culm banks separately and for the year 1943 are $0.1572 and $0.3344 per ton, respectively. The rates are based on the estimated remaining tonnage from such sources, exclusive of undeveloped coal lands. These rates per ton are obtained by dividing the net book values of unmined coal in developed lands, and recoverable coal in culm banks, respectively, by the related estimated remaining tonnage. The amount of depletion recorded is determined by multiplying the tonnage produced from each source during the year by the respective rates so computed.

8. Island Creek Coal Co., Boston, Mass.; certifying accountants, Barrow, Wade, Guthrie & Co.

NOTE 2.—

The policy of Island Creek Coal Co. and subsidiaries, in respect to provision for depreciation, depletion, and amortization of physical properties has been, in general, to charge against earnings each year an amount, based upon rates applied to tonnage sold, which amount is credited to reserve. These rates are based upon the relationship of tonnage sold to the estimated tonnage available and recoverable through operations. The reserve accumulated on the basis stated will, in the opinion of the management, be adequate to provide for the retirement of fixed assets as they become no longer useful through exhaustion, wear and tear, and obsolescence.

The rates used in computing depreciation and depletion charges for the registrant and its subsidiary, Island Creek Fuel & Transportation Co., is 15 cents per ton of coal sold, and 5 cents per ton of coal mined by lessees. Those rates were adopted prior to the incorporation of the subsidiary named, the business of which was formerly conducted by the registrant. The depreciation and depletion charges included in the consolidated for Carnegie Coal Corp., and its subsidiary, Brooke County Coal Co., are $36,000 per annum for depreciation and 1 cent per ton of coal mined by lessees for depletion. The depletion charges included in the consolidation for United Thacker Coal Co., are 2¼ or 4½ cents per ton of coal mined by lessees, dependent on the kind of coal mined. These rates, in the opinion of the management, will result in sufficient reserves to equal the consolidated cost of the physical assets upon retirement or exhaustion.

The subsidiaries of the registrant not mentioned above do not have depreciable or depletable properties.

It has been the consistent practice of the registrant and its subsidiairies to provide for depreciation, depletion, and amortization of fixed assets by direct charges to profit and loss. Depreciation, depletion, and amortization charges are not considered as an element of cost of sales, selling expense, or general and administrative expense, and are not taken into account in determining the value of coal inventories.

9. The Lehigh Coal & Navigation Co., Philadelphia, Pa.; certifying accountants, Lybrand, Ross Bros. & Montgomery.

The registrant's policy with respect to depletion is to include in the cost of operations provision for depletion based on fresh mined coal shipped, carried away or sold by lessees on the following bases:

Alliance property, $0.0226 per ton.

Panther Creek property, $0.02155 per ton.

10. The Lehigh Valley Coal Co., Wilkes-Barre, Pa.; certifying accountants, Lybrand, Ross Bros. & Montgomery.

Depletion: A depletion charge is made on each ton of coal mined by the company of its tenants and subtenants as follows:

Mined from fee lands, various rates, ranging from 3.76 cents to 28.9 cents per gross ton according to region.

Mined from leased lands, various rates, ranging from 5.66 to 13.4 cents per gross ton according to region.

These rates per ton are the rates allowed under determinations by the Bureau of Internal Revenue or used by the company as the basis for the depletion deduction in income-tax returns and are based on valuations and tonnages as of March 1, 1913, made by the Bureau of Internal Revenue in 1921, adjusted to give effect to acquisitions subsequent to March 1, 1913, and to increases or decreases in recoverable tonnages as estimated by company engineers.

11. Lehigh Valley Coal Corp., Wilmington, Del.; certifying accountants, Lybrand, Ross Bros. & Montgomery.

> (2) The companies' policy with respect to depreciation and depletion is as follows:
>
> Depletion: A depletion charge is made on each ton of coal mined by the company or its tenants and subtenants as follows:
>
> Mined from fee lands, various rates ranging from 3.76 cents to 28.9 cents per gross ton according to region.
>
> Mined from leased lands, various rates ranging from 5.66 to 13.4 cents per gross ton according to region.
>
> These rates per ton are the rates allowed under determinations by the Bureau of Internal Revenue or used by the company as the basis for the depletion deduction in income-tax returns and are based on valuations and tonnages as of March 1, 1913, made by the Bureau of Internal Revenue in 1921, adjusted to give effect to acquisitions subsequent to March 1, 1913, and to increases or decreases in recoverable tonnages as estimated by company engineers.

12. The New River Co., Mount Hope, W. Va.; certifying accountants, Ernst & Ernst.

> NOTE G.—It is the policy of the company to provide reserves for depletion of coal lands at depletion rates designed to extinguish the carrying amount of coal lands over the useful lives of the properties. Depletion rates used are based upon the estimated tonnage of recoverable coal in the seams. Fixed assets (except coal lands) are divided into two classes, namely, "fixed-plant" and "special-life" assets. Fixed-plant assets are depreciated on a tonnage basis, the rates used being based upon the estimated tonnage of recoverable coal in the seams. Provision for depreciation of special-life assets is computed by applying depreciation rates based upon the estimated remaining useful lives of the assets. Provision for amortization of leasehold valuation has been made for the year 1943 at the rate of 4 cents per net ton of coal produced. Prior to October 1, 1940, the company used a rate of 3 cents per net ton of coal produced and, in addition thereto, made special provisions for amortization of leasehold valuation from time to time by direct charges to surplus.

13. The Pacific Coast Co., Seattle 4, Wash.; certifying accountants, Price, Waterhouse & Co.

The policy of registrant and its subsidiary companies has been to make such provisions in respect of depreciable and depletable properties as is considered adequate to accumulate reserves which will equal on the average the gross book value of the respective properties, less estimated salvage value thereof, at the expiration of their useful lives.

Provisions for depletion of coal and limerock deposits and amortization of development expenditures are made at tonnage rates, determined generally by dividing the estimated recoverable tonnages into the relative book values, applied to the tonnage removed.

14. Peabody Coal Co., Chicago, Ill., certifying accountants, Arthur Andersen & Co.:

> The depletion provisions for the year were based upon rates, per ton of coal mined, designed to amortize the recorded values of coal rights on the basis of recoverable tonnage estimated by the companies' engineers. The rates used ranged from $0.0015 to $0.075 per ton.

15. Pennsylvania Coal & Coke Corp., New York, N. Y., certifying accounts, Anchin, Block & Anchin:

> The lease of coal properties from the Clearfield Bituminous Coal Corp. is being depleted (or amortized) at such rates as to return the investment at or before the exhaustion of the coal. The rate of depletion used in this report is $0.0273 per net ton of coal mined during the year.
>
> Coal owned in fee is being depleted on the same basis. The rates range from $0.0190 per gross ton to $0.0921 per gross ton.

16. The Philadelphia & Reading Coal & Iron Co., Philadelphia, Pa., certifying accountants, Haskins & Sells:

> (F) The policy followed with respect to the provision for depletion, depreciation, maintenance, repairs, and renewals for the year 1943 is as follows:
>
> The Philadelphia & Reading Coal & Iron Co: Provision for depletion of coal lands was made at the rate of $0.05 per ton on coal mined by the company and by tenants from fee lands.
>
> Subsidiary coal companies: Provision for depletion of coal lands was made at the rate of $0.05 per ton on coal mined.
>
> Reading Iron Co.: Provision for depletion of coal lands was made at the rate of $0.05 per ton of coal mined.

17. The Pittston Co., Hoboken, N. J., certifying accountants, Eppler & Co.:

> Provision for depletion of bituminous coal properties is made at rates based on estimated recoverable tons of commercial coal. The average rate for 1943 was $0.033299 per ton.

18. Pond Creek Pocahontas Co., Boston, Mass., certifying accounts, Barrow, Wade, Guthrie & Co.:

> NOTE 2.—The policy of Pond Creek Pocahontas Co. and subsidiaries, in respect to provision for depreciation, depletion, and amortization of physical properties has been, in general, to charge against earnings each year an amount, based upon rates applied to tonnage sold, which amount is credited to reserve. These rates are based upon the relationship of tonnage sold to the estimated tonnage available and recoverable through operations. The reserve accumulated on the basis stated will, in the opinion of the management, be adequate to provide for the retirement of the fixed assets as they become no longer useful through exhaustion, wear and tear, and obsolescence.
>
> The rate used in computing depreciation and depletion charges for the registrant is 12 cents per ton of coal sold and for its subsidiary Marianna Smokeless Coal Co., the rate is 15 cents per ton of coal sold. Registrant's other subsidiary, Pond Creek Pocahontas Sales Co. has no investment in depletable and depreciable property.
>
> It has been the consistent practice of the registrant and its subsidiaries to provide for depreciation, depletion, and amortization of fixed assets by direct charges to profit and loss. Depreciation, depletion, and amortization charges are not considered as an element of cost of sales, selling expense, or general and administrative expense, and are not taken into account in determining the value of coal inventories.

19. St. Louis, Rocky Mountain & Pacific Co., Raton, N. Mex.; certifying accountants: Peat, Marwick, Mitchell & Co.

(3) Depletion on coal lands and coal rights is provided for on the basis of 4 cents per ton of coal mined.

20. Truax-Traer Coal Co., Chicago, Ill.; certifying accountants, Arthur Anderson & Co.

> Provision for depletion of coal lands and leaseholds is computed on the basis of the tons of coal mined at rates sufficient to amortize the ledger amounts thereof over the recoverable tonnage as estimated by company engineers.

21. The United Electric Coal Cos., Chicago, Ill.; certifying accountants, Haskins & Sells.

> 2. (a) For several years prior to August 1, 1937, provisions for depletion of coal reserves, mineral rights, lands, development expenses, etc., at productive mines and for depreciation of buildings, machinery, equipment, etc., at productive mines, with the exception of assets shown in Schedule V to be depreciated on a straight-line basis, were made at rates established as of August 1, 1933, based on estimated recoverable tonnages. Since August 1, 1937, such provisions have been based upon rates revised from time to time as a result of corrected estimates of recoverable coal made by the company's engineers. Amortization of development expenses is being provided only through provisions for depletion.

22. Virginia Iron, Coal & Coke Co., Roanoke, Va.; certifying accountants, A. M. Pullen & Co.

(2) Depletion charges for registrant are based on unit rates fixed by the United States Bureau of Internal Revenue. The method used by the Bureau in determining the value, for depletion purposes, of property acquired at the date of organization of the registrant was as follows: An estimate was made of the recoverable tonnage as of the date the valuation was to be made and the prevailing royalty rates were applied to these total recoverable tonnages over the period estimated as required for the mining thereof; the present worth of the future expected earnings therefrom was then determined by the use of Hoskold's formula. This method was used for both coal and ores. The depletion rate on coal, based on the value as of 1899, date of organization of the registrant, was determined at $0.0064 per ton; ores, $0.1245 per ton. The depletion rate on the registrant's coal deposits in Virginia, based on the value of the coal reserves as of March 1, 1913, was determined at $0.03 per ton by the United States Bureau of Internal Revenue, Coal Valuation Section.

Registrant's coal lands in Kentucky were owned by the registrant from the date of its organization in 1899 to January 1921, when the Colony Coal & Coke Corp., wholly owned subsidiary, was organized and these coal lands transferred to it by the registrant; they were reacquired by the registrant as of April 1, 1939, through merger of the Colony Coal & Coke Corp., with the registrant. The depletion rate on the Kentucky coal deposits was established by the United States Bureau of Internal Revenue, Engineering Section, at $0.016 per ton, based on the value of coal deposits as of March 1, 1913. This rate was determined by dividing the estimated recoverable tonnage into the estimated value of the coal in the ground, based on actual sales made around that date.

In the interest of conservation the registrant has used, for accounting purposes, the rate of $0.03 per ton on coal mined in Virginia, and $0.016 per ton on coal mined in Kentucky, rather than the original rate of $0.0064 per ton. The Colony Coal & Coke Corp. used the same rate ($0.016 per ton) during the period of its ownership of the Kentucky coal lands, and the balance of the reserve for depletion shown by its books was transferred to registrant's books as of the merger date. The depletion rate on ores, based on fair value at March 1, 1913, was determined at $0.1245 per ton by the United States Bureau of Internal Revenue, Metals Valuation Section, same as the rate that was determined as of 1899, mentioned previously.

Depletion charges at above stated rates have been regularly written off for all years.

23. Westmoreland Inc., Philadelphia, Pa.; certifying accountants, John Heins & Co.

(E) The policy of the registrant with respect to provision for depreciation and depletion charged to income account for 1943 remains without change from that pursued during the preceding year. The rates and bases used are in conformity with those established by the Bureau of Internal Revenue in relation to the Federal tax liability of predecessor companies and/or registrant for prior years, summarized as follows:

(1) 1,686,295.33 net tons mined by lessee, the Westmoreland Coal Co., and sublessee producing tonnage of no significance, from coal lands in Pennsylvania acquired prior to 1913 March 1 by predecessor companies, at the cost of $0.03101 per net ton (based upon aggregate estimated recoverable tonnage in relation to average composite cost of mineral)	$52, 292. 02
(2) 533,967.55 net tons mined by lessee mentioned under (1) from coal lands in Pennsylvania acquired subsequent to March 1, 1913, by predecessor companies at the cost of $0.09375 per net ton (based upon aggregate estimated recoverable tonnage in relation to average composite cost of mineral)	50, 059. 45
Depletion for 1943 provided by charge against income	102, 351. 47

24. West Virginia Coal & Coke Corp., Cincinnati, Ohio; certifying accountants, Arthur Anderson & Co.

Provisions for depletion were computed at rates established by the registrant's engineers which approximate the amount of the investment in coal lands and rights divided by the estimated recoverable tonnage. The rates used were as follows:

Northern division, 3.45 cents per ton of owned coal produced.
Southern division, 2.30 cents per ton of owned coal produced.

Mr. GREEN. Yesterday, Mr. Brown, when I was asking some questions, immediately accused me of being prejudiced against the small oil producers, and nothing could be further from the truth. I want to clear up that point if it needs clearing up.

I grew up in small business. I have been out there when they drilled in dry holes. So I know some of the problems the small oil producers have.

I also want to say that what I have to say here before the committee applies to the Accounting Department of the Office of Price Administration, which is my responsibility. I do not propose to make any statements concerning pricing policy or any other policy of the Office—accounting only.

We have been on record as to what we believe accepted accounting practice is. I would like to read into the record a short statement that is taken from my statement before the Senate Banking and Currency Committee and reprinted in the Journal of Accountancy, which is the official organ of the American Institute of Accountants. I took out a short paragraph or two that was in my statement. I think it summarizes pretty well what I try to establish as accounting policy for the Office.

We have not, however, felt that a particular method of accounting became an established method merely because it was used by a given company or because its use was permitted for a specialized purpose such as the Federal tax law. Instead, the accounting methods followed by a company are measured against the body of generally accepted accounting principles and methods followed or endorsed by the recognized professional accounting societies, leading practitioners, and companies.

These accepted principles or established methods have found expression in bulletins published by leading accounting organizations such as the American Institute of Accountants, in the professional journals, and in texts and reference treatises on this subject. In a practical way they are to be found in the statements of business corporations certified by independent certified public accountants as having been prepared in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Accounting methods thus established are the one which we consider we should follow if we are to arrive at accurate accounting determinations which will permit the establishment and maintenance of generally fair and equitable prices as required by the act. Where the accounting methods of a company are contrary to these generally accepted accounting principles, we have not considered them to be established accounting methods.

I will let that stand as our statement of policy.

Now, the Journal of Accountancy, in commenting on that statement, had this to say—and I would like to read it into the record, because I think it has some influence on the question as to whether we followed accepted accounting practices.

On several occasions we have criticized Government agencies in their use of accounting as in instrument of regulation for departing from generally accepted accounting principles to accomplish specific regulatory purposes which we have felt should have been effected by frank, direct exercise of regulatory authority rather than warping sound accounting methods. In this instance we are glad to congratulate a Government agency, and one which is highly unpopular in some quarters, for the sensible policy enunciated by Mr. Green, with which we believe every professional certified public accountant will agree.

Now that is our statement of what we believe accepted accounting practices to be, not only in the oil industry but in all industries.

We realize that small companies, many times, don't have accountants and they don't have bookkeepers. We realize that they have special problems. We take those into consideration, and should the committee desire, I can cite any number of cases where we have leaned over backward to help small companies, not only in the oil business but other places.

Mr. Brown would not agree we have done it to help oil companies, but there are many other cases where we have gone out of our way to assist companies in preparing our forms to give them help of accounting nature.

To put it in a very few words, it has been my policy to try to operate on a common-sense basis. Accounting is largely a common-sense proposition, and I don't believe we can operate any other way.

I have talked to leading accountants in a number of places. I have spoken before the National Association of Cost Accountants in some six or seven States, and in every case I have pointed out the method by which we operate, and I have said that it is my hope that we can eliminate controls as quickly as possible.

The accounting profession, both the public accounting and private accounting, for the various industries, I think, upon a check would show they know how we operate and they are in full agreement with what we do.

I think it is significant that Office of Price Administration accounting has no connection with any other department. We operate on an entirely independent basis, responsible only to the Administrator, and we operate as a public accounting firm.

So, when Mr. Judd, in his oil questionnaires, requests some figures he has absolutely no control over the outcome of the figures he gets. In other words, it is the responsibility of the Accounting Department to arrive at those figures and turn them over to him.

Two things should be put into the record. One is that we don't originate any studies. We can't go out and make work. Certainly, we work on an entirely objective basis. We have absolutely no interest in the outcome of the figures. I have contended consistently, and still say, that is the only way you can get reliable accounting information.

It is my personal opinion that we have accounting in the Office of Price Administration on as high a plane as it has ever been in Government service. We have adopted and followed good business practices, and we are ready to show that at any time anyone wants to know.

Now as to these charges that have been made against us. Mr. Brown on three occasions, before this committee, before the Senate Banking and Currency Committee, and before the House Banking and Currency Committee, has charged us with not following accepted practices which, if I read the law correctly, makes us in violation of the law. I think that that is a very serious charge, and I want to defend myself against it; that is, I want to defend the agency against it.

I have stated what our policy is, what we understand to be accepted accounting practice. I don't have a statement from Mr. Brown or from any of the representatives of the oil industry as to what they believe accepted accounting practices are; in other words, what are we not following that we should follow.

Now in the hearings before the Senate Banking and Currency Committee on page 451, Mr. Brown was asked this question by Senator Taft:

What about this replacement cost, is that standard accounting practice or is that a tax allowance?

Mr. Brown answered:

It has never been used because we have never had to raise the question of price before, so the question of replacement cost has not been very important.

Now, gentlemen, I submit Mr. Brown is saying that we do not follow an accounting practice which he himself says was never thought of in the industry before.

Now the question has been raised of last-in-first-out, and the witnesses that have testified against us say that this replacement cost is last-in, first-out. Last-in-first-out is a method of pricing inventory. It is a method of pricing current assets. We recognize the last-in-first-out method the same as we recognize any accepted accounting practice. We will not let a company for its cost submission to OPA switch from some other valuation to a last-in-first-out method unless there is some logical reason for doing it, and then we agree 100 percent. We submit that last-in-first-out was never intended to be used for the valuation or charge-off of fixed assets.

Mr. Hall. Explain that.

Mr. Green. Last-in-first-out means you charge into cost the last units you have purchased at the cost at which you have purchased them. In other words, if you buy 10 desks on 10 separate days at 10 separate prices, the last-in-first-out method of pricing would say that the highest-priced desk, the last one you bought, would be the first one you sold, all 10 desks being alike. It is used when you can't identify specific unit or product.

It is a recognized practice. One of the leading accountants, Mr. George Ellis, of Chicago, told me a little while back—I just happened to think of this—that there never should be a last-in-first-out method, that it should have been taken care of by accounting reserves. I doubt if I know enough about it to agree or disagree, but I have faith in Mr. Ellis' opinion.

Be that as it may, we do accept it where it can be shown that it is a valid method. We insist that it has nothing to do with pricing of oil in the ground, and we insist it has nothing to do with replacement cost.

Now should such an amendment like this be put in the act, I doubt seriously if it could be applied to the oil industry only. It would have to be applied to all businesses, all merchandising enterprises, and all manufacturers. In fact, I believe personally that if some special provision is put in the act for the purpose of helping small oil companies that you hurt other small companies. I don't see any way you could get a provision of this kind in the act without making it universal, and if it should be universal it will mean an increase in reported cost for all industry.

In summary, as far as the charge we have not followed accepted accounting practice in failing to use replacement cost, all I can say is that in my opinion the charge is ridiculous.

Now the other charge—why do we say percentage depletion is not accepted accounting practice for cost determination. We say that for several reasons. Cost or sustained depletion is recognized as correct method for determining operating cost.

Now regardless of the size of the company, we submit to any accounting authority that the oil industry wants to bring into the picture the question of whether or not sustained depletion, cost depletion, is a correct way to determine cost.

Mr. HALL. Explain both of those terms.

Mr. GREEN. I think, Congressman, that they need explaining badly. I will try to explain them as simply as I can.

Sustained depletion is an accounting method that attempts to write off the cost of natural resources over the period in which they are used, preferably on the basis of extraction. Now, if you have oil wells and you estimate by your best engineering figures that so much oil will come out of the ground on that particular lease, the sustained depletion method simply says that the cost that you have put into that particular product should be written off so much per barrel on the barrels of oil withdrawn. It stops when you recover 100 percent of cost.

That is what we claim is right. That is what the accounting profession will suport us in saying is right.

Percentage depletion has nothing to do with cost. In the Internal Revenue Act there are percentage figures given for several industries. In lieu of sustained depletion they are permitted by statute to take a percentage of gross income for depletion. For coal companies it is 5 percent of gross income. For certain ore-mining companies it is 15 percent of gross income. There are several other percentages for special types of metals. For the oil industry it is 27½ percent of gross income.

Now there is a limiting factor on that.

Mr. HALL. Over how many years?

Mr. GREEN. Forever. That is our contention, that you recover your cost over and over again. There is no limit on the number of times you can recover your cost. It is 27½ percent of gross income from now on in.

Now there is a limiting factor on that, supposedly a limiting factor. You cannot take percentage depletion at the rate of 27½ percent of gross income at more than 50 percent of net income computed without benefit of the depletion charge. That is a limiting factor. But the provisions in the law, I believe—maybe only in the regulations—are that this can be done by leases, so that you eliminate the bad leases and you work only on the good leases.

The net effect of that is that the overriding 50 percent of the net, exclusive of depreciation, is not as firm as I would say it was originally intended to be.

Should the committee want me to, I will have members of my staff write up the details of that for submission in the record. (Refer to exhibit D.)

Mr. HALL. I would like to have it.

The CHAIRMAN. We would be glad to have it.

Mr. GREEN. We will supply it.

Does that illustrate the difference between the two?

Mr. HALL. Yes.

Mr. GREEN. Now as to accounting authorities, the accounting authorities that I say support me in this: First, the magazine of the American Institute of Accountants, the Journal of Accountancy; secondly, Carman Blough, director of research for the American Institute of Accountants, a former partner of Arthur Andersen, one of the most outstanding accountants in the country, has written me a letter covering the points at issue (exhibit D). I have a letter from Eric L. Kohler, former executive officer of the Petroleum Administration for War, on percentage depletion. I wrote Mr. Kohler and asked him for this primarily for the purpose of refuting the charge of percentage depletion on coal companies, but the principles are exactly the same and the letter is available (exhibit D).

I have from the chief acountant of the Securities and Exchange Commission a letter summarizing a report of both coal companies and oil companies. I was talking about this yesterday. We agreed that the companies reporting to SEC were not small companies, and therefore not of so much interest to this committee (exhibit D).

I have a letter from a former president of the American Accounting Association, A. C. Littleton, supporting the position I have taken in response to a question that I have asked him (refer to exhibit D).

I have a letter from the United States Maritime Commission signed by R. E. Anderson, Director of Finance, which is not quite on this point, but it does state that they don't follow income-tax practices the same as the point we have made (refer to exhibit D).

I have talked with accountants in a number of places. I have talked with accountants in the War Department. I have talked with accountants in the Navy Department. I have talked with accountants in other places. I am informed by the Office of Contracts Settlement that in all their termination procedures they do not follow this special income-tax legislation.

So far, in all, the people I talked with, there has been no one that has disagreed as to the principles involved.

Corporations that use accountants follow the same practices that I claim that we use. I think it was pretty generally agreed yesterday that for the larger oil companies sustained depletion was an established method, and the question was resolved into one of what little companies do.

I have additional information on that this morning.

Mr. Brown and Mr. Becker both, according to my interpretation—and I may be incorrect—have admitted that sustained depletion is cost.

Now as to percentage depletion being recognized at more than cost, as not true costs, first of all, as I said, it lets you recover more than the cost of the property, how many times more I don't know. We could get that information from a study of Internal Revenue figures, I suppose.

There are two places in the law where the Bureau of Internal Revenue itself does not recognize percentage depletion. In the net operating loss carried forward they do not recognize it in the law itself. In the regulations the provisions for determining earnings and profits in distributions they do not recognize it. So, one place in the law, one place in the regulations, the Bureau of Internal Revenue does not recognize its own statutory percentage depletion.

We submit this morning that cost-depletion data are available. We believe, and I think it is pretty generally agreed, that companies with adequate records reflect it in their books. That was subject to the limitation yesterday of companies that had good accountants, large companies, the large public firms. Secondly, under tax law all corporations are required to compute costs depletion, and although Mr. Brown says that they do not do it, if they do not do it, it is they who are violating the law.

I am authorized to say that the Income Tax Unit of the Treasury Department, Bureau of Internal Revenue, has told us this morning that 95 percent of all operators, large and small, show cost depletion in their reports to the Bureau of Internal Revenue, and the 5 percent that do not show it in many cases have their assets fully charged off, so there would be nothing in the way of sustained depletion.

The tariff survey that Mr. Brown referred to yesterday, we looked into that a bit, and only a few of the 2,800 companies involved did not report sustained depletion. In the survey that we now have in process all major companies and independents have reported it. Out of 185 small operators reporting, all but 6 reported cost depletion and only one of those claimed his books were kept on percentage basis.

If I have not produced enough evidence, first, to show the correct cost determination in small companies, as well as big, I will submit that the principles of cost determinations are the same in large companies or small.

Secondly, if I have not proved what the practice of small companies actually is in regard to depletion, I have these two suggestions to make to the committee. I don't think either one is necessary, but I am willing to do either one.

According to Executive order of the President, the Office of Price Administration has access to income-tax data when it needs it. We are constantly writing to the Secretary of the Treasury to get access to those figures, and we actually keep eight employees over at the Internal Revenue all of the time. If the story is in the tax returns of these small companies, I am perfectly willing to authorize a study to examine those returns to find out what the truth of this thing is.

Now, if that is not satisfactory, not desirable, I have another suggestion. We have an accounting staff located partly in Washington and partly in the field offices. We have 8 regional offices and 93 district offices. I would guess that we have an accountant within a very short distance of any oil company you could mention in the continental United States at this moment.

I am perfectly willing, if the committee so desires, to pass the word out on a priority basis to the regional accountants and have them send men to actually look at the books of these companies, any number that you gentlemen say, so that we can come back to you and give you the actual facts in the company offices, if any more substantiation of my position is needed.

Thank you very much.

The CHAIRMAN. Mr. Brown, did you want to ask a question?

Mr. RUSSELL B. BROWN. I think probably there has been some difficulty in understanding more than anything else, and I would like to clear a few of those things up.

Mr. Green speaks as though I was critical of his position. I think what I stated in my statement was that there was an accounting system such as replacement cost that was a recognized accounting system. He has established that as being true.

The next statement that I made was that they, in advance of getting the information in here, stated that such accounting would not be recognized before the committee had had a chance to discuss that either with them or with you. As a result of that statement a number refused to send in their questionnaires or failed to send them in. I think that is what I said, and I think that is pretty well established by what he said.

I intended in no way to reflect on his character. What we are trying to do is get a job done.

If you clear that question it would solve some of our problems. So, I go back to the question I asked you yesterday: What accounting system do you propose to take care of an industry, a large number of the members now losing money? What means of accounting do you propose that would show that situation as to the oil industry? And, how is he to stay in business if he can't get any increase in business?

Mr. GREEN. Accounting systems are not the governing factors as to whether companies make money or lose money. Some of the most successful companies in this country had no accounting system, and some of the companies with the best accounting system failed. It is the function of accounting, and accounting systems, I suppose, to give the facts to the owners or managers of the business, to the extent they want those facts. Many accountants go wrong on that when they establish detailed and complicated accounting systems for small business, which they shouldn't do, and it would have been so easy for us in our accounting work in OPA to throw in all kinds of complicated accounting systems for small business. To the best of our ability we have not done that.

Certainly, we get complaints against our accounting, but, in general, we have been as sympathetic as we possibly could to small business of all kind, and to big business where it was necessary.

In other words, we have tried to do an accounting job, and I think I am safe in saying that it is probably the most complex accounting job undertaken by any agency, public or private. It has been our job to make that work.

As far as your attack on me, as a personal matter and as an accountant, that is entirely immaterial. I don't care in the least. I do care about how the Accounting Department of OPA has done its job.

It may be of interest that even the meat packers in their attacks on OPA still have had a good word for the Accounting Department in OPA.

Mr. RUSSELL B. BROWN. I appreciate your statement there. I still don't know what you want to substitute for replacement cost. Have you any method you can suggest to us?

Mr. GREEN. Not a method probably in the sense you would call it a method. I think what you should do, probably, is to get the cost according to established accounting practice. We maintain that is sustained depletion. Replacement cost has nothing to do with it.

Now, then, from there on in you have got a question of getting a price increase. I sympathize with your position. I know what you want, but it seems to me that you have jumped on this accepted accounting-method proviso as a device for getting a price increase. All I am asking, as far as my particular department is concerned, is that you go after the price increase on the factors that are pertinent, and don't accuse us of not following accepted accounting practice when you, yourself, say that the industry never thought of this before in the hearings last March before this Senate committee.

Mr. RUSSELL B. BROWN. As you know, the statements I made in the Senate committee are the same as I made here yesterday. The industry has never kept an accounting system with the view of price fixing. That is exactly what I said yesterday, and I say that yet. And that is true. But still we have no formula on which we can base figures on facts to show whether or not we are losing money.

Mr. GREEN. It is not the purpose of my shop to develop figures to show you are losing money. It is not to develop figures to show you are making a profit. Our particular job is to develop figures—period. If they show the oil industry is losing money, then Mr. Judd has a problem on his hands. If they show the oil industry is not losing money, then Mr. Judd is clear.

The point I want to get across is that we, under no circumstances, ever start out to collect figures with any end-product in mind. We will summarize our figures, and we will make them available to the committee, and under proper safeguards they are available to you.

Mr. RUSSELL B. BROWN. Am I correct in my statement that cost accounting does involve replacement cost?

Mr. GREEN. No.

Mr. RUSSELL B. BROWN. It isn't used?

Mr. GREEN. That is correct. I refer you to accounting authorities.

Mr. RUSSELL B. BROWN. The next question I would like to clear up is the one about you being prejudiced. I did say that, and I do believe that, and here is what I base it on.

You made the statement yesterday that we were in a preferred position.

Mr. GREEN. Yes.

Mr. RUSSELL B. BROWN. That same statement was made by one of your men in the Senate, Mr. Johnson. Here is the answer of one of the oldest members of the Finance Committee to that, and it may be of interest for the record here, and I would like to read just that answer in referring to this favored position.

The answer was this:

> It was not given for tax relief, and it was not given as a privilege. It was given as the Congress' method for determination of the best method of finding out what the depletion ought to be. So, I think your whole assumption is basically wrong.

Now, that is what I am basing my statement on when I say you were prejudiced in prejudging our case.

Then the second point on that was that by bringing that in it is a resort to what I think is an unfortunate and unfair thing of injecting a question into this issue that isn't a proper question. The question of depletion allowance was first injected by your Office, and it was something on the character of attacking a witness on the stand on trial for one type of crime and asking him, "Are you the fellow that killed your mother-in-law," and injecting an entirely new issue in it that belongs in another place. That is what I think was unfortunate and unfair. I think you are entitled to know what I base my statement on.

Mr. GREEN. I may not have all the facts at hand. Certainly we would have no reason to raise the question of sustained depletion. My guess is, and maybe somebody here can bear me out in it, certainly we can look up the record, that this question was first raised by the Coal Association, where they insisted that we follow internal revenue practice.

Your testimony before the Banking and Currency Committee is that you asked us, I believe, to permit percentage depletion. I am not sure whether you insisted that we follow internal-revenue practice or not, but internal-revenue practice is the only place that percentage depletion could come from.

Now in order to show why internal-revenue practice is not accepted cost-accounting procedure, it was necessary, I believed, and still believe, to point these special advantages that the extractive industries get in a tax law, and the one that gets the greatest advantage is the oil industry. The have got a 27½-percent rate as against the coal companies 5-percent rate, and the other companies in between some place.

The CHAIRMAN. Mr. Green, I wish you would state those favored positions of the oil companies.

Mr. GREEN. May I write those down and submit them in the record?

The CHAIRMAN. That would be all right (refer to exhibit D).

Mr. HALL. We have been trying to find out what is an accepted accounting practice. From your answer to Senator Taft at the Senate hearings I would take it that for sometime back you didn't have any accepted accounting practice.

Mr. RUSSELL B. BROWN. We have had none at all for price fixing, that is true.

Mr. HALL. Am I to assume from that that you have adopted this new method in order to get a raise in the price of crude oil?

Mr. RUSSELL B. BROWN. I think the proper assumption from that is this, that we don't keep books, never have kept books——

Mr. HALL. Has this practice you now want sprung up since the OPA has been operating?

Mr. RUSSELL B. BROWN. To this extent. We want to apply our method of accounting to some method of cost accounting that can be used in price fixing. That is what we are trying to do.

Mr. HALL. What I am trying to find out is this: The argument yesterday was whether or not Mr. Green was following accepted accounting practice. Now I want to find out from you—and you can answer it yes or no—whether or not you used the method you are now insisting on before OPA came into being.

Mr. RUSSELL B. BROWN. No. We have a record of that that is available from the facts in our books, but it wasn't kept for price fixing. I am trying to make that clear.

Mr. HALL. Certainly the issue is now clear that it was not an accepted method before OPA came into existence. I am not criticizing you, but you want that method now in order to boost your price?

Mr. RUSSELL B. BROWN. We want some method that will reflect the facts in regard to price increase, that is right, and that is one method of showing that.

The CHAIRMAN. Do you have any other questions to ask Mr. Green?

Mr. RUSSELL B. BROWN. That is all.

The CHAIRMAN. Have you finished, Mr. Green?

Mr. GREEN. I just want to make one more statement. It seems pretty clear that the statement that we are not following accepted accounting practice is false. I think it is ridiculous. The case is that the oil industry is trying to sell us some new so-called accounting system that nobody used, ever used, as a device to get a price increase. I say we shouldn't accept it.

Mr. RUSSELL B. BROWN. I don't think that is quite accurate. We do say that an accounting system which is generally accepted, and that is the replacement cost, is available for use in this case.

The CHAIRMAN. We will hear the next witness.

STATEMENT OF DAVID F. CAVERS, ASSISTANT GENERAL COUNSEL FOR PRICE IN THE OFFICE OF PRICE ADMINISTRATION

Mr. CAVERS. Mr. Chairman and members of the committee, I believe that the remarks just made by Mr. Green make it unnecessary for me to embark on a legal argument in justification of the accounting method pursued by the Office, but I would be happy to do so if you wish.

The CHAIRMAN. I think for the record it will be all right for you to put it in. It would be all right to insert a statement.

Mr. CAVERS. I would be glad to do it at a later date.

Assuming the legality of the accounting method followed——

The CHAIRMAN. Mr. Brown, would you like to question Mr. Cavers on the legality of this method?

Mr. RUSSELL B. BROWN. I think we agreed that the method is available.

The CHAIRMAN. We will excuse Mr. Cavers and permit him to file a statement in the record. (Refer to exhibit C.)

Mr. CAVERS. I wonder if I might add an additional point on a somewhat different issue. If, as a matter of price policy and not with reference to the obligations of the accounting method proviso, the Office of Price Administration were to undertake to use replacement cost as a factor in determining maximum prices for crude oil, consideration would have to be given to the legal obligation of the Office to make comparable adjustments in the prices of other products.

If I may, I should like to bring to the attention of the committee the fact that in the report which was placed in the record by Mr. Judd at the start of this session of the committee, the memorandum prepared by the National Industry Refiners Advisory Committee, on page 17, the refiners committee points out as follows:

> The point has also been made by several members that the factor of replacement cost which is receiving considerable attention in relation to crude-oil costs is also involved in refinery operations. Practically no refinery in the United States, except the one wholly constructed during the war, could possibly be replaced for anything like the amount of money that it originally cost. Based

on considerable information obtained on this point, it appears that the average cost of typical refinery capital items is today more than 50 percent greater than in the years just prior to the war, and if the comparisons were made with cost for the early thirties, the disparity would be even greater. Depreciation charges, however, are based upon historic capital costs and such depreciation charges are certainly not being accumulated on a basis which would permit the replacement of the items being depreciated on the basis of today's replacement cost.

Now that contention could be advanced by any industry whose reproduction costs are more today than they were at the time the capital assets were acquired. I suppose that includes a very high proportion of all industry in the country.

But it seems to me what the contention of the industry amounts to is that provision should be made in the pricing structure not for the replacement of the capital invested in the wasting asset, but rather for the expansion of the capital of the industry.

That contention has been made from time to time in utility cases. The Supreme Court in the recent Natural Gas Pipe Line case, in an opinion by Mr. Chief Justice Stone declared that there was no constitutional requirement that the owner embarking on a wasting asset business of limited life shall receive at the end more than he has put into it. That position was reiterated in the Hope Natural Gas Co. case. (Citations of those cases are 315 U. S. 593, *Natural Gas Pipe Line Co. case, and* 320 U. S. 591 for the *Hope Natural Gas Co. case.*)

In 1933 the Public Service Commission of Wisconsin made an observation with reference to the contention that rising capital cost should be reflected in prices, which, I think, is of relevance here. The commission observed:

It is difficult to see why the consuming public should be compelled legally to function as investor in the plant of a utility by meeting its capital requirements. The provision of funds to finance enhanced price of fixed capital is solely the responsibility of the corporation and should not be permitted by subtle process of inflated depreciation.

In addition to the various industries which Mr. Green listed as having percentage depletion as a method of computing tax deductions, it should be added the lumber industry was, by changing the tax law in 1943, authorized to take the market value of stumpage as of the first of the year in which it was cut. I think it is a matter of common knowledge that stumpage prices tend to go up with the prices of timber, and to allow stumpage cost to escalate in accordance with the tax deduction would be accelerating the spiral of inflation in the lumber field.

I think we should add, however—I am sure Mr. Green would accept this comment—that in our opposition the Office of Price Administration is not in any way indicating its opinion as to the propriety of their use in the matter of tax deductions under the tax law.

The CHAIRMAN. Thank you very much.

Mr. Judd, do you want to be heard now?

Mr. JUDD. I would like to be heard now.

Mr. RUSSELL B. BROWN. I think the witness has perhaps cleared up one thing that I got confused with Mr. Hall on. The point I was trying to clear up is just what the witness has said, that we didn't keep books on a basis of price fixing. We do think that a replacement cost is a method of cost accounting and, therefore, that was one suggestion we had that we felt we shouldn't foreclose until we had an opportunity to develop the facts.

What I said previously, and what I still think, is that all we are asking in the developing of this questionnaire is to be able to show to the Office of Price Administration the true condition, and if it reflects that an operator is selling his product at a price that he cannot stay in business, then, we want that adjustment made.

I hope I make myself clear. I am afraid I didn't awhile ago.

Mr. HALL. We have spent a day trying to find out what your accepted accounting method is so far as small companies are concerned, and you said you had no accepted method prior to the Office of Price Administration. That answers my question.

STATEMENT OF O. D. JUDD, OFFICE OF PRICE ADMINISTRATION

Mr. JUDD. Before I start like to say that Mr. Sumner Pike, who has been Director of the Fuel Division for the last 3 years, and he has occupied that position without compensation, and I think it might be of interest to the members of the committee and probably to the industry members, that Mr. Pike is available for any questioning after this prepared statement, which is a brief summation of the entire picture, is presented.

The testimony of Mr. Merle Becker, Mr. J. V. Brown, and Mr. Russell Brown, was to the effect that the Office of Price Administration was not carrying out the mandates of Congress in that they refused to recognize percentage depletion as being a standard method of accounting in the oil industry. They further represented that the questionnaire sent out to the industry was not being returned by the various interested producers because certain members of the Office of Price Administration had made public statements to the effect that replacement cost will not be considered in the questionnaire computations.

It was further alleged that the base period, namely, 1936–39, was a depressed period for the oil indstry and therefore unfair when used for the purpose of determining whether or not an increase in the price of crude oil should be made.

It was further stated that the refining interests had been permitted to increase their prices per barrel of product and they especially referred to a 50-city survey on gasoline prices to bear out this argument.

We will attempt to answer each of these statements.

1. The use of percentage depletion instead of sustained depletion for cost purposes: It has been claimed by the industry's witnesses before the committee that although accepted accounting principles as subscribed to by the leading accounting authorities of the country indicate that sustained depletion is the correct cost-accounting procedure, the small independent operators to a great extent use percentage depletion in setting up their own books because they are unable to compute sustained depletion. It should be pointed out that percentage depletion is based upon the gross income of oil production and sustained depletion reflects cost position. Therefore in any cost study which is to represent a factual finding the accounting principle which deals directly with cost would appear to be of paramount importance and the one which the Office of Price Adminis-

tration should use. The report, dealing with the cost of producing crude petroleum in the United States which was conducted by the United States Tariff Commission for the Office of Price Administration, dated December 1942, states as follows:

> The method generally used by the industry in amortizing this investment (not book investment in leaseholds) is to divide the amount paid for the lease by the producer's share of the estimated economically recoverable reserves.

It is assumed, therefore, that those who made this study concurred in our opinion that industry generally used actual or sustained cost depletion.

However, in order that the presently conducted crude survey will not be impeded by the failure of small producers to report because of their possible inability to provide sustained depletion figures, we have agreed to survey a representative group of small producers to determine whether or not they do have sustained depletion figures. This survey will cover approximately 200 small independent producers and a finding will be made within 1 week from the date started.

While we feel percentage depletion should not be used for our study, in that it permits the full write-off of all capital costs several times during the life of a property, we do not desire to impose upon the independent segment of the industry an impossible requirement, if such it be.

2. Replacement cost: The industry requests that we use replacement cost in determining the present cost of producing crude oil and defines such replacement cost as present finding, developmental, and operating cost. It should be pointed out that the oil industry has never kept its books on the basis of replacement cost. Furthermore, no other industry keeps its books on this basis.

It is industry's contention that unless replacement cost is used and is accepted by the Office of Price Administration in their finding on the crude-oil survey that industry is selling stock from their shelves at less than replacement cost: That such being the case the oil industry does not have any incentive to continue exploring for oil. It would appear that the best answer to this contention on the part of industry is the present rate of exploratory drilling and the present reserve position of the industry.

Even after the abnormal withdrawals of 1944, the petroleum reserves of this country, as estimated by the A. P. I. are at an all-time high, and the present rate of exploration as revealed by the results of 1944 drilling are higher than for any year since exploratory drilling was segregated from a total of all drilling. The tabulated results for each year since 1937, the date when the first separation was made of exploratory and developmental drilling, shows the following trend:

	Number exploratory wells drilled		*Number exploratory wells drilled*
1944	3,881	1940	3,038
1943	3,512	1939	2,589
1942	3,223	1938	2,638
1941	3,264	1937	2,224

It would seem inadvisable to bring into wartime pricing an element which has heretofore never been used either by the selling or buying portions of industry as a basis for determining the current price of a barrel of oil.

Although industry generally has not claimed that the use of replacement cost was an established industry practice, computations made by oil authorities conclusively prove there was no relationship between replacement cost and the price of oil as indicated by the following:

Year	Cost to find and acquire (per barrel)[1] [2]	Price of crude at the well[3]
1931-34	$0.2973	$0.80
1935	.2452	.96
1936	.2115	1.09
1937	.1261	1.18
1938	.1395	1.13
1939	.1671	1.02
1940	.2263	1.02
1941	.3202	1.14

[1] IPAA, October 1941, report on crude petroleum costs.
[2] Identical series given in report of Phillips Petroleum Co., costs of finding, acquiring, and producing crude oil in the United States under conditions pervailing for the years 1937 through 1941.
[3] Bureau of Mines.

It will be noted that although the above estimates of cost of finding oil decreased from the 1931-34 bracket through 1935, 1936, and 1937 the price of oil increased each year whereas when finding costs increased in 1938 and 1939 oil prices decreased. Although finding costs still advanced in 1940 over 1939, prices did not advance. In 1941 finding costs advanced $0.0939, and oil advanced $0.12. This latter advance certainly was the result of war demand and not because of any replacement cost relationship.

3. Depressed period for the oil industry:

In Mr. Russell Brown's testimony he referred to the fact that the base period 1936-39 was a depressed period for the industry when, according to his estimate, 60 percent of the operators were losing money. He further testified that Mr. Leon Henderson, former Price Administrator of the Office of Price Administration, stated in his report as of April 1942, the First Quarterly Report, that at the time the defense program was launched the petroleum industry was depressed. The Administrator went on to point out that the production of crude oil in Illinois had been unrestricted and that the excess supply had resulted in weakened price structure throughout the mid-continent area. He also indicated that under the influence of defense program, prices had begun to rise at a rapid rate. The Administrator's reference was undoubtedly to the year 1939, not to the base period, namely, 1936-39, nor to October 1941 as of the date when crude oil prices were frozen.

The average price for oil in the base period was $1.105 per barrel, and in October 1941 was approximately $1.19 per barrel. This latter price represented the highest price at which crude oil had been sold since 1930. Also, the Bureau of Internal Revenue selected the years 1936-39 as a basis for excess profits taxes for those engaged in the oil industry, and according to the Bureau of Internal Revenue, no protest to the use of that period has been made by the oil industry.

Further, Bureau of Internal Revenue data indicates that the earnings of no other 4-year period would be as favorable since 1926 and prior to price control.

4. Press statements regarding the use of replacement cost: In the first meeting of the National Crude Oil Industry Advisory Committee the members of that committee were advised that the Office of Price Administration would not use replacement cost as a factor in computing present costs of finding and producing crude oil.

Sometime later, inquiries from trade papers as to our attitude in this respect made it advisable to make our position clear. We felt, and still do feel, that it would have been a major mistake not to have fully acquainted the oil industry with our position.

We do not subscribe to the conclusion that our frankness regarding the standards we would employ indicated we had prejudged the issue.

5. Gasoline price increase: In the testimony of Mr. Merle Becker he indicated that the price of gasoline had increased 92 cents per barrel since 1941, whereas the price of crude oil had advanced but 6 cents. The implication of this statement is that the refiners have profited to the extent of an additional 92 cents per barrel on gasoline, while the crude oil producers were held down to a 6-cent increase. This implication is not correct. The major portion of the 92 cents referred to was comprised of increased transportation cost to the east coast, increased local taxes, and increased prices for jobbers and retail dealers in subnormal areas. The balance of the increase referred to occurred prior to price control. To substantiate this statement the National Petroleum News in its gasoline index as of October 6, 1941, shows the tank-car price of gasoline as 6.77 cents per gallon and an average for October 1941 of 6.73 cents per gallon. As of May 28, 1945, this same index shows the average tank-car price of gasoline as 6.72 cents. This index, therefore, indicates that the refining industry rather than having increased its earning powers through increased prices is as of today receiving less money at the tank car level than they received in October 1941.

While it is true that the refining interests have shown increased profits, it must be borne in mind that a substantial portion of these profits is subject to renegotiation and in addition to this fact, the industry has made substantial investments in order to produce certain products for the war effort thereby increasing their capital investments.

It would appear, therefore, that the figure of 92 cents per barrel increase in gasoline prices should not be assumed to reflect an increase for the refining industry.

In conclusion I would like to state that the Petroleum Branch of the Office of Price Administration is desirous of protecting the producing branch of the petroleum industry to the greatest degree possible consistent with the objectives of wartime price control and established practices of the industry. We are ready and willing to give full consideration to all valid costs related to the production of crude oil and to authorize price adjustments when such costs indicate the need for such adjustment. We do believe, in discharging our duties in accordance with the mandates of Congress, and in the best interests of the oil industry, we should not recognize nor accept the introduction of some new method for computing costs.

The CHAIRMAN. Mr. Brown, you may ask a question.

Mr. JAMES V. BROWN. In bringing in the economics of the industry on reserves the question of reserves is one that is confusing. The API reserves that Mr. Judd speaks of deal with extensions and revisions relating to fields discovered many years ago. That also brings out the accounting for price fixing——

The CHAIRMAN. I thought you wanted to ask a question. If you want to make a statement, suppose you wait until he concludes.

Mr. JAMES V. BROWN. I am sorry. I did have a question. So many questions have developed since that I have forgotten just what that was.

The CHAIRMAN. Mr. Hall?

Mr. HALL. No questions.

The CHAIRMAN. Mr. Eastwood?

Mr. EASTWOOD. I think I caught in Mr. Judd's statement an implication that we had an increase in reserves which he felt was occasioned, to a large extent, by favorable prices.

Did I understand you to say that?

Mr. JUDD. I said it was occasioned by prices which were not unfavorable.

Mr. EASTWOOD. I understand that the east Texas field, for example, back in 1933, had estimated reserves at a certain number of barrels, that they had withdrawn about five-sixths of those barrels, but they still have practically as much as was estimated at that time, which it is claimed by Texas sources is due mainly to the conservation measures used in that State. That necessarily wouldn't be price. Wouldn't that be conservation?

Mr. JUDD. I think conservation retained the reserves. I don't think it increased them. It would spread it over a longer period of time.

Mr. EASTWOOD. I understand that there was an estimate of, let us say, 3 million barrels and they took out 2½ million over a period of 10 or 12 years and today they figure they have about the same amount of reserves.

Mr. JUDD. That bears out our contention that original reserve estimates by the Petroleum Administration for War or API are ultraconservative and do not represent the true reserve position. Your true position is not reflected until 25 or 30 years after the oil is discovered. It is purely an estimate that they make when the field is first discovered. The reserve figures are always subject to revision, and that is why we use the API figures, because they reflect those in the year the revisions were made and the Petroleum for War Administrator's figures reflect them back to the year of discovery.

The CHAIRMAN. Will you insert the questionnaire in the record?

Mr. JUDD. Yes, sir; I will be glad to.

(Refer to exhibit G.)

Mr. HALL. Do you agree with the statement on the part of the two Browns that it does cost $1.25 now to replace on the shelf the articles they used to put there for a dollar?

Mr. JUDD. No, sir; I do not. In the first place, I think the replacement-cost theory which they used is not factual. In other words, the reserve picture changes daily and that reserve picture cannot be estimated in advance because it depends entirely upon the strikes made. There is no valid way of saying what the replacement cost will be.

Mr. HALL. You are in disagreement with the Petroleum Administrator, are you? Hasn't he requested a raise?

Mr. JUDD. Yes, sir; I disagree. The PAW Administrator made a statement in Chicago that the price of oil was not holding back drilling.

Mr. HALL. How can you answer that question definitely, however, as to the cost of today and the costs, say, of 1939 until you look over this questionnaire?

Mr. JUDD. We can't answer it definitely, Congressman Hall. I don't intend to answer it definitely. You asked me for my opinion. My opinion is that the basis on which they asked us to compute replacement cost is unsound because they use the initial estimated reserves of PAW, and those reserves, as Mr. Eastwood pointed out in connection with the east Texas field, are not the total reserves which should be used.

Mr. HALL. If this questionnaire should develop figures which might prove your opinion wrong, might that change the position of OPA?

Mr. JUDD. In my opinion it wouldn't. I wish I could put it in a few words and make myself clear. The average replacement cost of a barrel of oil to the individual oil man is a fictitious and unrelated figure as far as he is individually concerned. What the industry average might be has nothing to do with what the individual has to contend with in replacing oil, because the individual's own operation and his own cost and what he recovers is what governs his profit and loss position, not what the industry generally does.

Mr. EASTWOOD. Didn't you set up a 60-cent figure in connection with the stripper-wells subsidy plan to cover some of those things that you now say you will not allow?

Mr. JUDD. No. We set up the 60 cents to cover administrative cost and various costs in addition to amortization and depletion, and so forth, which various companies figured on different basis. There was no set basis for figuring those. The industry said, "We will set a flat figure which will cover administrative costs——"

Mr. EASTWOOD. None of those things included in that 60-cent figure are in section D of this questionnaire which you are not going to take into consideration?

Mr. JUDD. Lifting cost, of course, isn't. We allowed the actual lifting cost.

Mr. EASTWOOD. I was just wondering if you had any of the information contained in section D elsewhere in your questionnaire, and just specifically what part of the answers to the questions in section D you were not going to take into consideratoin.

Mr. JUDD. Mr. Noble could give you a comment on section D.

STATEMENT OF L. H. NOBLE, ACCOUNTING DEPARTMENT, OFFICE OF PRICE ADMINISTRATION

Mr. NOBLE. My name is L. H. Noble of the Accounting Department of the Office of Price Administration.

Your question, Mr. Eastwood, as to the element of cost in section D in the questionnaire, which is the section generally considered to be the one to develop replacement cost, whether or not they include or do not include the cost in section E, which is to develop the historic cost of peration—is that your question?

Mr. EASTWOOD. Probably the way you phrase it it is much better than I could have. I just want to find out what in section D you did not intend to take into consideration in your calculations. I think by elling us which ones you won't take into consideration——

Mr. NOBLE. Both sections include the same type of costs. They simply call for their compilation in two different manners.

Mr. EASTWOOD. You mean you are including replacement cost in section E?

Mr. NOBLE. No, sir; not as such. We are including all historic cost in section E.

Mr. EASTWOOD. Historic cost, though, might possibly represent lower cost than replacement cost as of today or in the future. Is that correct?

Mr. NOBLE. Yes, sir. Section E is an effort to determine what the net results of operations would be as determined in accordance with general accounting principles, which would be to relate expenditures to actual income produced. All costs which can be directly attributed to the income produced are to be charged against the income of that year. Whereas section D is on a cash basis in that it requires the reporting of all capital expenditures in the year, which, without regard to the future years, would receive the benefit of those. But those figures are then used in an effort to develop the finding cost per barrel. They are to be related, as I understand it, to the reserve discovered as a result of those expenditures.

They are two entirely different accounting concepts.

Mr. EASTWOOD. Do I understand from what you stated that each one of those sections is designed to produce the same type of information?

Mr. NOBLE. Not the same type.

Mr. EASTWOOD. I was trying to quote what you said previously.

Mr. NOBLE. They include the same elements of activity, finding, acquiring, developing and lifting, but on an entirely different basis.

Mr. EASTWOOD. On historic rather than present and projected?

Mr. NOBLE. Section E takes them into cost as they are amortized or prorated over the asset consumed, whereas section D takes them into cost as they are expended. So it would show expenditures for finding, for instance in the year 1944, and for developing in 1944, whereas in section E we would merely take the amount of those expenditures and any prior years expenditures which we related to the oil lifted in 1944.

Mr. EASTWOOD. Thank you.

Mr. CHAIRMAN. Had you concluded, Mr. Judd?

Mr. JUDD. I have concluded unless there are some questions.

The CHAIRMAN. Any other questions? Mr. Brown, would you like to ask a question? If you have a statement we would prefer you wait until he finishes.

Mr. RUSSELL B. BROWN. I want to identify an article and I don't want to introduce it unless it has Mr. Judd's criticism, because it is a newspaper article that I understand he doesn't agree with.

Will you tell us what is incorrect? I don't want to take advantage of your position.

Mr. JUDD. Do you want me to make that verbally? I will have to take some time to read it over.

Mr. RUSSELL B. BROWN. I didn't want to inroduce it if there was anything unfair in the statement.

The CHAIRMAN. Why don't you introduce it and let him comment on it in the record if he desires?

Mr. RUSSELL B. BROWN. That is all right. I would like to have that introduced.

(The article referred to is as follows:)

[Chicago Journal of Commerce, Monday, March 5, 1945]

IT IS OFFICIAL: OPA TO IGNORE CRUDE REPLACEMENT COST: PROFIT IS BASIS

(Chicago Journal of Commerce, Washington bureau)

WASHINGTON, March 4.—Official confirmation was obtained today of earlier understanding that the Office of Price Administration would ignore replacement costs in its current crude-oil price survey and that it was basing its ceilings on industry profit.

Replacement costs are not being considered in the crude-cost survey because no reliable figures can be given, it was asserted. The industry long has pinned its hopes of increases largely on the replacement-cost factor.

Orville Judd, Associate Director of OPA's Fuel Price Division, stated that new discoveries constantly affected finding costs and that benefits gained from the discovery of one large pool which might reduce costs tremendously could not be evaluated over a short period of time.

Mr. Judd said all known costs, such as exploration, amortization, and depreciation, were taken into consideration in preparing the questionnaire which has been under consideration by the industry for the last 3 weeks.

SAYS AVERAGE OF 8 CENTS

In addition, he said, both actual finding costs for past years and a 27½-percent depletion allowance were being granted the industry, which has received a price increase of 8 cents from an average of $1.14 per barrel in October 1941 to an average of $1.22 per barrel at present.

The OPA executive said the agency's policy always had been to base price ceilings on the profits of an industry, and that increases would be ganted in any case where net profits are not equal to those of a normal period.

He pointed out that machinery already was set up to adjust prices to changed conditions at any time, and explained that the cost survey was being made in four parts to take care of any class which might need a price increase, although OPA was not required by law to do so.

MORE THAN OFFSET

Mr. Judd said petroleum reserves, the number of producing wells, and the number of drillings all showed increases, and while production costs admittedly had increased, he thought these had been more than offset by the 8 cents a barrel increase already granted and much lower selling costs.

As an example, he cited figures which showed the industry sold 1,680,148,000 barrels last year, compared with 1,380,000,000 barrels in the best peacetime year, and producing wells had increased from 349,000 in the best peacetime year to 412,851 in 1944.

He said he did not think a price increase at present was justified, but that it would be granted if the questionnaire showed a need for it, and that prices would be increased any time a definite need was indicated.

The CHAIRMAN. Any other questions?

Mr. HALL. Weren't you going to tell us what Mr. Ickes said?

Mr. JUDD. Oh, yes. This is Mr. Ickes speaking in Chicago, and the source is National Petroleum News, dated December 20, 1944, page 12.

Mr. HALL. What was the date of the speech?

Mr. JUDD. The speech was just prior to that date. It was in December. I don't have the correct date.

The CHAIRMAN. Let me make this statement. If anyone here desires to be heard briefly, if he will communicate his desires to Mr. Eastwood in writing we will arrange to hear you between now and 12 o'clock.

Mr. JUDD. This answers your inquiry regarding the Administrator's position. This is in December 1944. This is after he made his suggestion of the 35-cent increase.

Now, I am quite aware that many an oilman will tell you that this decline in new discoveries over the last 5 years has only been temporary and has been the result of wartime abnormalities. Give us manpower and materials, and unfreeze our prices, they will tell you, and we will find you plenty of oil. Well, it might be pointed out that there were no price ceilings in 1939 or in 1940, or until late in 1941; and that there was no particular manpower or materials problem covering most of this period, either. It might also be said that there have been more exploratory wells drilled during the last 3 years—in spite of scarcity of materials and manpower and controlled prices—than ever before in our history.

That is Mr. Ickes' statement.

Mr. HALL. What is he doing, knocking down his own argument?

Mr. JUDD. I don't know.

Mr. JAMES V. BROWN. Would you tell us the total number of well completions in those years as compared with the exploratory wells, their relationship with former years in the comparisons you made? You say wildcats are greater now than in the previous history. What are the total completions?

Mr. JUDD. I think what you mean is that total completions are down. We have long contended, and so have expressed ourselves in public and in hearings, and we believe the reason is indicated by the fact that this decline in developmental well drilling came after the order was put out restricting materials for developmental wells.

Mr. JAMES V. BROWN. Do you know whether there are any restrictions on eastern wells?

Mr. JUDD. You mean east of the Mississippi River or eastern seaboard?

Mr. JAMES V. BROWN. For example, Pennsylvania and New York. Do you know if there are restrictions on materials there?

Mr. JUDD. I have no idea.

Mr. JAMES V. BROWN. Do you know if the well completions have increased or decreased in that area?

Mr. JUDD. No, sir.

Mr. JAMES V. BROWN. Could you tell us whether or not the completions increased in California after the price increase out there?

Mr. JUDD. Yes; it did increase. May I tell you why they increased?

Mr. JAMES V. BROWN. I would like to have that.

Mr. JUDD. Because the price of heavy oil in California was at uneconomically low point. We so recognized that and advanced it. We don't make that same finding in regard to other oil in the country.

Mr. JAMES V. BROWN. You said the tank-car prices now are less than they were at the beginning of price control.

Mr. JUDD. Yes, sir.

Mr. JAMES V. BROWN. Can you tell me what the tank-car price was on April of 1941?

Mr. JUDD. I am sorry. I don't happen to have the figures with me. I will be glad to get them for you.

Mr. JAMES V. BROWN. I wish you would enter it into the record. Can you tell me what the PAW figures for the new crude oil reserves discovered for those same periods of years that you entered the reserves in the record for API?

Mr. JUDD. You are asking me a lot of things I don't have the material on.

Mr. JAMES V. BROWN. I had to ask a question.

The CHAIRMAN. If you have them yourself from an authority you are willing to use, why don't you put them in the record?

Mr. JAMES V. BROWN. In his statement he gave crude oil reserves as reported by API. Let me ask him if he would recognize the reserves as they are prepared and reported by the PAW. They make an estimate of the reserves.

Mr. JUDD. They make an estimate of the reserves, but we don't recognize it. In the first place, API is an institution that has been established for more than 20 years. The API is a long-established concern. The PAW is a temporary Government agency.

In the second place the PAW reflects all revisions and extensions back to the years of discovery. The API reflects them in the years which they are developed. Therefore, we believe it is more valid to use API.

Mr. JAMES V. BROWN. Mr. Chairman, may I have permission to put in the record a statement in response to the remarks of Mr. Green and Mr. Judd?

The CHAIRMAN. Without objection, so ordered.

VINCENNES, IND., *June 11, 1945.*

NATIONAL CRUDE OIL ADVISORY COMMITTEE,
Washington, D. C.

(Attention James V. Brown.)

DEAR JIM: I have taken up with the producers here in Indiana the question of answering Government questionnaires which the OPA submitted covering crude petroleum costs. This is to advise you that those producers have informed me that they filled all the Government questionnaires they intend to fill and that their bookkeeping system is such that in many instances they do not have the information asked for by OPA. They also advise me that to answer these questionnaires the expense to them to have the work done would run into a sum anywhere from $100 to $500.

The story is the same everywhere. Oilmen have been filling forms for 4 years and have received nothing but abuse from it. Therefore, they feel that they have done their part and that these questionnaires are primarily a fishing expedition; that figures have been submitted time and again and they have gone as far as they intend to.

Sincerely yours,

O. L. STURBOIS.

The CHAIRMAN. Had you finished?

Mr. CAVERS. I wonder if we may have permission to put in the record the letters Mr. Green alluded to in his testimony?

The CHAIRMAN. Yes.

Mr. Russell Brown, do you have any statement to make?

Mr. RUSSELL B. BROWN. No, sir.

The CHAIRMAN. Do you have anything further, Mr. James V. Brown?

Mr. JAMES V. BROWN. That is all.

The CHAIRMAN. Any other requests for time?

Mr. EASTWOOD. No; we don't have any.

Mr. JUDD. I would like to make one more statement. I made the statement in here that we would survey 200 small companies on this depletion allowance. Mr. Green in his testimony this morning said that it would be upon instruction and advice of the committee.

May I have the advice of the committee?

The CHAIRMAN. We will advise you later on.

We want to thank all the witnesses for their appearances. We appreciate it very much.

Without objection now, the committee will stand adjourned.

(Whereupon, at 11:30 a. m., the hearing adjourned.)

EXHIBIT A

SUPPLEMENTAL STATEMENT ON CRUDE OIL PRICE QUESTION

(By Russell B. Brown, general counsel, Independent Petroleum Association of America)

To the Select Committee on Small Business, House of Representatives, United States Congress:

Responding to the privilege of extending our remarks to further discuss the issues before this committee, we felt that our discussion should primarily be confined to the purposes stated in the chairman's announcement of the meeting, to wit: "We shall ascertain in the coming hearings why there has been the delay; also, whether the study is being made on the basis recommended by the Small Business Committee." We tried to confine our remarks on the day of our personal appearance to those issues suggested by you. In our statements we attempted to give our reasons for the long delay in completing the cost survey which this committee caused to be initiated. I do not recall that those appearing on behalf of the OPA answered any question raised by your committee in your announcement of this meeting. I am still confused as to what their position is on these questions.

Unfortunately, the facts as set forth by us on that day were construed by those appearing on behalf of OPA as some attack on the soundness of the theory of accounting they use. Their presentation seemed to consist of a defense of one method of accounting through academic discussion of abstract questions. OPA's petroleum cost survey is a statistical collection of data that does not conform to any one method of accounting. The industry contends that since the collection of cost data is a statistical job, all "relevant" factors in the process of finding, developing, and producing crude petroleum should be considered. In view of the confusion that has resulted during this hearing, I feel it is well to summarize our concept of this problem for the consideration of the committee.

The necessity of wartime price fixing required legal formulas and sanction. In drafting our present price stabilization law, the Congress recognized the difficulty of the absence of uniform accounting designed to fix prices. The Congress provided that the price authorities should have the advice of industry committees. This advice was not sought by OPA for oil for a number of years. It was only after you insisted that a committee was established.

The National Crude Oil Industry Advisory Committee was then appointed by OPA. It was a representative committee and so stated to be by OPA. There were industry accountants on this committee. So that your committee may have full opportunity to examine the representative character of the industry committee, I attach hereto a list of the committee and their company affiliations.

After full consultation certain recommendations were made to the OPA as to the methods that could best be employed in obtaining the information necessary on which the OPA should base price ceilings. They suggested the form of questionnaire that could be answered by companies in the industry to obtain this information.

The National Crude Oil Industry Advisory Committee is qualified to know the specific, practical, and proper accounting method applicable to the problem of determining the proper costs of finding, developing, and producing crude petroleum. Price fixing is not a part of our normal economy. Few companies, if any, base their book accounting with price fixing as an objective. Therefore, in order to insure to the committee full and complete information and advice on industry accounting in the light of the requirements of the law governing the Office of Price Administration, the committee invited additional outstanding and nationally recognized representative industry accountants to sit with them in planning and approving the work on the problem assigned to the committee.

These representatives of all segments of the petroleum-producing industry made available to OPA the services and advice of leading industry-engaged accountants, skilled in the everyday practice of their specialized profession. These accountants, together with the subcommittee members of the National Crude Oil Industry Advisory Committee, met in St. Louis, Mo., with Mr. Noble, a member of the OPA Washington accounting staff. The meeting was in session February 1–3, 1945.

I submit separately herewith the names of the petroleum company accountants.

The recommendations of the committee were reviewed and considered by the accountants. They participated with the subcommittee in the deliberations and concurred in the findings which, in part were as follows: "* * * that the form of the questionnaire which you proposed was not suitable for assembling data that could be properly used in approximating the current actual cost of finding, developing, and producing crude petroleum * * *.

"After reviewing our ideas in detail with you and your staff on several occasions subsequent to the initial meeting, the committee is definitely of the opinion that your approach to the problem would be both incorrect and misleading.

"We, therefore, submit as a recommendation of the committee a form of questionnaire designed to furnish the necessary data to determine the complete current cost of crude production including the cost of replacement of present wasting reserves."

OPA was furnished the names of those accountants who attended the meeting and the minutes of the subcommittee meeting which were officially transmitted to OPA.

These individuals are truly representative of the petroleum industry, experienced in the technical and practical problems of management, geology, engineering, accounting, and legal phases of crude-petroleum production. These men with years of training and experience know how to determine the cost of finding, developing, and producing crude petroleum in accordance with a properly established accounting method within the crude-petroleum-producing industry.

It is recognized in the accounting profession and by Government agencies "that no uniform method of accounting can be prescribed for all * * * parties" (Treasury Decision 5000, title 26, Internal Revenue). All accounting authorities agree that there is more than one established method and purpose of accounting in any industry. Under free economy it was not the practice of accountants in the preparation of profit and loss statements to report on the methods used by management in the determination of a fair and equitable price of the products sold. Several "relevant factors" influence the price at which a commodity is sold. Cost accounting was developed as a specialized branch of general accounting by which a calculation is made of the proper elements of cost of a product in such manner that the account may be used by management to ascertain production costs, both per unit and in total for the purpose of securing economical, efficient, and profitable operation and the setting of selling prices.

The law under which OPA operates provides for recognition of the recommendations of such industry committees.

The Office of Price Administration refused to use the questionnaire provided by the industry committee. They finally agreed to add to the questionnaire prepared by OPA, a section recommended by the Industry Committee, but refused to follow the industry recommendation as to its use.

At the time the questionnaire was being circulated, long before the results were available for study, the OPA through letters, public statements and press releases, stated, and continue to state that they will not be bound by the industry committee's recommendation and that they will not use cost information obtained as a result of that part of the questionnaire prepared by the industry.

In an effort to collect the material from which some workable formula could be developed, the committee has been diligent. Such premature publicity indicating that OPA will be governed only by some inflexible predetermined method hinders this effort.

This is the situation that we have believed to be the cause in the delay in completing the questionnaire.

We tried to present this situation to your committee in our personal appearance. I stated to your committee that it was important that OPA be directed to follow the will of Congress as outlined in the law which we believe permits the use of the method of accounting recommended by the leading accountants of the petroleum industry.

Pending the receipt of the full record which may indicate more detailed answer, it seems to me to be appropriate in conclusion to comment upon portions of the statement of Mr. O. D. Judd, Associate Director of the Fuel Price Division of OPA, merely to remove any erroneous impressions that may have been created by such portions.

On page 7 of the typewritten copy of Mr. Judd's statement, he referred to the "testimony of Mr. Merle Becker" concerning increases in the price of gasoline and crude oil since 1941. Mr. Becker did not say that "the price of gasoline had increased 92 cents per barrel since 1941 whereas the price of crude oil had advanced but 6 cents," as Mr. Judd asserted. In fact, Mr. Becker did not make any comment at all of this nature.

There was a quotation in the statement made by me, this was not my own assertion, but was a quotation from the sixth interim report of the House Small Business Committee and was the finding of the committee after some weeks of study of the factors pertinent to the crude price situation. There was never a reference to refinery profits but rather to increases allowed in the sale of gasoline to the consumer.

The second point in Mr. Judd's testimony relates to his oral introduction of an address by Petroleum Administrator Ickes and the reading of a portion thereof. The address was made in Chicago on December 8, 1944, before the Chicago Council on Foreign Relations. The portion which was read would seem to indicate that Mr. Ickes had reversed his 1943 stand on crude-oil prices when he made a spirited presentation to the OPA in favor of an increase in crude-oil price ceilings to average 35 cents per barrel. Weeks of the time of Mr. Ickes' staff and of his advisers had been spent in preparing the data in support of his recommendations. Following the rejection by OPA of his unqualified endorsement of the position the independent producers had taken previously, Mr. Ickes then appealed to the Director of Economic Stabilization and again supplied much data. On each occasion the recommendations were so carefully and painstakingly written, so thoroughly supported by factual data and reports, as to seem to the oil industry to be irrefutable.

Your committee doubtless identifies from memory and from the record testimony of Mr. Ickes in favor of crude-oil price increase when he was a witness at your hearing on April 16, 1943.

It would be most remarkable if Mr. Ickes were to turn his back on his carefully prepared arguments in the casual manner suggested by the reading of a part of a paragraph from his Chicago speech. He has not done so. His Chicago remarks were partly in the nature of asserting a pride in the achievements of his office, but more particularly in giving his view that an international oil policy is needed which will serve as assurance against a shortage here.

As I recall, Mr. Judd's reading of the Ickes address stopped with the assertion that "there have been more exploratory wells drilled during the last 3 years—in spite of scarcity of materials and manpower and controlled price—than ever before in our history." I think it is only fair to supply the rest of that paragraph, which was as follows:

"But let us overlook that. The fact remains that looking for oil doesn't mean finding it, and every oilman knows it. And so, even though I hope with every oilman that the unfavorable trend of the last 5 years will, in fact, be found to be only temporary, I don't know that it will, and neither does anyone else."

It is necessary for present purposes to attempt to belabor a paragraph from a speech which was devoted chiefly to the international oil situation. Elsewhere in the same speech Mr. Ickes mentioned two or three times the necessity for encouraging exploration work at home. We have no reason to think that he has eliminated as a factor of encouragement that of adequate price, which he so eloquently asserted to the OPA long ago, in his advocacy of a raise in ceilings and in his rejection of subsidy as a means of encouraging exploration. There was no evidence of withdrawal of his recommendation of price increase.

NATIONAL CRUDE OIL INDUSTRY ADVISORY COMMITTEE

COMMITTEE MEMBERS

George S. Bays, consulting and research engineer, Stanolind Oil & Gas Co., Philcade Building, Post Office Box 591, Tulsa, Okla.

Merle Becker, vice president and controller, W. C. McBride, Inc., 2101 Missouri Pacific Building, St. Louis, Mo.

D. Harold Byrd, president (geologist), Byrd-Frost, Inc., 1110 Tower Petroleum Building, Dallas 1, Tex.
J. P. Coleman (petroleum economist), McCarty & Coleman, 500 First National Bank Building, Wichita Falls, Tex.
Wilson B. Emery, vice president and manager of production (geologist), the Ohio Oil Co., 539 South Main Street, Findlay, Ohio.
B. A. Hardey, chairman, Louisiana Mineral Board, Commercial National Bank Building, Box 1237, Shreveport, La.
Edwin W. Hayes, Box 813, Independence, Kans.
James W. Johnson, Consolidated Gas Co., Shelby, Mont.
J. P. Jones, 69 Main Street, Bradford, Pa.
Raymond B. Kelly, division manager (petroleum engineer), the Pure Oil Co., Illinois Producing Division, Olney, Ill.
Dana H. Kelsey, vice president, Sinclair Prairie Oil Co., Sinclair Building, Tulsa, Okla.
H. M. McClure, Box 147, Alma, Mich.
W. H. Morgan, formerly vice president, R. R. Bush Oil Co., 2790 Cherry Avenue, Long Beach 6, Calif.
Gilbert J. Mueller, vice president and director, Argo Oil Corp., 1104 First National Bank Building, Denver 2, Colo.
John G. Pew, assistant to vice president and director, Sun Oil Co., First National Bank Building, Dallas 1, Tex.
E. P. Potter, treasurer and controller, Amerada Petroleum Corp., 120 Broadway, New York 5, N. Y.
E. B. Reeser, director, Barnsdall Oil Co., Petroleum Building, Tulsa 2, Okla.
Carle E. Reistle, Jr., general superintendent, production department (chief petroleum engineer), Humble Oil & Refining Co., Post Office Box 2180, Houston 1, Tex.
Charles F. Roeser, president, Roeser & Pendleton, Inc., 613 Fort Worth Club Building, Fort Worth, Tex.
Albert C. Rubel, vice president (petroleum engineer), Union Oil Co. of California, 617 West Seventh Street, Los Angeles 14, Calif.
J. D. Sandefer, Jr., 903 Burch Hotel Building, Breckenridge, Tex.
N. W. Shiarella, president (geologist), Miller & Shiarella, Box 247, Owensboro, Ky.
C. P. Watson, vice president (geologist), Seaboard Oil Co. of Delaware, Inc., 417 South Hill Street, Los Angeles 13, Calif.
Howard J. Whitehill, president and general manager, the Whitehill Oil Corp., Box 867, Tulsa, Okla.

PETROLEUM INDUSTRY ACCOUNTANTS IN ATTENDANCE AT MEETING OF SUBCOMMITTEE OF NATIONAL CRUDE OIL INDUSTRY ADVISORY COMMITTEE, ST. LOUIS, MO., FEBRUARY 1–3, 1945

Merle C. Becker, vice president and controller, W. C. McBride, Inc., 2101 Missouri Pacific Building, St. Louis, Mo.
James V. Brown, petroleum analyst, Independent Petroleum Association of America, 500 Investment Building, Washington 5, D. C.
Roy C. Busby, secretary and treasurer, the Whitehill Oil Corp., Post Office Box 867, Tulsa 1, Okla.
A. J. H. Carnegie, head, accounting department, Sinclair Prairie Oil Co., Sinclair Building, Tulsa, Okla.
Ralph R. Claggett, assistant controller, The Pure Oil Co., 35 East Wacker Drive, Chicago, Ill.
J. B. Galbraith, controller, Stanolind Oil & Gas Co., Post Office Box 591, Tulsa, Okla.
W. R. Hunter, controller, Barnett Drilling Co., Wichita, Kans.
H. C. King, controller, the Ohio Oil Co., 539 South Main Street, Findlay, Ohio.
H. A. Lapham, assistant controller, Union Oil Co. of California, 617 West Seventh Street, Los Angeles 14, Calif.
R. V. Loftin, controller, Humble Oil & Refining Co., Post Office Box 2180, Houston 1, Tex.
Marion F. Munro, controller, Sun Oil Co., First National Bank Building, Dallas 1, Tex.
B. R. Pitcock, attorney in fact, C. C. Harmon, H. J. Whitehill, et al, Post Office Box 867, Tulsa, Okla.
A. J. Points, assistant to the president, Ashland Oil & Refining Co., Ashland, Ky.

E. P. Potter, treasurer and controller, Amerada Petroleum Corp., 120 Broadway, New York 5, N. Y.
W. A. Runkel, head, producing accounting department, the Ohio Oil Co., 539 South Main Street, Findlay, Ohio.
E. M. Skeehan, vice president and treasurer, Barnsdall Oil Co., Petroleum Building, Tulsa 2, Okla.

EXHIBIT B

SUPPLEMENTAL STATEMENT ON CRUDE OIL PRICE POLICY

By O. D. Judd, Associate Director, Fuel Division, Office of Price Administration

In line with the permission granted us to extend our remarks, supplementing our testimony before your committee, we desire to incorporate the following in the records of the committee's proceedings:

Mr. Russell B. Brown, general counsel of the Independent Petroleum Association of America, in his supplemental statement, contents of which he has made public, states that we did not confine our testimony to the announced purposes of the hearing and specifically refers to the part of the committee's announcement which stated:

"We shall ascertain in the coming hearings why there has been delay; also, whether the study is being made on the basis recommended by the Small Business Committee."

We had intended presenting a tabulation, at the hearing, setting forth the dates and pertinent information relative to the progress of the survey but through oversight neglected to do so. We are, therefore, attaching the tabulation to this supplemental report.

A review of dates and explanatory notes contained in the list will indicate the Office of Price Administration did not unduly delay the completion of the survey but did attempt to thoroughly consult with the industry on every important phase of the study.

In our testimony before your committee we attempted to establish four basic reasons why "replacement cost" as defined and sponsored by the industry should not be included in our cost computations. The main reasons are as follows:

1. The use of replacement cost in computing industry costs is not an established accounting practice.

2. Neither the oil industry, nor any other industry of which we have knowledge, normally used, nor now uses, replacement cost in their own cost accounting.

3. The use of replacement cost, if once given recognition, could not be restricted to the oil industry. The application of this new theory to all industries would introduce a most serious and wholly unjustifiable inflationary threat to the national economy.

4. Replacement cost is not the important factor in exploratory drilling that the industry represents it to be. As indicated in our testimony, replacement cost, computed on the basis industry recommends, has no direct bearing on the activities of the individual operator or even on the industry as a whole.

One of the trade papers calls attention to the fact that although we established the fact that exploratory drilling was at an all-time high, since the year 1937, when exploratory and developmental records were first separated, we failed to indicate how many wells were drilled by independent operators and what the trend had been in that respect.

The independent operators drilled 2,686 exploratory wells in 1944, 2,476 in 1943, 2,223 in 1942, and 2,616 in 1941. Thus the independent drilled more wells in 1944 than in 1941. During the same years the major company drilling of exploratory wells was as follows: 1,267 in 1944, 819 in 1943, 612 in 1942, and 519 in 1941. It will be noted that although the independents driller more than double the number of wells the major drilled in 1944, yet the majors materially increased the number of wells drilled in 1944 over those drilled in 1941. It would, therefore, appear that ceiling prices have not prevented either the independent or the major from increasing his exploratory efforts during price-control years.

In these extended remarks we desire to particularly emphasize the fact that in none of our public statements have we made any assertions which could be construed to indicate any prejudgment of the results of the crude survey. We have attempted to outline our standards honestly, clearly, and concisely. We have always dealt with the industry in a frank, straightforward manner, and believe the industry has appreciated our position in this respect. Any claim that our frankness as to the standards which we employ has had a detrimental effect on the completion of the survey is, in our opinion, tantamount to stating that the industry does not desire full information as to how we will judge factual evidence they submit to us. We do not believe such is industry's position.

November 15, 1944: Mr. Eastwood called at office asking certain information be compiled for use by the Small Business Committee.
November 17, 1944: Information sent to the committee.
December 4, 1944: Small Business Committee report made.
December 11, 1944: Petition from three crude producers to form national committee.
December 12, 1944: We secured copies of the Small Business Committee's report.
December 13, 1944: Mr. Judd called on Judge Vinson to discuss committee's report and our position relative to making a survey.
December 14, 1944: Phoned Whitehill (National Stripper Well Association), Boyd (API and PIWC), and Brown (IPAA), requesting recommendations for advisory committee membership.
December 15, 1944: Received recommendations from Whitehill.
December 18, 1944: Received recommendations from Brown.
December 22, 1944: Received recommendations from Boyd.
December 26, 1944: Decided membership of the Advisory Committee.
December 27, 1944 to January 2, 1945: Cleared acceptances with proposed members by phone and telegraph and replaced one who refused and added two from territories omitted by recommendations from associations.
January 2, 1945: Cleared individual appointments with Industry Advisory Section.
January 3, 1945: Sent out letters of appointment.
January 15–18, 1945: Committee meeting held. Cost form drawn in preliminary draft.
February 2–8, 1945: Meeting with subcommittee in St. Louis on cost form to be sent out. (This meeting held at request of committee.)
February 5–9, 1945: Discussing with staff and Bureau of the Budget changes suggested by Advisory Committee, redesigning form, forwarding revised form to subcommittee members.
February 17, 1945: Mr. J. V. Brown met with Mr. Judd and said the survey form would be back from subcommittee about February 21.
February 27, 1945: Mr. J. V. Brown came over to this office to check over names of operators selected for the sample.
March 3, 1945: Mr. Judd called Mr. J. V. Brown re the form with changes committee had made, and Mr. Brown promised to send the form to us.
March 8, 1945: Draft of form received by this office from Mr. Brown.
March 10, 1945: Meeting on the changes to determine whether or not the changes in the form should be made in conformity with the committee changes.
March 15, 1945: J. V. Brown called Mr. Judd re form.
March 18, 1945: Form sent to Graphics Section.
March 19, 1945: Form approved by Bureau of the Budget.
March 23, 1945: J. V. Brown came to the office to proof form.
March 23, 1945: Form sent to printers.
April 7, 1945: Form received from printers.
April 9, 1945: Form mailed out from this office.
April 9, 1945: Mr. Potter and Mr. J. B. Brown met with Mr. Judd to discuss a letter which was to go out from the Industry Advisory Committee asking the trade to get the form back to us promptly and fully filled out.
May 1, 1945: Date for return of crude-oil cost forms extended to May 15 upon request of committee. (Request granted by telephone.)
May 15, 1945: Because of length of report, date for return of crude-oil cost forms extended to June 1 upon request of committee. (Request granted informally by telephone.)
June 9, 1945: Letter sent to producers extending date for return of crude-oil cost forms to June 30, 1945, and appealing for completion and return of forms.

EXHIBIT C

STATEMENT BY DAVID F. CAVERS, ASSISTANT GENERAL COUNSEL FOR PRICE, OFFICE OF PRICE ADMINISTRATION, TO THE SMALL BUSINESS COMMITTEE OF THE HOUSE OF REPRESENTATIVES ON THE APPLICABILITY OF THE ACCOUNTING METHODS PROVISO (EMERGENCY PRICE CONTROL ACT, SEC. 2, PAR. (a)) TO OPA DETERMINATIONS OF PETROLEUM COSTS

In the testimony before the Small Business Committee the charge has been made that the Office of Price Administration has failed to abide by the accounting methods proviso, inserted in paragraph (a) of section 2 of the Emergency Price Control Act by the Stabilization Extension Act of 1944. This failure is said to spring from the use by the Office of the sustained, rather than the percentage, method of measuring depletion in determining the costs of producing crude petroleum and by the refusal of the Office to adopt the method of reflecting "replacement cost" in accordance with a proposal advocated by the Independent Petroleum Association of America.

Testimony before this committee by Mr. Paul Green, OPA Deputy Administrator for Accounting, has established the sarcely to be disputed fact that the sustained depletion method is an established accounting method in the petroleum industry. Indeed, it may well be contended that it is the only established method of measuring depletion as a cost as distinguished from a deduction allowed for tax purposes.

If, however, it is assumed, for purposes of argument, that the percentage method is an "established accounting method," within the meaning of the accounting methods proviso, it does not follow that the Office of Price Administration has violated either the letter or the spirit of that proviso by its use of the sustained depletion method. The contrary is true.

The proviso reads as follows: "*Provided*, That no regulation or order shall contain any provision requiring the determination of costs otherwise than in accordance with established accounting methods."

The Office of Price Administration, in using the sustained depletion method, has not required depletion cost to be determined "otherwise than in accordance with established accounting methods." It has clearly followed an established accounting method.

What the proviso does is to prevent the Administrator from concocting a method of determining costs which has not achieved recognition as an "established accounting method," and compelling an industry to determine its costs by that method. It does not preclude the Administrator from specifying that a particular established accounting method be used to determine any cost for the determination of which there may be two or more such methods.

There is a sound reason why the Administrator should be accorded the power to require the use of one established method where there are two or more. If this were not the case, the Administrator would not be able to assure the comparability of costs as between different producers using different methods. Lack of reliability in the data obtained by industry-wide surveys and discrimination as between individual producers would be the inevitable result.

The clear requirement of the proviso makes it highly doubtful as a matter of law that the Administrator could require the determination of "replacement cost" as proposed by the Independent Petroleum Association of America. The proponents of "replacement cost" have conceded that it has not been established as an accounting method of the petroleum-producing industry. Indeed, it may be doubted whether any use has been made of the method for cost-accounting purposes. If it were adopted by OPA and its use should have the effect of depicting the industry's costs as lower than they are shown to be by the established accounting methods employed by OPA, there is no question but that OPA would be assailed as violating the prohibition of the proviso. I do not know what answer could be made to such a charge, and I do not see why the fact that the use of "replacement cost" would have the opposite effect should make any difference in OPA's legal authority to use the method.

Actually, the proponents of "replacement cost" are seeking a change in the price policies of the Office of Price Administration in the guise of a contention as to accounting methods. The adoption of the special policy for petroleum pricing which they advocate, apart from its economic implications, would raise grave questions as unlawful discrimination in favor of the petroleum industry unless all industries were accorded the inflationary privilege of computing depletion and depreciation on a replacement or a reproduction-cost basis.

Respectfully submitted.

DAVID F. CAVERS,
Assistant General Counsel for Price.

EXHIBIT D

OFFICE OF PRICE ADMINISTRATION,
Washington, D. C., June 21, 1945.

The Honorable WRIGHT PATMAN,
Chairman, Select Committee on Small Business,
United States House of Representatives.

DEAR CONGRESSMAN PATMAN: The attached materials are herewith respectfully submitted for inclusion in the record of the recent hearings before the Select Committee on Small Business. The materials include:

1. Extension of my remarks on points in favor of oil producers contained in the Internal Revenue Code and the Treasury Department regulations. This material was requested by you during my testimony.
2. Copies of letters referred to in my oral testimony. Mr. David F. Cavers, assistant general counsel for price of the Office of Price Administration, asked to include these letters and permission for their inclusion was granted by you.

A third item was a request from Congressman Hall for a further explanation of the provision of the separability of oil-producing properties in the computation of percentage depletion. Since this request related to the subject matter contained in point No. 4 of the attached list, the answer to it has been merged with the discussion of that point and no separate statement has been prepared.

I wish to take this opportunity to thank you and the committee for your courtesy in permitting me to appear before you and for the privilege of submitting these additional materials.

Sincerely,

PAUL M. GREEN,
Deputy Administrator for Accounting.

EXTENSION OF REMARKS OF PAUL M. GREEN, DEPUTY ADMINISTRATOR FOR ACCOUNTING OFFICE OF PRICE AMINISTRATION

On June 12, at the conclusion of the testimony of Mr. R. B. Brown, Congressman Patman gave me the opportunity to ask Mr. Brown some questions. In the discussion that followed, I listed provisions under the Internal Revenue Code and in the Treasury Department regulations which I believed to be favorable to the oil companies. On June 13 Congressman Patman requested that I elaborate these points. I am glad to comply with the Congressman's request. Also, Congressman Hall requested that I submit a discussion of the tax provisions for property separability. Since this is the fourth point in the series, I am combining herewith the two statements. The provisions are as follows:

1. Use of percentage depletion

Under the Internal Revenue Code, oil producers may deduct an allowance for depletion equal to 27½ percent of gross income provided that it is not more than 50 percent of net income computed without benefit of the depletion allowance (sec. 114 (b) (3)). In my opinion this provision is favorable to the companies because—

(*a*) It permits a deduction from gross income which bears no relation to cost. The Prentice-Hall Tax Service, volume 2, 1944, refers to this matter in paragraph 14495, as follows:

"PERCENTAGE DEPLETION ALLOWED THOUGH NO COST BASIS.—The words of the statute and the legislative history do not justify the contention of the respondent that percentage depletion is no longer allowable after the cost of the property has been recovered tax-free. He has cited no case in point. His rulings are to the contrary (I. T. 2327, C. B. VI-1, p. 18, G. C. M. 14448, C. B. XIV-1, pp. 98, 100). It is possible, and not unusual, for a taxpayer to recover tax-free, through percentage depletion, an amount greater than the cost of the property (*Commissioner* v. *Elliott Petroleum Corporation* (82 F. (2d) 193 (17 A. F. T. R. 595); cf. *Thomas* v. *Perkins* (301 U. S. 655 (81 L. Ed. 1324, 57 S. Ct. 911, 19 A. F. T. R. 538); *F. H. E. Oil Co.*, 41 B. T. A. 130, 134; *Cook Drilling Co.*, 38 B. T. A. 291). It follows that a taxpayer may recover a larger amount tax-free through depletion than he could through a sale or other disposition of the property. The statute ignores all such inequalities and allows the deduction regardless of whether or not cost has been recovered. Cf. *Second Carey Trust*, 41 B. T. A. 800, 807, 808, affirmed (C. A. D. C.; 1942), 126 F. (2d) 526, 28 A. F. T. R. 1371 (certiorari denied October 12, 1942) where no cost was proven. This petitioner had gross income from these properties during the taxable year and had a depletable interest in them. Therefore, it is entitled to the deduction of percentage depletion provided under section 114 (b) (3). (*Louisiana Iron & Supply Co., Inc.*, 44 B. T. A. 1244. To the same effect: *H. R. Cullen et al.* (41 B. T. A. 1054) reversed without discussion of this point, 118 F. (2d) 651, 26 A. F. T. R. 887.)"

(*b*) The deduction may be taken indefinitely and thus oil producers may recover, tax-free, the actual cost of their properties several times over. While other extractive industries are permitted to a lesser degree the same type of deductions, manufacturing and merchandising companies do not have this privilege. They are required to pay taxes on all amounts recovered in excess of cost.

The position of the Treasury Department is described by the Office of War Information[1] as pointed out by Mr. Forasté in his study of Depletion in the Oil Industry (p. 42). It is:

"A third loophole cited by the Secretary is the provision allowing percentage depletion for mines and oil wells. A businessman who has a machine which can be expected to last 10 years is permitted to deduct one-tenth of the cost of that machine each year for 10 years. This is fair since at the end of 10 years he will have to buy a new machine. Obviously though, he should not be permitted to deduct more than the cost of the machine. This is not true, though, of mines and oil wells. Each year owners of oil wells are permitted to deduct an arbitrary 27½ percent of the gross incomes from their wells * * *. Over the years it often means that they deduct far more than the total capital put into the property. These deductions continue indefinitely. In many instances they amount to straight subsidies from the Public Treasury."

Mr. Forasté (p. 42) also refers to the remarks of Mr. Randolph Paul when the latter represented the Treasury Department before the House Ways and Means Committee[2] in which he expressed the Treasury's belief that percentage depletion involves "favored treatment to a particular industrial group" and also said, among other things:

"Percentage depletion does not appreciably stimulate exploration and discovery. It is not essential to the maintenance of stripper wells. Its elimination will in no way endanger the supply of raw materials needed for the war effort * * *. We now know that the 1918 fear of oil shortages was unfounded * * *. Percentage depletion cannot be justified by any special risks in the oil industry * * *. A taxpayer who uses percentage depletion and who is not subject to the net income limitation gets the same depletion allowance whether he capitalizes his development expenses or deducts them currently as expenses * * *. The expensing of development cost is, therefore, equivalent to allowing a double deduction, once when the costs are incurred and once through depletion * * *. It is found that the elimination of percentage depletion and the expensing of intangible development costs * * * will yield about $206,000,000 of much needed revenue, and will remove from the statute a long-standing and inequitable privilege."

2. *Writing off intangible drilling costs as incurred*

The regulations give the oil companies the privilege of writing off intangible drilling expenditures as incurred (Reg. 111, sec. 29.23 (m)–16). These expenditures are part of the fixed capital outlay and therefore should be recovered over the life of the asset. Obviously when there is no limit on depletion charges from the point of view of cost, it is to the advantage of the oil companies to write off intangible drilling expenditures currently and thus recover them in addition to the depletion charge. Since the writing off of these expenditures does

[1] In Battle Stations for All, February 1943.
[2] As reported beginning at p. 138, in the Transcript of Hearings Before the Committee on Ways and Means, House of Representatives, 77th Cong., 2d sess., on Percentage Depletion and Option on Intangible Costs, Revenue Revision of 1942, on Mar. 23, 24, Apr. 16, 17, 1942.

not reduce the amount of the percentage depletion deduction, the amounts recovered in excess of cost are still further increased.

3. Writing off of excessive amounts of expenses

All companies have many border-line items which they can find justification for capitalizing or for writing off as expenses immediately. Examples of such items in oil production are geophysical, geological, scouting, and other exploratory activities. Generally it makes little difference over a period of years which method is followed because the total amount written off is the same whether it is done in 1 year or a number of years. However, when the cost base for computing depletion is discarded it is to the advantage of the company to write off everything possible currently. Whether it is written off or not, it is recovered through the percentage depletion charge. If it can be written off as an expense in addition, the net result is to increase the amounts recovered tax free.

4. Separability of properties

The Internal Revenue Code in authorizing the use of percentage depletion for tax purposes provides that such allowance shall not exceed 50 percent of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the allowance be less than it would be if computed on a cost basis.

The Treasury Department regulations (Reg. 111, sec. 29.23 (m)–1 (i)) define "property" as "the taxpayers' interest in each separate mineral property." Thus, in determining the gross income on which the percentage depletion is based and the net income by which it is limited, the amounts relate to each tract of land or lease, individually considered. The regulations, therefore, permit oil operators to take percentage depletion on profitable properties, cost depletion on unprofitable ones and, in addition, to charge off losses for abandoned properties and all current intangible drilling expenditures. It is thus quite possible for an operator to claim percentage depletion in amounts substantially in excess of 50 percent of his aggregate taxable net income before depletion. The privilege of separation of properties thus allows the oil producer to break down his operation in the way most beneficial to him.

I have discussed these points for the purpose of showing why income tax laws and regulations do not provide an acceptable basis for sound cost determinations. My remarks should not be construed as an expression of an opinion by the Office of Price Administration as to propriety of the provisions for the purposes of income-tax legislation.

COPIES OF LETTERS ON ACCOUNTING POLICY OFFERED AS EVIDENCE IN THE TESTIMONY OF PAUL M. GREEN, OPA DEPUTY ADMINISTRATOR FOR ACCOUNTING, BEFORE THE SELECT COMMITTEE OF THE HOUSE TO INVESTIGATE AND STUDY SMALL BUSINESS, JUNE 13, 1945

AMERICAN INSTITUTE OF ACCOUNTANTS,
New York 17, N. Y., March 28, 1945.

Mr. PAUL M. GREEN,
Deputy Administrator for Accounting,
Office of Price Administration, Washington 25, D. C.

DEAR MR. GREEN: I am in receipt of your letter of March 24, 1945, asking that I write you a statement of my opinions on the question of accepted accounting practice in regard to percentage depletion, 5-year amortization of emergency facilities, and depreciation on replacement costs. It is my understanding that you wish to have this information for consideration in connection with the current activities in Congress to extend the Emergency Price Control Act and particularly with respect to the amendment to the act proposed by the National Coal Association, which would require "that determined costs for purposes of such regulations or orders shall include, but not be limited to, deductions from gross income recognized by the Bureau of Internal Revenue for Federal income-tax purposes."

There is not sufficient time for me to present the matter to the institute's committee on accounting procedure for an official expression of opinion, so it must be understood that this reply is entirely an expression of my own personal views and must not be treated as though it were a statement by the American Institute of Accountants. I should like to emphasize that I am not expressing any opinion as to the pricing policies that should be adopted by Congress or the

Office of Price Administration or as to the factors that should be taken into consideration in the fixing of prices, but that I am stating my opinions regarding only accepted accounting practices in determining costs with respect to the three items mentioned.

There have been a number of instances in which special provisions have been written into the tax law for the benefit of particular classes of producers. Two outstanding examples are (*a*) percentage depletion, a tax deduction allowed to certain extractive industries for the purpose, I believe, of inducing the risk of capital in the exploitation of natural resources; and (*b*) special amortization, a tax deduction allowed to war contractors on facilities for which certificates of necessity have been issued, a policy adopted to induce the investment of private capital in facilities for the production of war materials which Government capital might otherwise have had to supply. Obviously, provisions of this kind, designed to encourage certain activities by granting relief from taxation, have no effect upon the actual costs of the companies involved. Costs are not determined by legislation but are matters of fact to be determined by judgment in the light of the circumstances involved. The costs of a company are its own actual expenses properly allocated to the income to which they relate and are not changed by the allowance or disallowance of an item as a deduction from income in determining the basis for the computation of income tax. Congress may stipulate the items to be allowed or disallowed or the factors to be considered by governmental departments in administering laws such as the Internal Revenue Code or the Emergency Price Control Act, but it cannot make an item a cost if it is not in fact a cost or prevent an item from being a cost if it is a cost.

(1) Depletion is the physical reduction of a supply of a natural resource. Depletion of oil, gas, coal, and other minerals takes place by the removal of a part of a natural deposit through the extraction operation. The proportion of the cost of the whole which is allocable to the part that is removed in a given period is the amount of actual depletion cost of production for that period. In certain fields it is not difficult to determine the total quantity of the removable mineral supply, while in others the estimate is often difficult to make even by experienced geologists and mining engineers. However, the problem is one of determining fact in the best manner possible and then calculating the portion of the total cost of the deposit allocable to each unit, i. e., ton of coal, barrel of oil, etc. This unit cost is the depletion cost of each unit extracted. In certain fields in which it is practically impossible to determine within reasonable limits the total number of units in the deposit, it is not uncommon for companies to ignore the element of depletion in caluclating their costs. Under similar circumstances, other companies have treated all income as recovery of cost until the entire cost of the deposit is written off. Although neither of these two procedures is theoretically sound, one or the other may be necessary in some cases.

Where the mineral is discovered after the property is acquired so that the cost does not represent the fair value of the deposit at the time it is discovered, it has been considered proper to determine depletion charges on the basis, not of the actual cost of acquiring the property but on what might be called an alternative cost; that is, the amount which could have been obtained for the property had the discoveror chosen to sell it after its discovery rather than to have kept and extracted it. This alternative cost is usually referred to as "discovery values." Under no circumstances does it seem to me to be proper accounting to treat as cost any depletion figure determined on the basis of an arbitrary percentage of sales value or income which is not calculated to determine the portion of actual cost or discovery value attributable to the output of the period.

(2) Amortization under a certificate of necessity is a special method of calculating a statutory tax deduction whereby the cost of a facility for which a certificate of necessity has been issued is deducted from income over a period of 5 years, regardless of its expected productive life, which is the period over which the cost is deducted in the case of depreciation. Both amortization and depreciation are based on the cost of the facility to the accounting owner. For accounting purposes the depreciable portion of the cost of a facility should be charged off over its anticipated life of usefulness to its present owner in such a manner as to charge to income in each period of such life, in a systematic manner, the amount of cost properly chargeable to that income. The special amortization allowed for tax purposes arbitrarily spreads the cost of a facility over the first 5 years of its life, irrespective of whether it will be useful to its owner in producing

income for a period of 5 years or of 50 years. If the anticipated life of the asset is less than 5 years, the depreciation deduction would be taken for tax purposes, because it would exceed the amortization allowance. The only situation under which amortization for tax purposes based on a certificate of necessity will coincide with depreciation based upon a proper accounting method of spreading cost is when the useful life of the facility is expected to be exactly 60 months and it is not expected to have any salvage value. The mere fact that the cost can be written off for tax purposes in the first 5 years of the life of an asset expected to have 50 years of usefulness to its present owner does not thereby make the cost of acquiring that asset allocable to the goods produced in the first 5 years and relieve the production of the last 45 years from depreciation cost.

It must be recognized that certificates of necessity have been issued for assets which, although essential to the war effort and therefore eligible for a certificate, will be very useful to their owners over periods much longer than 5 years. If certificates of necessity for 100 percent of the cost of such assets were issued, it is clear that amortization for tax purposes would not measure the cost attributable to the income of the amortization period. If certificates for only 35 percent of the costs were issued to cover the excess of wartime acquisition costs over normal costs, there may be sound justification for treating the amortization of the 35 percent over the war period as a proper cost of the income of that period. On the other hand, there have been many certificates of necessity issued for assets which have a physical life capable of much more than 60 months' service but which will be of no useful value to their wartime owners after they cease to produce materials for war. Although the resale or salvage value of such assets may be more than their scrap value, nevertheless the excess of their cost over their estimated resale, salvage, or scrap value should be spread over their wartime production. The principle that should be followed in every case is to systematically spread the amount by which the cost of the asset exceeds its estimated disposal value at the end of its anticipated usefulness to its present owner over that period of usefulness. If such a procedure should result in the same amount as that allowed as a deduction for tax purposes under section 124 of the Internal Revenue Code it would be purely accidental.

If the emergency period ends, or he receives a certificate of nonnecessity before the 60 months have expired, the owner of the facility covered by a certificate of necessity may elect to recompute his tax deductions over that portion of the life of the facility which expired prior to the end of the emergency period, or he may elect to write off the unamortized portion of the cost over the remaining life of the facility. Obviously, these are tax elections and have no relationship to actual cost.

(3) Accounting rests basically upon costs and their proper allocation to the income of the fiscal periods to which they relate. As discussed above, depreciation cost for a fiscal period results from the proper allocation of the total depreciable portion of the cost of a facility to the several periods during which it is expected to be useful. The depreciation of a productive facility allocable to a fiscal period is part of the cost of the goods produced by it during that period. It is not considered good business practice to write properties up and down with fluctuations in their market value or in their cost of reproduction. To do so would result in such an absence of objective measurements and such fluctuations of charges for depreciation that the financial statements would be of little value. It follows that in the absence of unusual circumstances the accepted basis of depreciation is the cost of the facility and not its current value. It is only in unusual and extraordinary cases, such as permanent, material change in the general price level, a reorganization or quasi-reorganization, that recognition may be given on a company's books to the current value of its assets. In those cases in which appreciation is recorded on the books, the depreciation on the appreciated value is treated as a charge to operations.

It must be recognized that assets which have been fully depreciated on the books may continue to have operating value; in other words, they may have been written off too rapidly. In such a case there may be justification for revising the depreciation schedule to permit the charging of an appropriate part of the cost to current periods. In case the asset has materially increased in value since its acquisition, it is generally recognized that the owner has an advantage in costs over his competitors who had to acquire identical facilities at higher costs. It is not considered good practice to adjust the costs in such cases to equal those of the competitor, since the costs are actually different.

This is a rather brief statement of my views with respect to the three matters you have in question, but I hope I have made my position clear. If not, I shall I shall be glad to have you let me know.

Very truly yours,

CARMAN G. BLOUGH, *Director of Research.*

UNIVERSITY OF ILLINOIS,
Urbana, Ill., March 16, 1945.

Mr. P. M. GREEN,
Director, Accounting Department,
Office of Price Administration, Washington, D. C.

DEAR MR. GREEN: I am glad to give you my views on the questions you raise about methods of determining certain kinds of operating costs. But, first, some preliminary observations.

In my opinion, the primary function of accounting runs strongly to the presentation of objective facts, and when that is not possible, to the nearest approach to that ideal. Stated negatively, I do not conceive it to be the function of accounting to present values, since values must be subjective in the nature of the case and, therefore, except in figures that have momentary significance only, are beyond trustworthy factual presentation.

The accounting presentation of operating costs should harmonize with this function of accounting. In no other way can we accomplish the periodic matching of revenues earned with the relevant costs sustained. And no other grouping of figures is more basic to the main purpose of accounting than this. We can therefore say that operating costs should reflect acquisition prices as closely as possible rather than attempt to state values of some sort.

Now, in more detail. The problem of operating costs can usually be stated this way: What cost is most relevant to the revenue of a given period? You raise the specific problem of depletion in extractive industries, asking: What is the proper amount to deduct from periodic revenue for depletion? My answer is, cost—that part of outlay price which is reasonably connected with the quantity of material sold in the given period. What that figure would be depends on certain facts: (1) Capital investment in ore bodies and (2) the proportion of the total ore body that engineers estimate has been currently recovered. The same problem of making an accounting allocation of outlay costs over several periods is met in simpler form when we assign one-sixth of the cost of a 6 months' supply of boiler coal to a monthly account for power costs.

It is sometimes argued that such allocation estimates are unreliable and a valuaiton approach favored instead. But is the alternative any more reliable as an objective determination of relevant facts? For example, it may seem simpler to deduct a percentage for profit and expenses from selling price to derive a remainder to express cost of material sold. But the very essence of accounting is to find out—by comparing separately determined costs and separately determined revenues—whether the interaction of economic forces has in fact generated a margin of profit. To start with revenue from sales and work back to deplation cost is equivalent to assuming what the calculation seeks to demonstrate; i. e., that such-and-such amount of profit or loss has been generated.

It is of course difficult to make dependable estimates of the proportion of the ore body extracted. But the difficulty is due to a human limitation which men can learn to make reasonable allowances for; the other calculation, however, is a clear distortion of the logical relation of facts, and no amount of exupediency can justify its results as superior in truth to results that rest upon known investments and careful engineering estimates of ore bodies.

You also mention operating costs arising under certificates of necessity and the short-run amortization of emergency facilities, asking: What is the proper determination of the amount to be deducted from revenue?

The circumstances described arise out of conditions requiring speedy execution. To bring about top production quickly and to protect the enterprise from capital loss from useless assets remaining, it is agreed for tax purposes, etc., that the investment shall be written off over a shorter period than the physically useful life of the asset would normally be. If any usefulness remains in the assets after the emergency (the whole cost having been received for emer-revenue), this usefulness, if any, becomes in effect a premium received for emergency services rendered. But from the point of view of cost determination (as a regular part of profit determination), accounting must allocate equipment costs (outlay price) over the time of the equipment's whole useful life. Accounting cannot justify future operating cost figures if these fail to reflect the use of assets actually used, as would be the case if physical assets were used in production after their money cost had been wholly written off against revenue.

Again it is a question of fact versus opinion. The opinion that prices should be granted to producers that are high enough to cover quick write-off of full equipment cost may be desirable and reasonable under the circumstances. But that view, made into a tax rule, does not establish an accounting principle.

The final question of fact cannot be conclusively established until postwar conditions reveal how much of the fully charged off equipment is actually useful for postwar production. Accountants therefore would be more likely to consider as truest operating costs those based upon a careful study of probable postwar equipment usefulness rather than those based upon an expedient rule of 5 years' amortization for all types of equipment.

A third question asks: What is the proper determination of depreciation as between a basis of outlay cost and one of current replacement price of similar equipment? Because the function of accounting is to determine profit as far as it can by the use of objectively ascertained facts that are fully relevant to the enterprise in question, accountants persist in charging depreciation as a periodic allocation of actual outlay costs of the enterprise. Replacement prices are not facts that are relevant to an enterprise which has not yet paid those prices. And depreciation accounting is not entered upon for the purpose of building up reserved assets sufficient to cover the purchase of higher-priced equivalent equipment. These higher prices must be financed in some other way, because depreciation accounting serves only to allocate to successive periods a previously determined outlay cost.

So I end as I began: Accounting should reflect costs rather than values.

Sincerely yours,

A. C. LITTLETON, *Professor of Accountancy.*

BIOGRAPHICAL NOTE

A. C. Littleton, Ph. D., certified public accountant (Ill.): In 1912 Mr. Littleton became a practicing public accountant. Since 1915 he has been a member of the accounting faculty at the University of Illinois. At one time he was the national president of the American Accounting Association, and for several years subsequent to 1937 he was codirector of research of the American Accounting Association.

His publications include extensive writings on accounting history and theory. He is coauthor of An Introduction to Corporate Accounting Standards and is the author of Accounting Evolution to 1900, published under the auspices of the American Institute of Accountants.

CHICAGO, *March 19, 1945.*

Mr. PAUL M. GREEN,
Deputy Administrator for Accounting,
Office of Price Administration, Washington, D. C.

DEAR MR. GREEN: You have asked me the question: Is it good accounting practice for a company mining coal to record in its accounts, and thus to have its financial statements reflect (*a*) depletion on coal deposits equal to 5 percent of the gross income from the property, or (*b*) accelerated depreciation, depletion, or amortization of 20 percent per annum on "emergency" facilities necessary in the interest of national defense?

The answer is the same in both cases: a decided "No." Books of account and financial statements should reflect the proration of the cost of limited-life assets over the period of their economic usefulness or over units of output or service flowing from such assets. The measure of the flow (often called expired utility) cannot be made by adopting the arbitrary percentages mentioned in the question. The "5 percent of gross" is an expense allowance for tax purposes in lieu of depletion based on cost which was originally put in the Internal Revenue Code by Congress as a simplification; it is not an industry "average" and was not intended to be reflected in the books of account but only in the computation of taxable net income. The 20-percent allowance on properties contributing to the war was simply an inducement offered to businessmen in computing taxable net income in an effort to get them to convert to the production of the materials of war; it had no relation to the length of the war nor to the period during which the assets would be in use; and it does not need to be spread in the records or shown on the financial statements.

Methods of accounting and the principles underlying them for coal producers have been in effect for many years and they have not been changed by the war. The standard practice for obtaining the annual depletion or expired utility of wasting assets such as coal lands (and often property improvements at or near the mouth of the mine) is first, to obtain a rate by dividing (*a*) cost less previous years' accumulations of depletion computations by (*b*) the actual yield in tons during the current year plus the estimated production in future years; and second, to apply the rate to the current year's production in tons. Estimates of the tonnage to be extracted in future years will vary as proven-quantity estimates are modified from time to time by continuing engineering explorations and studies, but over the years the method has proven to be substantially accurate and its acceptance by the industry has been well-nigh universal. Moreover, this method conforms to practices long common among business organizations generally.

Sincerely yours,

E. L. KOHLER.

BIOGRAPHICAL NOTE

Eric L. Kohler, M. A., C. P. A. (Illinois): From 1915 to 1937, Mr. Kohler was engaged in the practice of public accounting, both as a staff member of Arthur Andersen & Co., and as a member of his own firm. Since that time he has been Comptroller of the Tennessee Valley Authority, has served with the War Production Board, and has been executive officer of the Petroleum Administration for War. Concurrently, since 1915 he has been a member of the accounting faculty at Northwestern University, and during a part of that time was a member of the Illinois State Board of Certified Public Accountant Examiners.

His publications include Accounting Principles Underlying Federal Income Taxes, Accounting for Business Executives, and Advanced Accounting Problems. He is the coauthor of Principles of Auditing and Principles of Accounting. In addition, he has been a contributor to several magazines on subjects dealing with accounting and management; and from 1928 to 1941 he was editor of the Accounting Review.

SECURITIES AND EXCHANGE COMMISSION,
OFFICE OF THE CHIEF ACCOUNTANT,
Philadelphia, May 26, 1945.

Mr. PAUL M. GREEN,
Deputy Administrator for Accounting,
Office of Price Administrator, Washington, D. C.

DEAR MR. GREEN: In your letter of May 11, 1945, you inquired as to the methods followed by coal companies and oil companies in accounting for exhaustion of their coal and oil resources.

Attached hereto are two exhibits, one dealing with coal companies and the other with various categories of oil companies. These exhibits summarize information as to the depletion policies followed by these companies as shown in recent annual reports filed with this Commission under the Securities Exchange Act of 1934.

As you will note from the exhibits, all of the coal companies take sustained depletion in reporting to us. In addition, most of the oil companies likewise take sustained depletion. There are, however, a few companies which have not followed this practice. For the most part this group comprises smaller companies or those of a specialized nature.

The exhibits also indicate that the public accountants certifying the financial statements of the coal and oil companies taking sustained depletion report in their certificates that the company's methods are "in conformity with generally accepted accounting principles." It is readily apparent from the statements of these companies not only that sustained depletion is a generally recognized and accepted method of accounting for the exhaustion of resources of this character but also that it is clearly the preponderant method of accounting for such resources in the preparation of general financial reports. Out of the 92 oil companies studied, only 8 took "percentage" depletion, and several of these may be classified as special situations. The certifying accountants, however, took no exception to this method.

The attached exhibits do not include companies such as the steel companies, which sometimes conduct extensive coal-mining operations. However, from a review of a fair sample of such companies, it appears that they also take sustained depletion in their general financial reports.

If examination of these exhibits raises any question, I shall be glad to be of further assistance.

Very truly yours,

WILLIAM W. WERNTZ, *Chief Accountant.*

EXHIBIT A

TREATMENT OF DEPLETION IN THE FINANCIAL STATEMENTS OF 26 COAL COMPANIES AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION

This exhibit summarizes the depletion policies followed by 26 coal companies, as disclosed in recent statements filed by such companies with the Securities and Exchange Commission pursuant to the requirements of the Securities Exchange Act of 1934. The group consists of companies whose major activity is coal mining and comprises substantially all such companies filing with the SEC.

Financial statements of all of these companies are certified by independent public accountants as being "in confromity with generally accepted accounting principles and practices."

In every case the depletion reflected in the statements filed with the SEC is actual sustained depletion, taken on a straight-line or tonnage-output basis. In no case is depletion taken based on the percentage-depletion method allowed for tax purposes. The following table summarized the situation:

Name of company	Certifying accountant	Method of depletion used in reports to SEC
1. The American Coal Co. of Allegany County, New York, N. Y.	Ernst & Ernst	Sustained.
2. Ayrshire Patoka Collieries Corp., Indianapolis, Ind.	Arthur Young & Co.	Do.
3. The Consolidation Coal Co., 30 Rockefeller Plaza, New York, N. Y.	Gould, McIntosh & Co.	Do.
4. Eastern Gas & Fuel Associates, 250 Stuart St., Boston, Mass.	Arthur Young & Co.	Do.
5. The Elk Horn Coal Corp., Cincinnati, Ohio	Ernst & Ernst	Do.
6. The M. A. Hanna Co., Cleveland, Ohio	do	Do.
7. The Hatfield-Campbell Creek Coal Co., Union Trust Bldg., Cincinnati, Ohio.	Haskins & Sells	Do.
8. The Hudson Coal Co., 230 Park Avenue, New York, N. Y.	do	Do.
9. Island Creek Coal Co., 75 Federal St., Boston, Mass.	Barrow, Wade, Guthrie & Co.	Do.
10. The Lehigh Coal & Navigation Co., Philadelphia, Pa.	Lybrand, Ross Bros. & Montgomery.	Do.
11. The Lehigh Valley Coal Co., Wilkes-Barre, Pa.	do	Do.
12. Lehigh Valley Coal Corp., Wilmington, Del.	do	Do.
13. The New River Co., Mount Hope, W. Va.	Ernst & Ernst	Do.
14. The Pacific Coast Co., 2106 Smith Tower, Seattle, Wash.	Price, Waterhouse & Co.	Do.
15. Peabody Coal Co., 231 South La Salle St., Chicago, Ill.	Arthur Andersen & Co.	Do.
16. Pennsylvania Coal & Coke Corp., Grand Central Terminal Bldg., New York, N. Y.	Anchin, Block & Anchin	Do.
17. The Pennsylvania & Reading Coal & Iron Co., Philadelphia, Pa.	Haskins & Sells	Do.
18. The Pittsburgh Coal Co., Henry W. Oliver Bldg., Pittsburgh, Pa.	Ernst & Ernst	Do.
19. The Pittston Co., 77 River St., Hoboken, N. J.	Eppler & Co.	Do.
20. Pond Creek Pocahontas Co., 75 Federal St., Boston, Mass.	Barrow, Wade, Guthrie & Co.	Do.
21. St. Louis, Rocky Mountain & Pacific Co., Raton, N. Mex.	Peat, Marwick, Mitchell & Co.	Do.
22. Truax-Traer Coal Co., 8 South Michigan Ave., Chicago, Ill.	Arthur Andersen & Co.	Do.
23. The United Electric Coal Cos., 307 North Michigan Ave., Chicago, Ill.	Haskins & Sells	Do.
24. Virginia Iron, Coal & Coke Co., Roanoke, Va.	A. M. Pullen & Co.	Do.
25. Westmoreland Inc., Philadelphia, Pa.	John Heins & Co.	Do.
26. West Virginia Coal & Coke Corp., 705 Atlas Bank Bldg., Cincinnati, Ohio.	Arthur Andersen & Co.	Do.

EXHIBIT B

TREATMENT OF DEPLETION IN THE FINANCIAL STATEMENTS OF 92 OIL AND NATURAL GAS COMPANIES AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION [1]

This exhibit summarizes the depletion policies followed by 92 oil and natural-gas companies as disclosed in recent [2] statements filed by such companies with the Securities and Exchange Commission pursuant to the requirements of the Securities Exchange Act of 1934. The group included in this exhibit comprises substantially all such companies filing with the SEC.

Financial statements of all but one of these companies are certified by independent public accountants as being "in conformity with generally accepted accounting principles and practices."

Sixty-nine of the companies, in the statements filed with the SEC, reflected actual sustained depletion taken on a straight line or unit-of-production basis. Eight of the companies reflected in such statements a charge for depletion based on the percentage-depletion method allowed for tax purposes. Two companies followed the practice of determining the amount of the annual depletion charge for certain classes of property by the use of the sustained-depletion method and at the same time used the percentage method for determining such charge for certain other classes of properties. One company used either the sustained depletion method or the percentage method, depending on which method resulted in the greater deduction from income.

The method used by two companies in determining annual depletion charges was not ascertainable from the statements of depletion policy made by them.

Two companies made charges in lieu of depletion charges.

Eight companies reflected no charge in financial statements filed with the SEC. Reasons given for the omission of such charge were such as the investment in properties had been written off in prior periods, or no estimate of recoverable oil had been obtained.

The following table summarize the situation:

I. COMPANIES WHICH USED SUSTAINED DEPLETION METHOD IN REPORTS TO SEC [1]

Name of company	Certifying accountant	Method of depletion used in reports to SEC
A. MAJOR PRODUCERS OF CRUDE OIL AND GAS		
1. Amerada Petroleum Corp., 120 Broadway, New York, N. Y.	Deloitte, Plender, Griffiths & Co.	Sustained.
2. Devonian Oil Co., 1705 National Bank of Tulsa Bldg., Tulsa, Okla.	Haskins & Sells	Do.
3. Eason Oil Co., 209 West Maple St., Enid, Okla.	T. S. Depew	Do.
4. Honolulu Oil Corp., 215 Market St., San Francisco, Calif.	Wittman & Co	Do.
5. Houston Oil Co. of Texas, Petroleum Bldg., Houston, Tex.	Haskins & Sells	Do.
6. Midwest Oil Co., First National Bank Bldg., Denver, Colo.	Alexander J. Lindsay & Co	Do.
7. Navarro Oil Co., San Jacinto National Bank Bldg., Houston, Tex.	J. L. Block & Co	Do.
8. North American Oil Consolidated, 351 California St., San Francisco, Calif.	McLaren, Goode & Co	Do.
9. Pacific Western Oil Corp., 15 Exchange Pl., Jersey City, N. J.	Arthur Andersen & Co.	Do.
10. Plymouth Oil Co., Benedum-Trees Bldg., 223 4th Ave., Pittsburgh, Pa.	Main & Co	Do.
11. Roeser & Pendleton, Inc., 613 Fort Worth Club Bldg., Fort Worth, Tex.	W. O. Ligon & Co	Do.
12. Seaboard Oil Co. of Delaware, 30 Rockefeller Plaza, New York, N. Y.	Haskins & Sells	Do.
13. Signal Oil & Gas Co., 811 West 7th St., Los Angeles, Calif.	do	Do.

[1] The grouping of companies followed is based on 1942 information as to the general character of their business.

[1] One hundred and three companies were originally included in this survey, but files for 11 companies were in use and could not be obtained for study within the time available.

[2] Annual reports for 1943 or 1944.

I. COMPANIES WHICH USED SUSTAINED DEPLETION METHOD IN REPORTS TO SEC—Continued

Name of company	Certifying accountant	Method of depletion used in reports to SEC
A. MAJOR PRODUCERS OF CRUDE OIL AND GAS—Con.		
14. Superior Oil Corp. (Calif.), 930 Edison Bldg., Los Angeles, Calif.	Price, Waterhouse & Co.	Sustained.
15. Texas Gulf Producing Co., Oil and Gas Bldg., Houston, Tex.	Mattison, Davey & Rader	Do.
16. Texas Pacific Coal & Oil Co., Fort Worth, Tex. Tex.	Haskins & Sells	Do.
17. Transwestern Oil Co., Milam Bldg., San Antonio, Tex.	Price, Waterhouse & Co.	Do.
18. Universal Consolidated Oil Co., 417 South Hill St., Los Angeles, Calif.	Lybrand, Ross Bros. & Montgomery.	Do.
B. MINOR PRODUCERS OF CRUDE OIL AND GAS		
19. Bandini Petroleum Co., 1206 Maple Ave., Los Angeles, Calif.	Ernst & Ernst	Do.
20. Bishop Oil Co., 315 Montgomery St., San Francisco, Calif.	R. G. Rankin & Co.	Do.
21. Bolsa Chica Oil Corp., 555 South Flower St., Los Angeles 13, Calif.	W. J. Nichols & Co.	Do.
22. Holly Development Co., Huntington Beach, Calif.	Price, Waterhouse & Co.	Do.
23. Kirby Petroleum Co., Houston, Tex.	Peat, Marwick, Mitchell & Co.	Do.
24. Margay Oil Corp., 610 Oklahoma Bldg., Tulsa, Okla.	Haskins & Sells	Do.
25. Mascot Oil Co., 489 I. W. Hellman Bldg., Los Angeles, Calif.	J. Arthur Greenfield & Co.	Do.
26. McClanahan Oil Co., Mount Pleasant, Mich.	Lybrand, Ross Bros. & Montgomery.	Do.
27. Oceanic Oil Co., 811 West 7th St., Los Angeles, Calif.	Windes & Irvine	Do.
28. Republics Petroleum Co., 811 West 7th St., Los Angeles, Calif.	Lybrand, Ross Bros. & Montgomery.	Do.
29. Rice Ranch Oil Co., 124 West 4th St., Los Angeles 13, Calif.	Thompson, Moss & Co.	Do.
30. Savoy Oil Co., 260 West Broadway, New York 13, N. Y.	C. A. Naylor	Do.
31. Wichita River Oil Corp., room 902, Chrysler Bldg., New York, N. Y.	Haskins & Sells	Do.
32. Woodley Petroleum Co., Second National Bank Bldg., Houston, Tex.	Mattison, Davey & Rader	Do.
C. OIL REFINERS AND DISTRIBUTORS WITH PRODUCING FACILITIES		
33. Ashland Oil & Refining Co., Ashland Oil & Refining Bldg., Ashland, Ky.	Ernst & Ernst	Do.
34. Atlantic Refining Co., 260 South Broad St., Philadelphia, Pa.	Lybrand, Ross Bros. & Montgomery.	Do.
35. Continental Oil Co. (Del.), 10 Rockefeller Plaza, New York, N. Y.	Arthur Young & Co.	Do.
36. Derby Oil & Refining Corp., Wichita, Kans.	do.	Do.
37. Empire Gas & Fuel Co., 1 Exchange Pl., Jersey City, N. J.	Peat, Marwick, Mitchell & Co.	Do.
38. Exeter Oil Co., Ltd., Post Office Box 5007, Long Beach 5, Calif.	Vaile, Henley & Roberts	Do.
39. Hancock Oil Co. of California, 2828 Juniper Ave., Long Beach, Calif.	Haskins & Sells	Do.
40. Lion Oil Refining Co., El Dorado, Ark.	Barrow, Wade, Guthrie & Co.	Do.
41. Mid-Continent Petroleum Corp., Mid-Continent Bldg., Tulsa, Okla.	Haskins & Sells	Do.
42. National Refining Co., Hanna Bldg., Cleveland 15, Ohio.	Ernst & Ernst	Do.
43. Ohio Oil Co., Findlay, Ohio	do.	Do.
44. Pan American Petroleum & Transport Co., 122 East 42d St., New York, N. Y.	Price, Waterhouse & Co.	Do.
45. Phillips Petroleum Co., 80 Broadway, New York, N. Y.	Barrow, Wade, Guthrie & Co.	Do.
46. Pure Oil Co., 35 East Wacker Drive, Chicago, Ill.	Arthur Andersen & Co.	Do.
47. Richfield Oil Corp., 555 South Flower St., Los Angeles, Calif.	Price, Waterhouse & Co.	Do.
48. Root Petroleum Co., Commercial National Bank Bldg., Shreveport, La.	Mattison, Davey & Rader	Do.
49. Shell Union Oil Corp., 50 West 50th St., New York City, N. Y.	Price, Waterhouse & Co.	Do.
50. Sinclair Oil Corp., 630 5th Ave., New York, N. Y.	Arthur Young & Co.	Do.
51. Skelly Oil Co., Skelly Bldg., Tulsa, Okla.	Arthur Andersen & Co.	Do.
52. Socony Vacuum Oil Co., Inc., 26 Broadway, New York, N. Y.	Arthur Young & Co.	Do.

I. COMPANIES WHICH USED SUSTAINED DEPLETION METHOD IN REPORTS TO SEC—Continued

Name of company	Certifying accountant	Method of depletion used in reports to SEC
C. OIL REFINERS AND DISTRIBUTORS WITH PRODUCING FACILITIES—Continued		
53. Standard Oil Co. of California, Standard Oil Bldg., 225 Bush St., San Francisco, Calif.	Price, Waterhouse & Co	Sustained.
54. Standard Oil Co. (Indiana), 910 South Michigan Ave., Chicago, Ill.	do	Do.
55. Standard Oil Co. (New Jersey), 30 Rockefeller Plaza, New York, N. Y.	do	Do.
56. Sun Oil Co., 1608 Walnut St., Philadelphia, Pa	Lybrand, Ross Bros. & Montgomery.	Do.
57. Sunray Oil Corp., 1 Wall St., New York, N. Y	do	Do.
58. Texas Co., 135 East 42d St., New York, N. Y	Arthur Andersen & Co	Do.
59. Tidewater Associated Oil Co., 17 Battery Pl., New York, N. Y.	Price, Waterhouse & Co	Do.
60. Union Oil Co. of California, Union Oil Bldg., 617 West 7th St., Los Angeles, Calif.	do	Do.
61. Wilcox Oil Co., Wilcox Bldg., 6th St. and Denver Ave., Tulsa, Okla.	Arthur Young & Co	Do.
D. OIL REFINERS AND DISTRIBUTORS APPARENTLY WITHOUT SUBSTANTIAL CRUDE-OIL PRODUCING FACILITIES		
62. Quaker State Oil Refining Corp., 11 Center St., Oil City, Pa.	Lybrand, Ross Bros. & Montgomery.	Do.
63. Standard Oil Co. (Ohio), Midland Bldg., Cleveland, Ohio.	Ernst & Ernst	Do.
E. OIL ROYALTY COMPANIES		
64. Consolidated Royalty Oil Co., Consolidated Royalty Bldg., Casper, Wyo.	C. H. Reimerth & Co	Do.
65. Louisiana Land & Exploration Co., Houma, La	Deloitte, Plender, Griffiths & Co	Do.
66. Maracaibo Oil Exploration Corp., Continental Build., Dallas, Tex.	Haskins & Sells	Do.
67. Midland Oil Corp., 67 Wall St., New York, N. Y	Joseph Rosenthal	Do.
68. Southland Royalty Co., 1607 Commercial Standard Bldg., Fort Worth ,Tex.	W. O. Ligon & Co	(2).
69. Venezuelan Petroleum Co., 630 5th Ave., New York, N. Y.	Arthur Young & Co	Sustained.

2 Royalties and leases, sustained; headrights, unit per day to write off cost at expiration of headright.

II. COMPANIES WHICH USED PERCENTAGE DEPLETION IN REPORTS TO SEC

Name of company	Certifying accountant	Total assets (approximate)
1. Atlantic Oil Corp., Kennedy Bldg., Tulsa, Okla	Peat, Marwick, Mitchell & Co	$544,000
2. Barnhart Morrow Consolidated, 1020 Subway Terminal Bldg., Los Angeles, Calif.	George F. Meitner & Co	664,000
3. Leonard Oil Development Co., 48 North Main St., Washington, Pa.	C. Ross Sproat	8,973,000
4. Mount Diablo Oil Mining & Development Co., 901 Central Bldg., Los Angeles 14, Calif.	V. B. Espinoza	102,000
5. Nordon Corp., Ltd., 417 South Hill St., Los Angeles, Calif.	Roy W. Burton	379,000
6. North Central Texas Oil Co., Inc., 30 Broad St., New York 4, N. Y.	O. F. Taylor & Co	1,588,000
7. Ohio Oil & Gas Co., 1300 Union Trust Bldg., Pittsburgh, Pa.	O. T. Bielau & Co	22,000
8. Shamrock Oil & Gas Corp., Amarillo, Tex	Dempsey A. Winn	9,574,000

III. COMPANIES WHICH USED EITHER OR BOTH SUSTAINED AND PERCENTAGE METHODS IN REPORTS TO SEC

Name of company	Certifying accountant	Method of depletion used in reports to SEC
1. Crown Central Petroleum Corp. (Md.), American Bldg., Baltimore, Md.	Ernst & Ernst	(3).
2. Intercoast Petroleum Corp., 57 William St., New York, N. Y.	Barrow, Wade, Guthrie & Co.	(4).
3. Reiter-Foster Oil Corp., 29 Broadway, New York, N. Y.	Allen R. Smart & Co.	(5).

3 Provide depletion in an amount equal to the greater of cost depletion based upon exitmated future production or percentage depletion.
4 Leaseholds—sustained. Royalties—percentage.
5 Old leases and royalties, sustained; leases and royalties acquired during year, percentage.

IV. COMPANIES FOR WHICH METHOD OF DEPLETION USED IN REPORTS TO SEC IS NOT DETERMINABLE

1. Bullion Mining Co., 24 Mining Exchange Bldg., Salt Lake City, Utah.	Alvin R. Erickson	
2. Leonora Mining & Milling Co., 33 West 1st South St., Salt Lake City, Utah.	H. B. Emrick	

V. COMPANIES WHICH DO NOT USE EITHER SUSTAINED OR PERCENTAGE METHOD OF DEPLETION BUT MAKE A CHARGE "IN LIEU THEREOF" IN REPORTS TO SEC

1. Barnsdall Oil Co., 900 Market St., Wilmington, Del.	Collins & Co.	(6).
2. Pittsburgh Oil & Gas Co., 120 Broadway, New York, N. Y.	do	(7).

6 Leaseholds written down to $1. In lieu of depletion company charges to income an amount equal to cost of acquiring leases during the year—in addition, intangible development costs are being written off on sustained depletion basis.
7 Actual expenditures for oil and gas leases charged to profit and loss.

VI. COMPANIES WHICH SHOW NO CHARGE FOR DEPLETION IN REPORTS TO S. E. C.

1. Canfield Oil Co., 3216 East 55th St., Cleveland, Ohio.	Ernst & Ernst	(8).
2. Crescent Eagle Oil Co., 33 East 6th South St., Salt Lake City, Utah.	S. W. Gaddie	(9).
3. Lincoln Petroleum Co.	S. J. Anderson	(10).
4. Merchants Petroleum Co., Fillmore, Ventura County, Calif.	H. M. Thomson	(10).
5. North American Oil Co., 1414 Fidelity Bldg., Baltimore, Md.	Ernst & Ernst	(10a).
6. Occidental Petroleum Corp., 215 W. 7th St., Los Angeles, Calif.	Scholefield & Co.	(11).
7. Red Bank Oil Co., Dallas, Tex.	Ulan Hill & Co.	(12).
8. Signal Petroleum Co. of California, Ltd., 433 South Spring St., Los Angeles, Calif.	E. R. Simpson	Depletion policy not stated.

8 Depletion policy not stated, no depletion charge reflected in financial statements, apparently little or no production of crude oil and gas during period.
9 Depletion policy not stated—wells were not producing in 1943.
10 Depletion policy, not stated—no depletion reflected in financial statements. Depletion policy not stated—no depletion reflected in financial statements—cost of leaseholds fully amortized prior to 1941.
10a Depletion policy not stated.
11 Depletion policy not stated—charge for depletion not reflected in financial statements—Investment in field fully written off in prior years.
12 No provision made for depletion—no estimate of recoverable oil obtained.

VII. ALTHOUGH THE FOLLOWING COMPANIES FILE WITH THE COMMISSION THEY WERE NOT INCLUDED IN THIS STUDY AS THEIR FILES WERE IN USE AND COULD NOT BE OBTAINED FOR STUDY WITHIN THE TIME AVAILABLE.

Name of company	Certifying accountant	Method of depletion used in reports to SEC
1. American Maracaibo Co., 921 Bergen Ave., Jersey City, N. J.		
2. American Republic Corp., Petroleum Bldg., Houston, Tex.		
3. Cosden Petroleum Corp., Big Springs, Tex		
4. Gulf Oil Corp., Gulf Bldg., Pittsburgh, Pa		
5. Jade Oil Co., 108 West 6th St., Los Angeles, Calif		
6. Mid-West Refineries, Inc., Grand Rapids, Mich		
7. Panhandle Producing & Refining Co., 122 East 42d St., New York, N. Y.		
8. Salt Dome Oil Corp., 2600 Esperson Bldg., Houston, Tex.		
9. Texon Oil & Land Co., Ponca City, Okla		
10. Utah Wyoming Consolidated Oil Co., 223 Judge Bldg., Salt Lake City, Utah.		
11. Venezuelan Holding Corp., Room 902 Chrysler Bldg., New York, N. Y.		

UNITED STATES MARITIME COMMISSION,
Washington 25, May 21, 1945.

Mr. PAUL M. GREEN,
Deputy Administrator for Accounting,
Office of Price Administration, Washington, D. C.

DEAR MR. GREEN: This will reply to your letter of May 19 with respect to amortization and depreciation.

The Commission does not recognize the statutory 60-month amortization period provided in section 124 of the Internal Revenue Code as applying to a determination of cost under its contracts, since that provision is regarded as having to do solely with determination of taxes.

Accordingly, allowance for depreciation is based on the estimated useful service lives of the facilities involved.

There have been certain instances where permanent improvements, which become part of the real estate, have been made by a contractor upon leased property. In such cases, the rate of depreciation is allowed, based upon the contractor's leasehold rights.

There has been no change or amplifying regulation issued by the Commission modifying section 7.91 of its Profit Regulations, adopted May 4, 1939, to which you refer.

Very truly yours,

R. E. ANDERSON,
Director of Finance.

EXHIBIT E

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA,
Washington, D. C., June 29, 1945.

The Honorable WRIGHT PATMAN,
Chairman, Select Committee to Investigate and Study Small Business,
House of Representatives, Washington 25, D. C.

DEAR MR. PATMAN: In response to the privilege given me of supplementing my statement, I am enclosing herewith an additional statement on the question of crude oil prices.

Very truly yours,

RUSSELL B. BROWN.

ADDITIONAL STATEMENT ON CRUDE OIL PRICE QUESTION

By Russell B. Brown, general counsel, Independent Petroleum Association of America

TO THE SELECT COMMITTEE ON SMALL BUSINESS,
House of Representatives, United States Congress:

The problem presented to your committee by these hearings has been simplified by the testimony before you.

I have previously discussed our efforts to obtain relief through the Office of Price Administration. I have related with some detail the reasons I felt have caused the delay in concluding the survey to obtain factual material on which to base proper price ceilings.

Witnesses have, with care and detail, reviewed for your consideration the problems confronting the producers of petroleum in the more than 2 years since you began your study of these problems. This testimony should have been heard and judged by the Office of Price Administration. That was the agency created by Congress for such purpose.

It was only because this agency failed and refused to comply with the law as written that it has been necessary for a committee of Congress to take the time and exercise the patience to review the facts on which conclusions might be formed as to the maintenance of our essential economy.

I have delayed the exercise of the privilege to supplement my previous testimony awaiting the receipt of copies of the supplemental statements from OPA in order that I might bring in review the difficulties which confront our industry in its efforts to have its cause properly and fairly judged by the agency created for that purpose. I have now received the supplemental statements filed by Mr. Judd and Mr. Green, officials of the OPA. These statements present no new facts and serve only to further confuse the issues before your committee. Detailed discussion of these statements has been prepared and presented to you by Mr. James V. Brown.

The issues remain the same. The OPA statements seek to avoid the real facts by the presentation of matters outside the issues that do not contribute to the further enlightenment of your committee.

The problem presented is one of inadequate price for the production of a raw material essential to our military safety and civilian requirements.

The law is clear; only the administration is confusing.

The act creating the Office of Price Administration and authorizing them to fix price ceilings provides in part as follows:

"Before issuing any regulation or order under the foregoing provisions of this subsection, the Administrator shall, so far as practicable, advise and consult with representative members of the industry which will be affected by such regulation or order, *and shall give consideration to their recommendations.*"

The italic portion was added by the act of 1944. It was an attempt by Congress to compel more than perfunctory compliance with the direction to consult with industry. As to oil, no semblance of compliance has ever been shown—a fact that has repeatedly been complained of by us without denial.

The act further provides:

"In the case of any commodity for which a maximum price has been established, the Administrator shall, at the request of any substantial portion of the industry subject to such maximum price, regulation or order of the Administrator, appoint an industry advisory committee, or committees, either national or regional or both, consisting of such number of representatives of the industry as may be necessary in order to constitute a committee truly representative of the industry, or of industry in such region, as the case may be * * *."

Except for one or two local committees, which never were encouraged to function and which finally disbanded because no attention was being paid to their recommendations, there was no effort made to comply with the provision regarding industry committees, so far as the production of oil is concerned, until your committee by your forceful report made this requirement evident.

On January 2, 1945, 2 years and 11 months after the law was passed, the OPA created such committee.

The law relating to the operation of such committees is quite clear and provides in part as follows:

"The Administrator shall, from time to time, at the request of the committee, advise and consult with the committee with respect to the regulation or order (on price), and with respect to the form thereof, and classifications, differentiations, and adjustments therein. The committee may make such recommendations to the Administrator as it deems advisable *and such recommendations shall be considered by the Administrator.*" Again, the italic portion was added by Congress in 1944, emphasizing the importance Congress felt was attached to the views of any industry with respect to its prices and costs.

The law contemplates a fair determination of questions presented to the OPA by a fair and unprejudiced body. No such procedure was ever possible with relation to petroleum.

I have stated to this committee that these hearings were prejudged by those officials unfavorable to our case. The record clearly sustains this allegation. In announcing the appointment of the National Crude Oil Industry Advisory Committee, on January 2, 1945, pursuant to the recommendation of your committee and some individual oil producers, Mr. Chester Bowles, Price Administrator, said in the press statement issued for releases that day:

"This does not represent any change in OPA's position, stated many times, that, in its opinion, there should be no general price increase for the crude-oil industry as a whole * * *. We are glad to make the survey in response to congressional committee and industry requests for a cost study. This will give us additional data for determining whether OPA's stand against a price increase is justified."

This statement, widely published, was interpreted by the oil producers to mean that OPA was chiefly concerned with the amenities due a committee of Congress. In this and other statements and newspaper accounts, examples of which I introduced into the record, may lie the explanation of the failure of many producers who received the cost questionnaire to make returns thereof. Would they not conclude from Mr. Bowles' words that he was seeking data, not to determine the merits of the producers' case, but to find support for the position taken long before?

Indeed, the prejudgment of the case—the instant case—goes still farther back, to last October, following the hearings held by your committee in Austin, Tex. A news article in the New York Journal of Commerce of October 14, began with these paragraphs:

"WASHINGTON, October 13.—The Office of Price Administration today declared that it would firmly oppose recommendations of the House Select Committee on Small Business for a minimum increase of 35 cents per barrel on the average over-all price of crude petroleum.

"Declaring that the oil industry today is in a better position than it ever has been before, an OPA spokesman ssaid that the agency's reasons for opposing the increase were based upon predictions which have subsequently proved to be facts.

"Although various segments of the industry had indicated otherwise, OPA said that a mapority was of the opinion the price structure as it exists is adequate to allow for new research, present production, and all other phases of petroleum development."

It was the contention of Mr. Green, Deputy Administrator for Accounting, in his appearance at your hearings that the basis of price determination was exact and in accordance with the most thorough examination of all factors which were pertinent. Yet, this "spokesman" who talked to the New York Journal of Commerce, said they had in the past been governed by "predictions." Without benefit of any survey and in spite of the report of your committee based on the testimony of many members of the industry, they said that a "majority" of the industry was of the opinion that the existing price structure was adequate. I have no idea who the spokesman was, nor how high his position. I do submit that such interviews go far to proving the assertion that OPA has been prejudiced and that the case was prejudged long ago.

I should like to refer again to the expression in the law, "and shall give consideration to their recommendations," and the still further emphasis given by Congress in the expression, "and such recommendations shall be considered by the Administrator."

Your committee and the industry, through the National Crude Oil Industry Advisory Committee, recommended consideration of cost of replacement of crude oil in setting price ceilings. OPA makes some show of compliance with the congressional mandate by including in the cost questionnaire a form recommended by the industry committee. But—and this point cannot be overstressed—before the questionnaire was in the mails, OPA officials, usually referred to as "spokesmen," were telling the public through the press that no attention would be paid to cost-of-replacement figures even when reported on the form.

Is it "consideration" to say, in effect, "You may bring in all the evidence you like along this line, but I have decided to pay no attention to it?"

I could extend this presentation of statements prejudicial to a fair and impartial survey of costs if the committee desires. The press was filled with them early in the year. There was much talk of the splendid profit position of the industry. On examination before your committee, Mr. Green relied on the statements of the large companies for support of his contention on profits. His accounting system, he said, was of a high order of excellence, yet it took into consideration only the methods and usages of the large companies. At one point he was asked this question:

"Mr. HALL (Congressman Leonard W. Hall). Have you, at any time, investigated the accounting system used by these thousands of independents throughout the country?"

To which Mr. Green answered, "No."

Mr. Green took exceptions to my statement in the June 12 hearing that he was unfair and obtained permission to extend his remarks on this question.

Mr. Green has now filed his statement in which he not only pleads guilty in four separate counts but elaborates in some detail on each count in an effort to justify the prejudice he entertains.

These counts indicate his prejudice against the economic operation of the industry on these four points that have had the continuous approval of the Congress of the United States in substance for more than a quarter of a century.

Mr. Green tries to demonstrate that the petroleum industry has been favored and therefore in order to correct the errors the Congress has thus long committed he will punish us now by denying a chance for a fair hearing on the simple question of price.

This is not the place or time to defend the Congress for this long-sustained policy. The Congress needs no defense by me. Suffice it to say that through the wisdom demonstrated by Congress, the people of the United States have developed a strong, virile, dynamic petroleum industry that is the envy of the entire world. Many nations now seek to emulate the success our country has enjoyed.

We have said and say again that there is no one system of accounting in the petroleum-producing industry based on price determination. The records kept furnish the facts from which necessary evidence can be obtained. That is why the law contemplates industry advisory committees and required consideration of their recommendations.

In peacetime this industry has powered and lubricated the greatest industrial development in the world. It has made possible the most convenient, extensive, and widely distributed transportation system ever enjoyed by man.

It has made an abundant dependable supply of petroleum products of ever-improving quality and at constantly decreased prices to the consumer.

It has built economically healthy communities throughout the oil-producing areas of some twenty-odd States. It has provided a revenue producing and collecting agency that brings more money to the various divisions of government with less expense and difficulty than has any other industry.

In time of war, it has been our element of safety. In World War I it was recognized as the greatest single element contributing to our success. In the present war when the success of the submarine interrupted the ocean transportation systems of the Allied Nations, it was the oil supply from continental United States that saved our allies and enabled us to build the greatest and most effective defensive and offensive war power the world has ever known. So important was our petroleum that it constituted two-thirds of our tonnage to the war fronts.

All this has been done by an industry under a policy of Congress through which the industry has made no undue profits and has borne its due and proportionate share of the Nation's tax burden.

It was only under the operations of controlled price policy by the Office of Price Administration that any part of the industry has made what may appear to be excessive profits. I suspect that such profits will prove to be profitable only to the taxing agencies. At any rate, they have not gone to the producers of crude oil.

I was amazed at this evidence of disrespect by one so new in Government for an agency to which he owed his governmental existence. In search of some evidence of the food on which he had fed to create in him such sureness of his own ability to sit in judgment on the Congress, I found these lines from his own testimony (p. 754 of the Record) in which, while referring to the Office of which he has charge, he says, "We have accounting in the Office of Price Administration on a higher plane than it has ever been in Government service." In view of the historic accomplishments of our Treasury Department and the success of our many other departments of long and permanent standing and, in view of the short time in which this young man has accomplished so much in his own estimation with a new and temporary agency, his pride is understandable.

Conceding the state of perfection of this accounting system, I am still puzzled at the inability of the OPA to supply information on the distribution of the stripper well subsidy money. Mr. Judd informed Chairman Wright Patman on April 17 that no records were available which would reveal a break-down of the payments. The plan was devised and is still supervised by OPA. The records of Defense Supplies Corporation, which disburses the money, do contain the names of the producers to whom the money was paid, if I am informed correctly. It would seem that we should, somehow, be able to find out to whom the subsidy goes.

I make no plea for any particular accounting system to be applied in the effort to determine a fair base for the fixing of ceiling prices on crude petroleum. I do believe that the books of the industry reflect statistical accounting data that may properly be used in the determination of this base. I believe that the industry committee is best qualified to assist the OPA in determining the material necessary to this inquiry.

The action of the OPA in stating in advance that they will not consider the recommendations on essential points made by the industry committee is harmful to the effort and has amounted to an absolute violation of the law. I illustrate this with one point. We have not urged in advance of the survey the adoption of any arbitrary formulas but rather a form of questionnaire that would obtain the material necessary to a final determination of the case. The question of using statutory depletion allowance in price fixing was raised by the coal industry before the Senate Banking and Currency Committee. That committee in its report stated as follows (report 325, p. 9):

"DEPLETION ALLOWANCES FOR COAL

"Representatives of the coal-mining industry protested to the committee about the recent abandonment by the Office of Price Administration of the reporting forms previously used by the industry under the Bituminous Coal Conservation Act, which allowed depletion to be reported on a sustained or percentage basis. They objected on the ground that it appeared that the Office of Price Administration was going to handle depletion costs in a manner inconsistent with the requirements of the 'accounting methods' proviso to section 2 (a) of the Emergency Price Control Act. They proposed an amendment which would authorize the determination of depletion in the same manner in which it is determined for the purposes of the income-tax laws.

"The committee was assured by the officials of the Office of Price Administration that maximum prices for coal had been fixed in the past on a district basis by a method which took into account the average depletion actually charged in 1942 by all the mines in such district whether sustained depletion or percentage depletion; that, in determining whether maximum prices should hereafter be adjusted, they will not change the method by which depletion has heretofore been taken into account; and that they will restore the form heretofore used which allows depletion to be reported on a sustained or percentage basis. The committee felt, therefore, that no amendments are necessary at this time."

Representatives of the coal industry again appeared before the House Banking and Currency Committee, urging the same issue.

When the passage of the Price Control Extension Act was being debated in the House, Chairman Spence, of the Banking and Currency Committee, in response to inquiry by Congressman Neely, stated that his committee in its report approved the position taken by the Senate committee in regard to depletion allowance to coal producers. Mr. Neely, quoting from the House committee's report as to the belief that the present law is adequate, asked this question:

"Is not the confidence thus expressed the result of the committee's belief that existing law requires OPA to give proper consideration, for example, to such a vital element as that of percentage depletion in fixing the price of coal?"

To which Mr. Spence replied that the Administrator should take into consideration all elements of cost and other pertinent factors in price fixing and that the agency had the undoubted right to consider percentage depletion as a part of production cost.

This record indicates a clear intent on the part of Congress that the law would permit the use of percentage depletion in price fixing and in admission by OPA that they understand it to be the law, yet in spite of congressional intent and OPA understanding, we have the open defiance of Congress by OPA before your committee wherein they state they will not make use of percentage depletion. I do not know whether it will be finally determined to be the appropriate method of accounting in oil or not, but I do say that an open declaration of intent to ignore the law seriously interferes with our effort to obtain the facts.

WASHINGTON, D. C., *June 28, 1945.*

EXHIBIT F

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA,
Washington, D. C., June 29, 1945.

The Honorable WRIGHT PATMAN,
Chairman, Select Committee to Investigate and Study Small Business,
House of Representatives, Washington, D. C.

DEAR MR. PATMAN: Responding to the privilege accorded to me to extend my remarks, I am enclosing herewith a supplemental statement on crude-oil prices.

Very truly yours,

JAMES V. BROWN.

SUPPLEMENTAL STATEMENT ON OPA CRUDE PETROLEUM COSTS SURVEY BEFORE THE SELECT COMMITTEE ON SMALL BUSINESS OF THE HOUSE OF REPRESENTATIVES

(By James V. Brown, secretary, National Crude Oil Industry Advisory Committee, and petroleum analyst, Independent Petroleum Association of America)

In response to the privilege which you granted me at the hearings, I submit for your consideration and for the record the following, in supplementing my previous statements:

The principal reasons why, in my opinion, the OPA crude petroleum costs survey has not been completed within the 90 days specified by the Select Committee on Small Business of the House of Representatives are:

1. Refusal by OPA to accept the recommendations of the National Crude Oil Industry Advisory Committee.
2. Refusal by OPA to adopt a simplified form of questionnaire for small oil producers.
3. Inability of the majority of oil producers surveyed to supply complete production-costs data from their existing accounting records in the form required by OPA.
4. Prejudgment of the case by Price Administrator Chester Bowles and O. D. Judd, Associate Director, Fuel Price Division.
5. Indicated prejudice of OPA Deputy Administrator of Accounting and his unwillingness to recognize all factors relevant to the cost of finding, developing, and producing crude oil, contrary to the intent of Congress as expressed in the law.
6. Partial disclosure of economic and factual data by OPA officials, in publications and before congressional committees, in support of their claims that an increase in the price of crude oil is unwarranted.

OPA officials indicate some misconceptions on their part regarding the position of the industry on "replacement costs" and the inability of small oil producers to supply complete and accurate statistical engineering and accounting data in a manner which conforms to the accounting standards as outlined by the Deputy Administrator of Accounting.

The average independent oil producer's records are such that it would be nearly impossible to supply the details called for on the questionnaire now used by OPA in its crude petroleum costs survey.

Oil producers whose volume of production is small, of whom there are more than 18,000, do not keep detailed statistical engineering, financial, and economic information for their general use which fits the pattern cut for them in OPA's accounting and price policies. Consequently, many producers are unable to comply with the requests of OPA to complete the complex questionnaire which OPA sent out to over 700 oil producers on April 9, 1945.

It was for this reason the National Crude Oil Industry Advisory Committee suggested the use of a simplified questionnaire for small oil producers. Upon the refusal of OPA to adopt that procedure, the committee requested representation on behalf of oil producers for the purpose of assisting OPA and the oil producers in an expeditious completion, audit, interpretation, and analysis of returns, and to avoid the delay incident to the completion of returns which are incomplete or incorrect. Mr. Judd told your committee he believed the purpose of the industry committee in requesting representation in the study of returns was that the committee questioned his integrity. Representation of individual oil producers was denied by Mr. Judd. Aside from the fact that OPA appointed the National Crude Oil Industry Advisory Committee to advise and consult with it and to represent the oil producers on this cost study, it is my understanding that the Emergency Price Control Act permits OPA to recognize an authorized representative of any person or corporation who desires representation before OPA.

No industry witness has made any point before this committee or any other committee regarding tax laws and regulations providing an acceptable basis for cost determinations in accordance with OPA standards. The industry's problem is—

1. That no uniform accounting system prevails in the crude petroleum industry,
2. That methods of accounting used by a few large companies are no indication that such methods are used uniformly by all the thousands of small companies,
3. That the majority of small oil producers use statutory depletion or write off intangible drilling costs, or both, and under these circumstances a complete determination of costs of producing crude oil by small oil producers according to OPA standards is a difficult problem, if not a practical impossibility,
4. That the OPA approach to the solution of the crude-oil price problem is incomplete, incorrect, and misleading.

It is my observation that over 86 percent of the reporting oil producers in the current OPA crude-petroleum costs survey either use statutory depletion or write off intangible drilling costs on their questionnaires. In these individual cases complete basic data is not supplied which would be necessary to enable OPA accountants, or any professional accountant, to accurately compute historic costs of producing crude petroleum for the industry as a whole, according to the inflexible, dogmatic, and academic standards laid down by Mr. Green, head of the OPA Accounting Department. OPA can, by a full disclosure of the facts, verify the accuracy of my statement from the questionnaires it now has on file.

Mr. Green informed your committee that only 6 out of 185 in the current crude costs survey use statutory depletion. He may have overlooked the fact that a large percentage o fthe same 185 wrote off intangible drilling and development costs. I believe that, if he investigates, he will discover that not less than 150 of the 185 questionnaires to which he referred show intangible drilling costs written off.

REPLACEMENT COSTS

Mr. Green states replacement cost in finding and developing crude petroleum is not a method of accounting accepted by leading accounting authorities. Mr. Judd contends that the use of replacement cost in computing petroleum production costs is not an established accounting practice.

Those of the accounting profession, whether engaged in public, Government, or industry practice, recognize the last-in first-out method of accounting in the valuation of inventories consumed in the production of goods sold. That method embodies the principle of, and its use is, the application of replacement costs. It has been used for several years in those industries where the management under a free economy determined, insofar as economic forces permitted, the price on the commodity it sold. The crude-petroleum producers have never had any control over the price of the product they sold. Under a free enonomy the importance of proper cost finding as it relates to the determination of price fixing was not generally considered in the industry. The views of industry experienced and industry engaged accountants as to proper cost finding in the production of crude petroleum were invited by the National Crude Oil Industry Advisory Committee. Studies have been made by committees of the industry, made up of qualified and competent, practical and experienced accountants. Their reports recognize replacement costs as a proper factor in the determination of the cost of finding and developing crude petroleum.

Anyone responsible for the management of any business must and does in the contemplation of the continuance of his business determine and use replacement costs. Humble Oil & Refining Co., Standard Oil Co. (New Jersey), The Texas Co., the Union Oil Co. of California, and many others have published their views on replacement costs. Mr. Merle Becker and Mr. Russell B. Brown have supplied excerpts from the financial statements of those companies and many others who, in the management of their companies, take into consideration replacement costs in their own calculations of the cost of finding, developing, and producing crude petroleum.

OPA in its crude petroleum costs surveys uses a formula in determining industry costs and margin which does not conform with the provisions of section 2 (a) of the Emergency Price Control Act, which provides that the Price Administrator: "shall make adjustments for such relevant factors as he may determine and deem to be of general applicability, including the following: * * *, general increases or decreases in costs of production, * * * and general increases or decreases in profits earned by sellers of the commodity * * *: *Provided*, That no such regulation or order shall contain any provision requiring the determination of costs otherwise than in accordance with established accounting methods."

OPA's cost standard as outlined by Mr. Green does not take into consideration "relevant factors." It imposes upon the crude oil producers an inflexible academic rule of accounting.

In actual practice the public accountant does not impose upon his client a requirement that the books of account conform exactly to a specified pattern cut out by the texbooks on accounting, or the academic thinking on abstract questions as expressed by accounting societies. If the industry were bound to any such hard and inflexible dogma, all published financial statements of the crude petroleum producing industry would be required to be on a uniform basis, and in turn require uniform methods of accounting for all elements of cost.

The facts are, there is no uniform accounting in determining finding, developing, and producing costs in the crude petroleum producing industry. Financial statements are not based on an identical set of accounting methods.

COST ACCOUNTING

Cost accounting as such has not been generally adopted by crude petroleum producers.

In manufacturing, the materials acquired for processing or for sale, while still in the possession of the manufacturer, are classified as inventory, or part of current assets held for conversion into finished products, and thence into cash. Accountants do not classify in their balance sheets, oil reserves in the ground, as inventory. They include the cost of these reserves in the property accounts which Mr. Green refers to as fixed assets.

These oil reserves, however, are the raw materials which an oil producer is holding for removal to the surface through development and production, and thence into cash. The principle is the same: a manufacturer's raw materials stock pile which must be processed in producing a salable article is little different from an oil producer's stock pile of oil reserves. Neither the raw materials subject to processing, nor the oil reserves subject to production, are readily converted into cash, yet either may be sold in part or in total. One is as much current as the other, so far as conversion into cash is concerned.

The purpose for which the manufacturer acquires the raw materials and the purpose for which the oil producer acquires oil reserves are identical. They are acquired to be processed and converted into cash. Each requires an additional expenditure of money and effort to make the raw material, or oil reserves, readily available for sale. The manufacturer in arriving at his cost of goods sold may use, and OPA will recognize, the cost of the last raw material acquired.

The oil producer's cost of his raw material is known as depletion. He is restricted to the use of his oldest, or at best, average costs in OPA calculations of "sustained depletion." He is denied the same methods which are available in manufacturing and merchandising, that of valuing his merchandise at current costs in arriving at the cost of goods sold.

LAST-IN FIRST-OUT METHOD RECOGNIZED BY OPA

Mr. Green stated: "We recognize the last-in first-out method, the same as we recognize any accepted accounting practice * * *. We submit that last-in first-out was never intended to be used for the valuation or charge-off for fixed assets."

This means that in any industry other than crude petroleum or other crude minerals, the acquisition cost of the latest lot of materials purchased is used as the price or cost of the materials processed or sold. For example—a refiner who has purchased three lots of crude petroleum of 100,000 barrels each, the first at 75 cents, the second at $1, and the third at $1.25 a barrel may, under the last-in first-out method in determining the cost of his first hundred thousand barrels of refined products sold, use $1.25 per barrel as the cost of the crude which was used in manufacturing the refined product sold.

The producers of crude petroleum are asking for no more than other industries are receiving. OPA practice recognizes, in its cost finding, the cost of the last items acquired in pricing the first items produced or sold by a manufacturer, a merchant, or even a refiner of crude oil. OPA should give practical application of the same principle in its price fixing in arriving at the cost of crude oil sold. The theory which Mr. Green applies to crude oil does not contemplate cost finding for a going oil producing business, but for the recovery of capital in a liquidating business.

The price at which goods are sold was never based on the book earnings of any company. More than one method of accounting can be, and is, used in any one business. The various methods are applied as they relate to the purpose for which the accounting is made. They may not all be recorded in the books, but they are related to the books. Not all businesses make their cost-accounting records a part of the general books of account.

PERCENTAGE DEPLETION

Under the Internal Revenue Code, oil producers may deduct an allowance for depletion equal to 27½ percent of gross income, provided that it is not more than 50 percent of net income computed without benefit of depletion; however, in no case shall the allowance be less than the amount which would be allowable if calculated on cost.

An accurate calculation of cost depletion is a technical determination requiring special engineering and accounting skill, services which are not always available or can be afforded by smaller oil producers. Congress recognized this fact by adopting a provision permitting an alternative method, to make possible a determination of depletion in lieu of cost. Any special benefit over cost is highly questionable. Latest available Treasury Department statistics on corporations engaged exclusively in the production of crude petroleum (year 1940) indicate that for those corporations who reported net income, the average amount of depletion allowed—which in this case would be substantially percentage depletion—was 19¼ percent of gross income. Those corporations who reported a net loss, and therefore would use cost or "sustained" depletion, showed 18.8 percent of gross income. Mr. Green's opinion that the statutory provision is unduly favorable and that oil companies can recover costs "six times" is not substantiated by the official statistics of the Treasury Department.

Mr. Green states that oil in the ground is a fixed, or capital asset. Under the Internal Revenue Code only 50 percent of the net profit from the sale of a capital asset, as defined in the code, is subject to tax. The tax on this 50 percent of net profit is limited so that the total tax does not exceed 25 percent of the net profit on the sale. This tax provision is available to anyone, in or out of business, and regardless of the nature of the capital asset sold. This limitation of taxable profit and limitation of tax is a right given by Congress to all who recover their capital invested in a capital asset. Depletion is the calculated amount of capital recovered from a capital asset. Congress limits statutory depletion to 50 percent of net gain. No special privilege is granted to the oil industry. In fact, it does not receive benefits equal to those which may be obtained by any and all taxpayers upon the sale of a part or all of their capital asset.

ACCEPTED ACCOUNTING METHODS

Mr. Green filed in the record a letter addressed to him by Mr. Carman G. Blough, director of research, American Institute of Accountants, who, according to Mr. Green, was a former partner of Arthur Andersen & Co., a firm of certified public accountants. He also submits a letter from Eric L. Kohler, at one time a staff member of Arthur Andersen & Co.

I wish to express a high regard for the ability of both of these men and the firm with which they were at one time associated. I find, upon referring to published financial statements of some 30 or 40 of the largest petroleum companies, that Arthur Andersen & Co. are the auditors for the Texas Co., the Pure Oil Co., Skelly Oil Co., and Pacific Western Oil Corp., for the year ended December 31, 1944.

The notes of these auditors, made part of the consolidated financial statements for the Texas Co., show intangibles capitalized since January 1, 1934, with capitalized costs amortized "at the rate of 8 percent per annum" and "war emergency facilities * * * amortized at the rate of 20 percent per annum, both on the company's books and for Federal income-tax purposes," with inventories "at cost determined on the first-in, first-out method."

In the Pure Oil Co. notes relating to and made a part of the consolidated financial statements appears, "Inventories of crude and refined oils are priced at cost, on the 'last-in first-out' method. * * * As at April 1, 1932, the net ledger amount of the parent company's tangible properties was reduced * * * to reflect fair value as determined in an appraisal. * * * Since January 1, 1934 the company has provided for depletion * * * by applying to the total barrels produced an 'over-all' rate (per barrel) * * * estimated by the company's production engineers." *The president of the company said, "Under wartime conditions, it is difficult to provide adequately through normal accounting channels for complete costs incident to current operations."* [Italics supplied.]

In the Skelly Oil Co. statement appears the following: "Conforming to the company's established policy * * * intangible drilling costs are capitalized. These * * * costs are amortized * * * on the unit-rate-of-production method applied to individual oil and gas properties."

Pacific Western Oil Corp. statement shows intangible development costs were capitalized up to September 1, 1935. The company now provides a reserve currently from income in amounts equivalent to the intangible development incurred. In effect, the company writes off its intangibles currently through a reserve account.

This one firm of accountants, therefore, recognizes in its audits of four petroleum companies, four separate and distinct methods of accounting on one element of cost. In two companies where inventory methods were stated, each handled this element of cost differently. This is evidence of the fact that it is not the accounting firms who determine the method of accounting which is used. It is the management of a company that determines what method of accounting its company shall use. How, therefore, could OPA determine accurately from these four financial statements average costs of producing crude petroleum or net earnings, in accordance with its inflexible standards? Congress wisely provided that "relevant" factors should be considered.

OPA USE OF PARTIAL QUOTES MISLEADING

Mr. Green cites four provisions in the Internal Revenue Code which, in his "humble opinion," are "special provisions in favor of the oil companies." He submitted a letter from Mr. Carman G. Blough, director of research, American Institute of Accountants, in support of his attack on the merits of (1) percentage depletion, (2) write-off of intangible drilling and development costs, (3) write-off of excessive amounts of expense, and (4) separability of properties, and claimed that Mr. Blough's letter "specifically covers replacement costs and points out the indirect subsidy nature of these things."

I have read Mr. Blough's letter. I am unable to find where he specifically covered all of the above four opinions or made any reference to these items being an indirect subsidy. He specifically stated that his expressions were entirely personal and emphasized that he was not expressing any opinion as to the factors that should be taken into consideration in fixing of prices. With regard to percentage depletion, Mr. Blough writes that it is, "For the purpose, I believe, of inducing the risk of capital in the exploitation of natural resources," and, "It is not uncommon for companies to ignore the element of depletion in calculating their costs—other companies have treated all income as recovery of cost until the entire cost of the deposit is written off. Although neither of these two procedures is theoretically sound, one or the other may be necessary in some cases."

The position of the oil industry is in agreement with Mr. Blough, that certain established methods of accounting in the industry may not be theoretically sound. They may be necessary in the absence of what is theoretically sound, and in such case sympathetic and professional understanding of such problems should be given, rather than a condemnation of the industry and an attack on those provisions which Congress so wisely provided to meet such situations.

Mr. Blough further writes that "where the mineral is discovered after the property is acquired, so that the cost does not represent the fair value of the deposit at the time it is discovered, it has been considered proper to determine depletion charges on the basis not of the actual cost of acquiring the property, but on what might be called an alternative cost—that is, the amount which could have been obtained for the property had the discoverer chosen to sell it after its discovery."

Although Mr. Blough does not consider it proper accounting to treat as "cost" percentage depletion, he does recognize it to be proper accounting to treat discovery value as "alternative cost." A look at the record will show that one reason for percentage depletion was to provide an alternative method of computing depletion on discovery value, and therefore—to that extent—statutory depletion is "alternative cost." The theory behind "alternative cost" is not unlike that of replacement cost.

Mr. Blough did not comment on the write-off of intangible drilling and development costs and did not comment on replacement cost as it applies to current costs of finding and developing a barrel of new oil.

Mr. Green, in his extended remarks for the record, where he again attacks the merits of percentage depletion, turns for support to the thesis of Mr. Paul Foraste, of the Standard Oil Co. of New Jersey, on Depletion in the Oil Industry. This thesis, prepared in partial fulfillment of the requirements for the degree of master of commercial sciences, is based on a collection of data from 32 companies in answer to 38 questions sent out to 190 companies in the United States.

Mr. Green makes it appear that Mr. Foraste "pointed out," regarding percentage depletion, the Treasury Department's claim that "it is * * * a third loophole" and constitutes "favored treatment" of the oil industry.

Mr. Foraste in his thesis said, "To take sides in a public controversy is contrary to the author's purpose, and not within the scope of this thesis. Nevertheless, even a thoroughly impartial observer would feel compelled, after reading the foregoing excerpts from the Treasury's denunciation, to conclude either (*a*) that Congress has been wrong in this matter for 25 years, or (*b*) that there must also be many strong points in favor of percentage depletion. In other words, the principle had to have genuine merit in order to remain alive so long." Mr. Foraste cited at considerable length a summary of the testimony before the Ways and Means Committee in March and April 1942 by the cochairmen of the general depletion committee for the petroleum industry. Mr. Green did not quote that part of the thesis.

With regard to intangible drilling costs, Mr. Foraste, on page 25 of his thesis, says: "Three companies with exactly the same income and expenditures in a particular year can report widely different earnings for that year to their stockholders, depending upon which method they use to account for intangible development costs, *although there will be no difference in the long run*." [Italics supplied.]

He further said, "The right to charge intangible development costs to expense under the option is granted in recognition of the hazardous and speculative nature of the oil business, in order to encourage exploration and development of the country's oil reserves. That purpose, although clearly recognizable in periods like the present, when the need of expanded exploratory drilling effort is so urgent, *is sometimes overlooked by administrative officials*, with the result that attempts are made occasionally to eliminate or modify the regulation." [Italics supplied.]

Mr. Green's allegation in his third point, that the oil industry is permitted to write off excessive amounts of expenses for income-tax purposes, is contrary to fact and wholly without foundation. The source of Mr. Green's information on that subject is considerably confused or misinformed. The fourth point, "separability of properties," is a requirement and not a privilege. The principle is sound. It is applied generally in the calculation of depreciation or depletion of all separate properties in any industry.

None of Mr. Green's four points of attack on Internal Revenue statutes has any bearing on the subject of cost of finding, developing, and producing crude petroleum. The industry asked that replacement costs and prevailing established methods of accounting be considered. OPA said "No" to replacement costs and insisted upon uniform reporting of academic theoretical accounting formula. The many producers who cannot comply are offered no alternative by Mr. Green, but received instead, an unwarranted attack on their tax rights established 25 years ago in Congress, which have been reviewed and renewed several times in that period.

Mr. Green stated that the Treasury Department "told us this morning" that 95 percent of oil operators show cost depletion. I do not find any published Treasury statistics on that subject.

My observations—while an income tax auditor with the Treasury Department on natural resources cases for 5 years, and as petroleum specialist with the United States Tariff Commission on the Crude Petroleum Production Costs Survey of 1939–42 for 1 year, and through public and private practice in oil-field accounting for 20 years—are, that between 80 and 90 percent of the oil producers expense intangible drilling costs. A large percent record percentage depletion in lieu of sustained depletion. Many attempt to calculate an estimated sustained or cost depletion. Few make any attempt to estimate amortization of intangible drilling and development costs.

In rebuttal to my claim that the crude petroleum cost survey returns of 2,500 companies which came to the Tariff Commission show that the practice of the majority is to follow statutory depletion and write off intangibles, Mr. Green said on the following morning, "We looked into that a bit, and only a few of the 2,800 companies involved did not report sustained depletion." It is a physical impossibility overnight to make any such determination. The 2,500 companies submitted nearly 15,000 separate reports of two pages each—about 30,000 pages in all. I spent 1 year examining those returns as assistant in charge. I can say with full knowledge of the facts that many failed to report any depletion and that many did not report amortization of intangible drilling costs, indicating that their method of accounting made it difficult to supply such data.

I visited the offices of a large number of oil producers during that survey. The majority of the small oil producers whom I visited use percentage depletion and write off intangible drilling costs. Some find it difficult or impossible to calculate theoretical sustained depletion and theoretical amortization of intangible drilling costs, hence they are unable to provide OPA with accurate costs which conform to academic theories.

The Army, the Navy, or the Maritime Commission do not buy crude oil as such, and, therefore, in contract resettlements have no occasion to pass on the accounts of oil producers. They do buy refined petroleum products. Accountants in those branches of our Government recognize last-in first-outs costs of crude oil and petroleum products in determining proper contract prices on refined products purchased under Government contract. The principle of last-in first-out is in line with replacement costs which crude producers have requested OPA to consider in pricing crude oil.

Mr. Judd claims that ceiling prices have not prevented the independent oil producers from increasing their exploratory efforts during price-control years. He gives the following figures, to which I add percentages and average during price-control years, for comparison with 1941:

Exploratory wells completed

Year	Independents	Percent	Majors	Percent	Total
1941	2,616	83	519	17	3,135
1942	2,223		612		2,835
1943	2,476		819		3,295
1944	2,686	68	1,267	32	3,953
Average, 1942–44	2,462	73	899	27	3,361

This proves that the independent oil producers have not been able to increase their exploratory efforts under price control. In the 3 years of price control independents, according to Mr. Judd's figures, drilled an average of 2,462 exploratory wells per year, a drop of 154 exploratory wells per year below their prewar figure. The majors, according to Mr. Judd, "materially increased the number of wells drilled in 1944 over those drilled in 1941"—in fact, the majors more than doubled their exploratory well completions. This was made possible under OPA price control—and is further indication that that policy is aiding in the trend toward monopoly. The Petroleum Administrator for War stated 5,000 exploratory wells were needed in 1944 to make available adequate supplies of petroleum. Mr. Judd's figures show the industry was unable to reach that goal by over 1,000 exploratory wells, although the material was available.

The independents have not been able to increase their aggregate production. Domestic company interest production data for the 26 largest companies in the United States, 1941-44, is shown in the following table:

Crude petroleum—Net domestic company interest production (26 companies)

[Relation to total United States net crude petroleum production]

Company	Barrels			
	1941	1942	1943	1944
Amerada Petroleum Corp	12,312,065	11,720,489	13,565,124	17,881,741
The Atlantic Refinery Co	15,091,000	14,515,000	17,678,000	24,631,000
Barnsdall Oil Co	7,255,176	7,713,656	8,982,445	9,835,324
Cities Service Co	24,960,600	26,592,000	27,621,000	26,800,000
Continental Oil Co	29,904,247	30,396,466	29,544,272	31,566,564
Gulf Oil Corp	47,196,000	46,654,830	55,642,782	68,929,628
Honolulu Oil Corp	4,254,812	5,190,959	6,992,058	9,681,575
The Ohio Oil Co	24,059,327	27,743,046	29,774,889	31,941,680
Phillips Petroleum Co	24,277,686	23,065,624	24,698,189	28,584,412
Plymouth Oil Co. and Big Lake	3,965,395	4,226,913	4,869,585	5,083,058
The Pure Oil Co	25,164,000	25,040,000	26,233,000	31,200,000
Richfield Oil Corp	7,210,000	7,200,000	7,400,000	8,236,000
Seaboard Oil Co. of Delaware	4,139,112	4,661,308	6,932,000	8,222,000
Shell Union Oil Corp	55,638,685	60,041,039	67,708,000	72,395,000
Sinclair Oil Corp	27,241,009	36,049,052	26,255,160	27,354,222
Skelly Oil Co	9,827,541	9,818,590	11,191,632	12,621,279
Socony-Vacuum Oil Co	52,095,893	51,690,071	56,399,485	61,707,600
Standard Oil Co. of California	36,196,361	43,974,763	52,695,140	63,410,000
Standard Oil Co. of Ohio	163,885	681,820	2,062,250	3,771,630
Standard Oil Co. of Indiana	38,165,109	40,480,720	50,954,002	62,682,503
Standard Oil Co. of New Jersey	79,984,799	79,141,033	108,763,000	134,874,000
Sun Oil Co	13,609,650	12,979,202	18,122,142	24,624,224
Superior Oil Corp	13,138,212	13,441,000	13,843,000	16,000,000
The Texas Co	73,866,000	65,310,919	71,900,500	83,833,215
Tidewater Associated Oil Co	23,829,960	24,668,491	27,520,603	31.165,770
Union Oil Co. of California	15,494,000	18,073,000	21,719,000	24,688,000
Total, 26 companies	669,039,924	681,069,982	789,067,258	921,720,425
Increase over 1941		12,030,058	120,027,334	252,680,501
Total United States net (85.5 percent of gross)	1,198,904,940	1,185,581,475	1,287,299,115	1,434,478,815
Percent 26 companies net to United States net	55.80	57.45	61.30	64.25
Total United States net increase over 1941		(13,323,465)	88,394,175	235,573,875
26-company percent of total United States increase over 1941			135.79	107.26

Source: Moody's or company financial statements.

NOTE.—Where companies report gross, net is estimated.

PRODUCTION INCREASES

Crude-petroleum production in the United States in 1944 was 19.6 percent greater than in 1941, an aggregate increase of 275,000,000 barrels, or 750,000 barrels daily.

Excluding royalties paid to landowners, farmers, and others, the producing oil companies' net domestic increase in production in 1944 over 1941 was 236,000,000 barrels.

Twenty-six companies account for an increase in net domestic crude production in 1944 over 1941 of nearly 253,000,000 barrels, which means that in the aggregate the remainder of the 20,000 oil producers are producing less oil now than before the war, at higher cost per barrel. With a frozen price at 1941 level, there could not be any over-all increase in earnings to this large group of oil producers.

In 1943 just seven companies increased their net domestic crude production over 1941, in an amount which is greater than the whole increase in net United States domestic production in that period. In 1944 the number of companies accounting for a production increase equal to the total United States increase would not exceed 20 companies.

In 1941, 26 large oil companies produced 56 percent of the total United States net crude production. In 1944 these same companies produced 64 percent of the total United States net production in that year. On the basis of 1941 production, the 26 companies in 1944 produced an amount equal to 77 percent of the 1941 United States net production—another evidence of the trend toward monopoly.

SUPPLY AND DEMAND REQUIREMENTS

The demand for petroleum during the first 5 months of this year to meet war requirements and rationed allowances was nearly 5½ million barrels daily. Current demand still exceeds that figure. The Petroleum Administration for War has announced that there will be no reduction in demand until the war in the Pacific has been won.

PRODUCTION

To fill the first quarter demand, 4,777,000 barrels of crude and 317,000 barrels of natural petroleum products, or 5,094,000 barrels of all petroleum were produced daily. Crude production is now about 4,870,000 barrels daily, with natural products about 350,000 barrels daily, or a total daily production of all crude and natural of about 5¼ million barrels daily.

MAXIMUM EFFICIENT RATE EXCEEDED

Production in the first quarter was running 250,000 barrels daily in excess of the maximum efficient rate; therefore, it is currently about 350,000 barrels daily in excess of maximum efficient operating levels.

SHORTAGE

Production failed to meet requirements in the first quarter by 380,000 barrels daily. The shortage in April and May averaged more than 400,000 barrels daily. Withdrawals from above ground stocks and imports met the balance of requirements.

STOCK DECLINE

To meet the shortage in the first quarter withdrawals from storage averaged 200,000 barrels daily. Withdrawals continued through April and May at an average of over 170,000 barrels daily.

ABOVE GROUND STOCKS BELOW WORKING LEVELS

Stocks of crude petroleum are about 227,000,000 barrels. All petroleum stocks are about 448,000,000 barrels. Both crude stocks and products stocks are below their minimum efficient working levels. Crude is over 8,000,000 barrels below a proper working level.

Well completions—Total exploratory and development well competions, 1937–44

Year	Total well completions [1]	Allocation	
		Exploratory completions [2]	Development completions [3]
1937	31,106	2,224	28,882
1938	27,149	2,638	24,511
1939	25,888	2,589	23,299
1940	28,094	3,038	25,056
1941	29,070	3,264	25,806
1942	18,151	3,219	14,932
1943	17,884	3,843	14,041
1944	23,106	4,796	18,310
5-year average, 1937–41	28,261	2,751	25,510
3-year average, 1942–44	19,714	3,953	15,761

[1] Bureau of Mines.
[2] F. H. Lahee, Sun Oil Co.
[3] Calculated.

NOTE.—Basis of classification of exploratory wells as reported here differs from the basis used in Mr Judd's table on exploratory wells.

EXPLORATORY AND DEVELOPMENT EFFORT IS INADEQUATE

I submit a table showing a few items relating to price, reserves, production, and well completions by periods; first, the 14 years 1917–30, a representative period of economic gain in the industry benefiting materially the Nation. The depression period of 1931 to 1941, covering 11 years, is followed by the data for the combined 25-year period. The OPA base period of 1936 to 1939 is set out. then the years 1940 and 1941 separately, and concluded with the war price-controlled years 1942 to 1944.

The 14-year period of an average normal price added an average of nearly a billion barrels of crude annually during that period to our oil reserves in excess of production. In the 11 years the depressed price brought us only an average of slightly over 400,000,000 barrels excess reserves annually, or throughout the 25 years' exploratory activities we were rewarded with an average of about 750,000,000 barrels excess reserves per year. That was the backlog built up with which we have won the first phase of our war. The 1936–39 period found us some excess reserves over production nearly 700,000,000 barrels on the average annually, but in 1940 that fell to about 300,000,000. In 1941 production exceeded reserves found by over 200,000,000 barrels, and in the war OPA controlled years of 1942 to 1944 we have produced on the average in each of those years over 730,000,000 barrels more oil than we found. All reserve figures used take into consideration estimated ultimate reconverable reserves, with proper allowance for expected future revisions and extensions.

Production continued to climb feeding on the backlog of excess reserves. However, the effort to replace those reserves has continually declined as indicated by over-all well completions. Exploratory or wildcat activity is best measured by the number of dry holes drilled. In 1917 to 1930 we averaged 6,348 dry holes annually, or 1 dry hole to every 103,000 barrels of production. Since the war, through limitations on material, manpower, and money, we averaged 6,273 dry holes annually, 1 to every 243,000 barrels produced.

In 1917–30 we averaged an annual addition of 9,900 producing oil wells per annum. In the 1942–44 war period, the average additional oil wells was 3,000.

In 1917–30 we averaged annually abandonments of 6,600 producing oil wells. In the price-controlled years of 1942–44, the average has exceeded 7,700.

Over the last 20-year period we found 25 barrels of oil reserves to each foot of well drilled. We drilled in that period 1 foot of well to every 15 barrels produced. On this basis, to maintain a normal production of 1½ billion barrels of crude oil, we should drill not less than 100,000,000 feet of hole. A normal average well depth is approximately 3,000 feet. This would indicate that we should drill no less than 33,000 wells per annum to maintain in this Nation an adequate backlog of producible petroleum reserves and an adequate available supply of crude oil to meet civilian and security requirements of this Nation.

"The cost of producing wells completed increased from an average of $30,000 in 1942 to $47,000 in 1943 and $66,500 in 1944," per Humble Oil & Refining Co. in its 1944 annual statement. On this basis, it appears that the petroleum industry must have funds to plough back into the business, in acquisition of properties, exploration and development of petroleum reserves, over 1½ billion dollars annually—to say nothing of lifting costs and a fair margin of profit. To accomplish the job the national average price of crude oil may have to be between $1.80 and $2 per barrel.

Crude petroleum—Average price per barrel, reserves discovered, production, well completions, additions, and abandonments, by stated periods

	1917 to 1930, inclusive, 14 years	1931 to 1941, inclusive, 11 years	1917 to 1941, inclusive, 25 years	1936 to 1939, inclusive, 4 years	1940	1941	1942 to 1944, inclusive, 3 years
Average price, per barrel, during period	$1.66	$0.98	$1.36	$1.11	$1.02	$1.14	$1.20
New reserves, extensions and revisions (API), million barrels, average per annum during period	1,209	1,641	1,399	2,734	1,893	1,969	1,810
New crude-oil reserves discovered, revised to revert extensions and revisions back to year of discovery and include estimated future extensions and revisions 1917–33 per H. J. Struth, 1934–44 per PAW, million barrels, average per annum during period	1,607	1,534	1,5757	1,887	1,664	1,186	793
Average annual production, million barrels	659	1,096	852	1,215	1,353	1,402	1,523
Average annual excess new reserves discovered over average annual production, million barrels	948	438	723	672	311	(−216)	(−730)
Average annual number of well completions:							
Oil	16,593	15,254	16,004	19,137	19,125	19,195	11,090
Gas	2,355	1,882	2,147	2,161	2,352	2,990	2,350
Dry	6,348	5,216	5,850	6,029	6,617	6,885	6,273
Total	25,296	22,352	24,001	27,327	28,094	29,070	19,713
Average number of barrels produced from old producing oil wells as related to each new well completion:							
Total wells	26,052	48,800	35,499	44,462	48,160	48,228	77,259
Dry holes	103,812	210,012	145,641	201,526	204,473	203,631	242,786
Average number of new productive oil wells placed in operation each year during period	9,926	6,263	8,314	9,850	8,620	10,950	3,680
Average number of producing oil wells abandoned each year during period	6,667	8,982	7,690	9,287	10,505	8,245	7,710

RATE OF FINDING NEW RESERVES

On the basis of API new reserves plus extensions and revisions, and using Bureau of Mines total well completions, we drilled on an average of 10.9 wells (1937–44) to find a million barrels of reserves.

Using API reserves and F. H. Lahee wildcat completions, in the 5 prewar years we drilled 4.9 wildcats to find a million barrels of new reserves. In the 3 price-controlled years of 1942–44 it required on an average of 11.3 wildcats to find a million barrels of new reserves, or 2⅓ times as many wells. However, the 3 price-controlled-year rate (1942–44) of 11.3 wells per million reserves is 4.7 times greater than the 2.4 wells required to find a million barrels of reserves in 1937.

Revisions and extensions as reported by API related to development wells (total completions less F. H. Lahee's wildcat wells), indicate additional reserves were developed 1937–41 at a million barrels to 12½ wells. In 1942–44 we drilled 10.8 wells in developing a million barrels of oil, yet the industry was unable to drill an average of 9,750 development wells each year.

EXHIBIT G

OPA Form 652-2223
(2-45)

Budget Bureau No. 08-R4509
Approval expires July 31, 1945

UNITED STATES OF AMERICA
OFFICE OF PRICE ADMINISTRATION
PETROLEUM PRICE BRANCH
WASHINGTON, D. C.

CRUDE PETROLEUM PRODUCTION REPORT

DEAR SIRS: The Committee on Small Business of the House of Representatives in the sixth interim report of the committee recommended that the Office of Price Administration survey the current costs of producing crude petroleum. A similar recommendation, coupled with a request for an increase in ceiling prices, was made by a number of crude oil producers. In accordance with these recommendations the National Crude Oil Industry Advisory Committee, representative of the various segments of the crude oil producing industry and of the oil producing regions of the United States, was formed for the purpose of advising and consulting with the Office of Price Administration.

The Industry Committee met with the Office of Price Administration and agreed that the proposed survey should be made as soon as possible. A subcommittee was appointed from the general committee to assist in drafting the form to be used in the collection of the data and to advise in the selection of the list of producers to which the reports should be sent.

It is the position of this Office that it is necessary to obtain data on earnings, both currently and for prewar years. It is the position of the National Crude Oil Industry Advisory Committee that the cost of replacing oil reserves should be fully considered. The Industry Committee wishes, therefore, to obtain information which will show expenditures made for finding and developing oil reserves.

This report form is being circulated in order to develop adequate data upon which to base fair decisions. Your operation is one of a small sample of crude oil producers, carefully selected as representative of the industry. We concur with the belief of your Industry Committee, therefore, that it is incumbent upon you to cooperate in making this study. We hope that every recipient will return this form. Unless a sufficiently large percentage of the forms is returned, we shall not be able to use the information received as a basis for determining the position of the industry as a whole.

We shall, of course, treat all reported data as strictly confidential, and the material obtained will be made available in over-all totals only so that the identity of information from any reporting company will not be disclosed.

The Office of Price Administration welcomes this study as a means of obtaining information on the current problems of the industry, and on any measures which may be necessary for the effective prosecution of the war. We wish to assure you that your cooperation will be appreciated not only by this Office but also by the National Crude Oil Industry Advisory Committee.

Very truly yours,

ORVILLE D. JUDD,
Associate Director, Fuel Price Division.

GENERAL INSTRUCTIONS FOR COMPLETING SURVEY REPORT

1. Please fill out this form in full and return one certified copy to the Office of Price Administration, Petroleum Price Branch, Washington 25, D. C., not later than May 1, 1945. Two extra copies of the form are enclosed for your own use. Additional copies may be secured upon request. The report should be typewritten; however, where long carriage machines are not available, the report may be written.

2. This report is to cover only the net company working interest in leased and other properties producing domestic crude petroleum. Submit but one report to include your entire domestic production activities, regardless of the number of pools or fields in which you operate. In case you have ownership in other producing corporations, submit data for your company only. Separate reports on crude-oil production are being requested from subsidiaries and affiliates. If you own a controlling interest (50 percent or more) in another company producing crude petroleum, we wish to obtain data from this company. Accordingly, if you are not advised in an accompanying letter that your subsidiary corporation is being asked to report, kindly inform us and copies of this form will be mailed to your

subsidiary. Include for the periods covered in this report, data on operations of former subsidiaries or affiliates that have been absorbed by merger or otherwise. Dry gas *only* wells and/or leases are not to be reported. All statistics, income, costs, and assets relating to dry gas operations are to be excluded.

3. The information reported should cover all of your domestic production operations by year for the years 1936 through 1944, except 1940. Producers operating on a fiscal year ending July 31 or later should report in each column the data for the fiscal year ended in the year called for by the columnar heading. Those whose fiscal year ends earlier than July 31 should report in each column the data for the fiscal year which ended in the calendar year immediately following the year indicated in the columnar heading and should change the headings accordingly. In the latter case, the figures for 1944 should cover as many months of the fiscal year ending in 1945 as are available when the report is prepared and the number of months should be clearly indicated if less than 12. The month and day on which the fiscal year ends, if other than December 31, should be inserted in the space provided in the headings.

4. Cents and fractions of barrels should be omitted.

5. Instructions for individual items of the report are on Page 4. All instructions should be read carefully before filling out the report. Please communicate promptly with the Office of Price Administration about any item or instruction which you do not fully understand.

PLEASE READ CAREFULLY INSTRUCTIONS ON PAGES 1 AND 4 BEFORE FILLING OUT THIS REPORT

Item	Year ended Dec. 31 or							
	1936	1937	1938	1939	1941	1942	1943	1944
A. Well and engineering data:								
1. Average number of wells producing during each period								
2. Productive wells (net company working interest only):								
(*a*) Number completed during each period (exclusive of wells purchased)								
(*b*) Average depth (in feet)								
(*c*) Estimated oil reserves (net company working interest) of productive wells completed each period (in barrels)								
3. Dry holes:								
(*a*) Number completed each period								
(*b*) Average depth (in feet)								
4. Input and service wells drilled for that purpose during each period								
5. Exploratory wells (included in A-2 (*a*) and A-3 (*a*) above):								
(*a*) Number of exploratory wells drilled each period								
(*b*) Average depth (in feet)								
B. Production in barrels:								
1. Net company working interest domestic crude oil produced								
2. Add, royalty oil including overriding royalties applicable (line B-1)								
3. Total (lines B-1 and B-2)								
C. Value of oil and other production income:								
1. Sales value of oil shown on line B-1								
2. Subsidy value accrued on oil shown on line B-1								
3. Gas sales from oil properties (net company working interest)								
4. Other production income								
5. Total (lines C-1 through C-4)								
D. Production, development, and finding costs:								
1. (*a*) Production costs								
(*b*) Overhead applicable to production—from line D-5 (*a*)								
(*c*) Total (lines D-1 (*a*) and D-1 (*b*))								
2. (*a*) Development cost of productive oil wells completed during each period [1]								
(*b*) Overhead applicable to development—from line D-5 (*b*)								
(*c*) Total (lines D-2 (*a*) and D-2 (*b*))								
3. (*a*) Expenditures during each period which relate to finding oil [2]								
(*b*) Overhead applicable to exploration—from line D-5 (*c*)								
(*c*) Total (lines D-3 (*a*) and D-3 (*b*))								
4. General and administrative expense and other overhead not included in lines D-1 (*a*), D-2 (*a*), and D-3 (*a*)								
5. Distribution of overhead:[3]								
(*a*) Prorated to production costs (insert on line D-1 (*b*))								
(*b*) Prorated to development costs (insert on line D-2 (*b*))								
(*c*) Prorated to finding costs (insert on line D-3 (*b*))								

E. Production expense:								
1. Operating expense								
2. Exploratory and dry-hole costs written off								
3. General and administrative expenses								
4. Depletion of leasehold and land costs								
5. Depreciation of tangible assets								
6. Intangible drilling and development costs:								
(a) Amortization, if capitalized								
(b) Expenditures, if written off currently								
7. Total (lines E-1 through 6 (b))								
F. (Do not make any entries on this line):								
G. Officers' or owners' compensation:								
1. Included in line E-7								
2. Charged to fixed assets used in production								
3. Total (lines G-1 and 2)								
H. Crude oil production assets:								
1. Fixed assets:								
(a) Leaseholds and land								
(b) Equipment, buildings, etc								
(c) Intangible drilling and development								
(d) Other (specify)								
(e) Total (lines H-1 (a) through (d))								
2. Inventories of crude oil, materials and supplies								
3. Total (lines H-1 (e) and H-2)								
4. Reserves for fixed assets:								
(a) Depletion of leaseholds and land								
(b) Depreciation of tangible assets								
(c) Amortization of intangible drilling and development costs								
(d) Other (specify)								
(e) Total (lines H-4 (a) through (d))								
5. Lines H-3 minus H-4 (e)								

[1] Include intangible drilling and development cost, well and lease equipment, and all other expenditures directly applicable to drilling all the wells shown on lines A-2 and A-4 in the respective periods.

[2] Include geophysical, geological, core drilling, land and lease expenses, cost of nonproductive leases acquired, and other lease costs, cost of dry holes completed and all other costs incurred which relate to exploration, including lease rentals and dry-hole contributions.

[3] The overhead as reported on line D-4 should be prorated to production, development, and finding costs above, on the basis of the total direct cost reported on lines D-1 (a), D-2 (a), and D-3 (a).

I. Accounting practices: Indicate the accounting practices followed since 1920 for corporate or general accounting purposes with respect to the capitalization and/or the expensing of the following costs: [4]	Expensed		Capitalized	
	From—	To—	From—	To—
1. Intangible drilling and development costs	19......	19......	19......	19......
(a) Productive wells	19......	19......	19......	19......
(b) Dry holes	19......	19......	19......	19......
2. Geological and geophysical costs	19......	19......	19......	19......
(a) Work leading to acquisition or retention of properties	19......	19......	19......	19......
(b) Other work	19......	19......	19......	19......
3. Leaseholds	19......	19......	19......	19......

I certify that the statements contained herein are true and correct to the best of my knowledge and belief.

Sign here ....
(Name of owner, partner, or corporate officer)

....
(Title) (Date)

[4] If the space provided on the form is insufficient to permit full disclosure of changes in accounting practices with regard to intangible drilling and development, geological, geophysical and leasehold costs, please submit an additional statement under your company's letterhead.

INSTRUCTIONS FOR INDIVIDUAL ITEMS IN REPORT

A. Well and engineering data.

The number of wells reported in this section should be adjusted to correspond to the proportion of the net company working interest owned.

Line A–1: Insert here, for each period, in net company working interest proportion, the yearly average of the number of oil and distillate wells producing each month.

Line A–2 (c): Report here only the net company working interest oil reserves expected to be recovered from wells completed during each period, as reported on line A–2 (a). The estimated recoverable oil reserves should be based on latest data available, applied retroactively. Exclude reserves estimated for undrilled locations, wells completed in previous years, and wells purchased.

Line A–5 (a): Report here all exploratory wells whether productive or dry which are included in lines A–2 (a) and A–3 (a).

B. Production in barrels.

Line B–1: Report here the quantity of net company working interest in merchantable oil produce by the wells reported on line A–1, the operating expense of producing which oil is reported on line E–1.

C. Value of oil and other production income.

Line C–1: Report here the sales value of net company working interest oil reported on line B–1. If the oil is processed in your own refinery, compute the value at posted prices in effect when the oil was produced. If no posted price was in effect for a given field, use "going" selling price to arrive at sales value of company working interest oil produced in such field. Do not include on this line any subsidies received or accrued. Do not deduct any production or severance taxes; these should be included in lines D–1 (a) and E–1.

Line C–2: Report here subsidies on oil included in Line B–1 sold after July 31, 1944.

Line C–3: Report here sales value at well of casinghead gas produced coincidently with crude oil, where this gas was sold or transferred to gasoline plants or elsewhere. If any such gas was consumed in producing oil or drilling wells and was charged to operating or development costs, the resultant credits should be included here.

Line C–4: Report here any other income strictly incidental to producing crude oil, such as equipment rentals, sales of water or steam, etc.

D. Production, development, and finding costs.

The purchase price of properties which were producing when acquired and all charges in amortization thereof should be excluded from this section.

In the case of partnership or sole proprietorship, where no salaries are recorded in the accounting records for the services of the owners, include a reasonable estimate of the value of the personal services actually rendered by such owners.

Lines D–1 (a), 2 (a), 3 (a), and 4 should in no case include any of the same items of cost, as they represent four separate and distinct functions.

Line D–1 (a): Report here lifting costs and all other costs which are directly applicable to the production and sale of oil, as distinguished from drilling of wells and exploratory activity. Such costs include labor, field supervision, repair and maintenance, fuel, power and water, small tools and supplies, bailing, shooting and acidizing, cost of treating oil, teaming and trucking, insurance, taxes (including production and ad valorem taxes, but not including Federal and State income and excess-profits taxes), etc. Field supervision includes superintendence, if any, and expense of maintaining a field office. Producers whose accounting systems do not provide for charging productive properties directly with items such as pay-roll taxes, workmen's compensation insurance, pension-plan costs, etc., should include such items through allocating on some appropriate basis. Where an operator performs work on the lease without direct compensation, an estimated amount based on the prevailing wage for the class of work done may be included in production costs.

Do not include depreciation, retirement losses, or other charges in amortization of equipment or facilities of the kind that would be included in "Development cost" reported on line D–2.

Line D–2 (a): Report here all expenditures or other costs (total cost without regard to year incurred) for productive oil wells completed during year. Include with respect to properties under development, cost of general lease or field equipment or facilities, input or service wells, pumping equipment or other installations during year of completion, and of depreciation or usage charges on all company-owned equipment used in drilling but not required for producing. Pay-roll taxes, workmen's compensation insurance, etc., related to productive drilling, also should be included. The costs shown on this line should relate only to the wells reported on lines A–2 (a) and A–4 and to the oil reserves reported on line A–2 (c). The reporting companies are not expected to make a detailed analysis of their investment account to obtain figures reported on line D–2 (a) but may use book figures as reflected by control accounts or other records covering development, provided such figures will be reasonably accurate in reflecting the total cost, exclusive of finding costs, of all producing wells completed during the period.

Line D–3 (a): Report here all expenditures each year which relate to finding oil, whether capitalized or expensed. Include depreciation (but exclude cost) of equipment used in geophysical or other exploratory work. Include depreciation or usage charges on all company-owned drilling equipment used in drilling dry holes. Insofar as practicable include pay-roll taxes, workmen's compensation insurance, and other expenses directly related to exploratory work.

Line D–4: After directly allocating, insofar as such direct allocation is practicable, expenses and charges to producing, development, and finding costs as reported on lines D–1 (a), D–2 (a), and D–3 (a), report here the remainder of all general company overhead of the crude-oil production department. Include salaries and office expenses (including district or division offices if any), depreciation of furniture and fixtures and other general equipment, general taxes such as capital stock, franchise, etc. Do not include interest or State and Federal income and excess-profits taxes.

E. Production expense

In this section should be reported for each period all amounts relating directly to operating expenses, development, and finding of oil which have been charged to profit and loss on the operator's corporate or general books of account, with the following exception:

i. All interest and financing expenses, gains or losses in securities, etc., and State and Federal taxes on income and excess profits should be excluded;

ii. Any large amounts charged or credited to profit and loss applicable to prior years should be reported if practicable under the years to which they are properly applicable;

iii. Debits or credits made to surplus or capital accounts or reserves established from surplus, applicable to items called for in this section, should be included to the extent that they relate to the reporting periods called for.

iv. If your general accounts show depletion or amortization of emergency facilities other than on the basis of actual, sustained cost, the amounts reported herein should be adjusted to reflect actual cost.

Expenses and charges in this section should be reported as closely as possible in accordance with the classification requested; but to the extent that such break-down is not readily available, items may be grouped and totals shown. No amounts should be duplicated by being reported on more than one line.

Line E–1: Report here all direct operating costs of lifting oil, such as labor, field supervision, repairs and maintenance, fuel, power and water, small tools and supplies, cleaning out (bailing, shooting, and acidizing), cost of treating oil, teaming and trucking, insurance, taxes (including production and ad valorem taxes), etc. Field supervision includes superintendence, if any, and expense of maintaining a field office. Operating costs should include all expenses and charges incidental to the operation of wells, such as pay-roll taxes, workmen's compensation insurance, pension-plan costs, etc. Where an operator performs work on the lease without direct compensation, an estimated amount based on the prevailing wage for the class of work done may be included in operating costs.

Line E–2: Report here all expenses relating to the exploration for new oil reserves which were charged off during each period, including dry-hole losses, dry-hole contributions, and undeveloped leases abandoned.

Line E–3: Include here general salaries and office expenses (including district or division offices, if any). If engaged in activities other than the production of oil, include under this heading that portion of general and administrative expense, including insurance and general taxes, allocated to the crude-oil-production department. Also report here any portion of your engineering, geological and geophysical, land and lease department expenses, and lease rentals, which was not included in line E–2 or charged to fixed assets. Do not include interest or other nonoperating expenses or State and Federal income and excess-profits taxes. In the case of partnerships or sole proprietorships, where no salaries are recorded, in the accounting records for the services of the owners include a reasonable estimate of the value of the general services rendered.

Line B-4: Report here for each period the amounts chargeable to depletion on the basis of actual, sustained cost. The depletion charge may be calculated as follows: For each period, divide the number of barrels produced by the recoverable reserves; apply this ratio to the unamortized general ledger balance of actual land and leasehold costs after deducting any residual land values. Write-offs of unamortized land and lease costs of developed properties abandoned should also be inclued in this line.

Line E-5: Report here for each period the amounts chargeable to depreciation of tangible producing plant and equipment such as derricks, casing, tubing, rods, pipe and fitting tanks, buildings, etc. Compute depreciation on the basis of actual cost, less salvage value, spread over the estimated useful service life of the property. Also include here charges made for losses on tangible equipment on developed properties abandoned.

Line E-6: Report here for each period amounts charged off covering intangible drilling and development costs of productive wells. If it has been your practice to capitalize these costs, report amortization, computed on the basis of actual cost, on line E-6 (a). If these costs have not been capitalized report expenditures for this purpose on line E-6 (b).

G. Officers' and owners' compensation

Line G-1: Report here all compensation to officers or owners which was included directly in expenses reported in section E.

Line G-2: Report here compensation, if any, to officers or owners which was charged to fixed assets.

H. Crude oil production assets

Report here fixed assets, inventories, and related reserves devoted exclusively to domestic production of crude oil, as carried on your corporate or general books of account as of the close of each period. Where intangible drilling and development costs have not been capitalized, the total of such amounts expended on all properties productive at the end of each period should be included in both lines H-1 (c) and H-4 (c), if such amounts can be approximated with reasonable accuracy from records readily available. The assets reported should be those used in relation to all operations in other sections of this report. Assets of former subsidiaries or affiliates that have been absorbed should be included for the periods prior to such absorption.

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