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FEBRUARY 4, 1977

SENATOR RADER: The joint hearings of the Alaska State Legislature relative to the sale of royalty gas will come to order.

We've been asked to announce that smoking in the courtroom is absolutely prohibited, and no beverages are permitted in the courtroom, or food either. I don't know if that's any problem, but if it is, be advised.

Today, as we announced yesterday, we're going to go first through our experts, the committee experts that have not yet testified. At the conclusion of that testimony we will consider further public testimony. I'll leave it up to the committee at that time to decide what they want to do, if they want to reopen public testimony at this time, or else request those members of the public who have not testified to submit their testimony independently to the Senate Finance, or Senate Resources Committee, or to the House Resources Committee.

This will be the last session of the joint hearings. Representative Gruening will hear from the Department of Resources and such others as the House determines, I guess next week or thereafter, at their pace; and the Senate will do the same, except that the Senate Committee will at least reconvene here at 10:00 o'clock Monday morning, primarily for the purposes of a

1 review and a rebuttal by our Department of Administration,
2 Attorney General's office, and whatever, concerning
3 misstatements that may have been made or positions that
4 are unclear, and also submit themselves to questions
5 by the committee members and, of course, other Senators
6 on any questions of which we have reason to question
7 their earlier statements or need clarification.

8 Representative Gruening, did you have any further
9 announcements as to your committee?

10 REP. GRUENING: I guess not.

11 SENATOR RADER: We'll first take up Dr. Carl Swanson. Doctor,
12 would you please identify yourself, give us a resume of
13 your background, your position, and I would suggest that
14 you go through your report and outline to us those portions
15 of your report which you think are most important to us,
16 and then open it up for questions. Would that be
17 appropriate with you?

18 DR. SWANSON: That would be very appropriate. I have some
19 remarks that I've outlined here which I'd like to give
20 to summarize the report, as well as a few remarks on issues
21 that have been raised during these hearings upon which
22 I'd like to comment. Would that be appropriate for me
23 to do?

24 SENATOR RADER: That would be appropriate. I'd like to have
25 your background read into the record first.

1 DR. CARL SWANSON: My name is Carl Swanson, I am Executive
2 Vice President of Jensen Associates, Inc., which is an
3 economic consulting firm with offices in Boston, Washington
4 and Geneva, Switzerland. The company specializes in
5 economic analyses, forecasting, pricing, analysis of
6 investments, advice on contracts, occasionally testimony
7 before various Congressional regulatory bodies, or
8 Legislative bodies, in matters of world oil, natural
9 gas, natural gas liquids, and occasionally some work on
10 electricity prices.

11 My educational background is at Massachusetts
12 Institute of Technology where I received a Bachelors Degree
13 in Economics and Engineering, and a PhD in Management.
14 I taught for five years at the Sloan School of Management,
15 at M.I.T. as an Assistant Professor. More recently I
16 have been a consultant, since that time.

17 In my consulting, relevant to the issues that you
18 face, I have assisted in the staff work, backing up,
19 price negotiations on long-term LNG projects, I have
20 performed analyses for computer simulation models of the
21 logistics of moving LNG from the liquefaction line across
22 the Atlantic Ocean to receiving terminals, into distribution
23 systems, and to the burner tip. I have assisted industrial
24 buyers under Order 533, analyzed supplies of natural gas
25 and contracts that are offered to them. We have assisted

1 producers in analyzing their contracts, producers in
2 analyzing their gas contracts, in order to see if they're
3 well protected. I have looked at supply and demand of
4 natural gas in the United States and impact upon curtail-
5 ments. I have forecast the world-wide supply and demand
6 to 1985 of propane and butane, that is liquefied petroleum
7 gases, and lastly, relevant to your concerns my firm and I
8 have analyzed the gaseous fuel markets in the states in
9 the northeast quadrant of the United States in order to see
10 the impact of price upon the demand for natural gas and
11 for propane by industrial consumers.

12 That's my background, and I think what I'd like
13 to do is briefly summarize the report which has been,
14 I believe, distributed to the committee and is available
15 to anyone else. Should I identify this report, Mr. Chairman?

16 SENATOR RADER: I would like to have the report made an exhibit
17 in our proceedings. Would the reporter inform us as to
18 the exhibit number.

19 MS. SANDERS: 16.

20 SENATOR RADER: Exhibit No. "16" will be the "Economic Analysis
21 of Alaskan Royalty Gas Contracts" to the State of Alaska
22 by Jensen Associates, Inc., consisting of some forty-four
23 pages, dated January 1977. Therefore, any matter which
24 the Doctor omits in his testimony will be available in
25 the supplement, or in the exhibit. Would you proceed,

1 Doctor?

2 (Whereupon Exhibit "16" was duly marked.)

3 DR. SWANSON: First let me summarize the report. There is a
4 summary of the report on the first four or five pages,
5 which you may already have read, and I will essentially
6 go through that summary.

7 Let me first, before I continue, identify who
8 I'm representing. We were hired, Jensen Associates, Inc.,
9 were hired by the Legislative Affairs Agency on behalf
10 of you ladies and gentlemen, the Legislature, to assist
11 you in analyzing the contracts that you are now considering.
12 Our mandate was to see if the contracts protect the
13 interests of Alaska. We did not address ourselves to the
14 legal issues; we confined ourselves to economic issues
15 as appropriate to business ---

16 SENATOR RADER: Excuse me, Doctor, let me interrupt you.

17 I do see some members of the Legislature, and I want to
18 invite you to seat yourselves at the front tables here,
19 if you would care to. It will be easier to participate
20 in the questioning and also address the witness.

21 I'd ask, do we have a page. We're supposed to
22 have a page here. When we get one I was going to ask
23 the page to invite other legislators who may come in
24 at a later time to come forward.

25 Proceed, Doctor, I'm sorry for the interruption.

1 DR. SWANSON: Thank you. We looked at this contract from two
2 points of view, or we asked two questions. One question
3 we asked was, if the El Paso project is not approved
4 has the State preserved itself the right to protect its
5 royalty gas and interest through provisions which allow
6 it to terminate the contract. The answer to that question
7 is yes.

8 The second question we asked is, if the El Paso
9 project or any pipeline project which the Governor would
10 like to support is approved, does this contract protect
11 the economic interests of Alaska; that is, if this contract
12 is in force is Alaska protected. We examined three dif-
13 ferent respects in which Alaska might be protected, and
14 one of them is, can Alaska use the gas within its own
15 state. Secondly we asked, are its interests in the natural
16 gas liquids protected. Thirdly we asked, will Alaska,
17 under the terms of this contract, receive a favorable
18 price.

19 Let me take those questions in order. First, I
20 think this contract has extremely well designed provisions
21 to allow Alaska to reserve natural gas from Prudhoe Bay
22 for its own use. The terms on reservations are unambiguous,
23 and Alaska with what I consider to be short notice, two
24 years, can take back to itself one hundred percent of the
25 royalty gas.

1 Secondly, there is a provision in the contract
2 which allows Alaska to exchange royalty gas for gas which
3 may be more proximate to its markets and use the royalty
4 gas, taking back the royalty gas in paper at least, in
5 order to trade for gas which may be more available to it.
6 This exchange provision provides a great deal of flexibility
7 to the State of Alaska.

8 Thirdly, the provisions of the contract do not
9 set any limit to when in the future the State could
10 determine it will need the royalty gas which is in
11 Prudhoe Bay. I interpret this to mean that the State
12 could decide today or sometime when this contract is in
13 force five years downstream gas which is currently being
14 delivered, or part of the gas which is currently being
15 delivered, would be needed in the future and thus Alaska,
16 as I interpret this contract (and you probably should ask
17 others about this) could at any time reduce deliveries .
18 to the purchasers. Now, since the Prudhoe Bay field has
19 a gas cap, it would appear to me -- I am not a reservoir
20 engineer and your reservoir engineers could comment on
21 the reality of what I'm about to describe -- but it seems
22 to me that Alaska could work out a deal with the producers
23 to reduce slightly the production of gas from the gas cap
24 and, in effect, store Alaska royalty gas for future years.

25 The second question we've addressed is, are the

1 rights of Alaska to the natural gas liquids well protected
2 and the answer is, I think very well protected. Alaska
3 has the right to extract ethane and heavier components
4 at any time before or after delivery to the purchasers.
5 I would interpret this to mean that if a gas processing
6 plant were to be built in Canada or the United States and the
7 liquids extracted there, that the rights of Alaska to
8 the liquids would still be retained. I would suggest
9 you ask Mr. Moody the same question.

10 Furthermore, within the contract, statements on
11 quality of the gas of the contract, I saw no limitations
12 to the btu content of the gas delivered to the consumers.
13 To be sure, there is a price adjustment clause built in
14 the contract for the btu content of the gas, but I believe
15 there is no quality limitation to the delivery of methane
16 or the natural gas which would restrict removal of liquids.

17 Third, I think the more important question and
18 lengthier analysis in our report, is what price will
19 Alaska receive for its royalty natural gas under the terms
20 of this contract. I think in order to understand the
21 terms of this contract as written I need to review for
22 you very, very briefly what I believe to be the course
23 of energy prices over the terms of this contract.

24 This contract has a term of twenty years,
25 beginning upon initial deliveries of natural gas, which

1 will occur sometime close to 1985 very likely, meaning
2 this contract will exist from sometime around 1985 to about
3 2005. As we look downstream at the price of energy in
4 the world, I think most energy consultants agree that
5 the Organization of Petroleum Exporting Countries is not
6 likely to lose control of world oil pricing between now
7 and 1985 certainly. I think most agree that the price
8 of oil will continue to increase in world markets. I
9 think the price of energy within the United States is
10 going to rise more rapidly than the price of world oil,
11 largely because at the current time the price of energy
12 in the U.S. is controlled below world levels. As these
13 controls are relaxed, particularly as more and more new
14 oil, as it's defined in the regulations, is produced,
15 and as more imported oil is brought into the United States,
16 the oil prices should increase in the United States more
17 rapidly than world oil prices.

18 Secondly, I think that it's very clear that there's
19 a consensus developing in the United States that the con-
20 servation of energy is a very, very important national
21 objective. There is yet no means that have proven to
22 be effective by which this conservation is to occur.

23 Europe and Japan have imported oil in great
24 quantities for many years, and they have very actively
25 for many years used taxes to increase the price of energy

1 to their consumers in order to force conservation and this
2 conservation, through the use of the price mechanism,
3 has proved to be effective. I would expect the U.S.
4 would begin to follow such policies of using prices to
5 bring about conservation.

6 In sum then, I think that to 1985 we should within
7 the U.S. and the world see increases in the price of energy.
8 After 1985 we believe, Jensen Associates, Inc. believes,
9 there is a very good likelihood, as long as industrialized
10 nations do not fall into worldwide depression, that the
11 production limits of the OPEC nations will
12 begin to be strained by the demand for oil in the indus-
13 trialized nations, and the chances after 1985 for very
14 sharply rising prices will exist. Between now and 1985
15 we would expect oil prices to essentially track inflation
16 in the industrialized nations.

17 This is the price scenario under which we need
18 to examine the price terms of this contract; that is,
19 prices rising gradually to 185 and with sharply rising
20 financial prices thereafter.

21 The question is, do the price terms of this
22 contract protect the interests of Alaska, its revenues
23 essentially, with sharply rising prices after 1985.
24 I think the people who framed the contract recognized
25 that there is a fair amount of uncertainty about energy

1 prices, which there are, and they designed the contract
2 to adapt to prices established outside the contract.
3 There is not a price, there is not a set price, a certain
4 number, in this contract for royalty gas. But prices
5 are established within the contract under two different
6 types of regulation that may occur in the future. One of
7 them is deregulation.

8 If the price of natural gas at the wellhead is
9 completely deregulated the terms of this contract, in my
10 opinion, protect the interests of Alaska well. There is
11 an annual redetermination clause which has been clarified
12 by the purchasers as applying to both Section 6.3 and
13 6.4 within this contract, which will allow the contract
14 to try prices on the North Slope of Alaska.

15 Now, the North Slope of Alaska is expected to
16 be producing oil and gas in many other locations in the
17 future. The terms of the deregulation clause in the
18 contract allow the price to attract the highest price
19 paid on the North Slope. One would expect that there
20 will be continuing discoveries on the North Slope, and
21 under deregulation continuing new fairly well market
22 base pricing of natural gas which will be tracked by
23 this contract.

24 Under deregulation this contract protects the
25 revenues and the prices Alaska will receive for its

1 royalty gas in interstate commerce very well.

2 The second scenario one can view with a future
3 is continued regulation of wellhead prices by the Federal
4 Power Commission and possibly by Congress. The shape
5 of that regulation is, hard for -- it's certainly hard
6 for me to discern as regulation has changed from time to
7 time with some fairly sharp shifts. Mr. Moody can explain
8 that to you better than I can. We attempted to indicate
9 it in our report.

10 But the contract does state clearly that Alaska
11 will accept the regulated ceiling prices for the natural
12 gas which the regulatory agency will set. It also says
13 that the price that Alaska will receive for the gas will
14 never exceed that price which the purchasers can include
15 in their cost of service to their customer. This is the
16 clause which protected purchasers. I would assume that
17 the contract could not have been written without that
18 clause in it. It essentially says that, given the very
19 large volumes of gas which we're discussing in these
20 contracts, that the purchasers will not have their share-
21 holders pay part of the price of the gas if the regulatory
22 agencies do not allow the full price of Alaskan royalty
23 gas to pass to the consumers. I think it is probably
24 likely that the purchasers would not have signed the
25 contract without such protection for their shareholders

1 and their bankers.

2 Now, Alaska under regulation, you and anyone
3 else who attempts to understand what the regulated price
4 for gas will be from Alaska, will be faced with some
5 difficulty, and that is because the recent national rate
6 decisions from the Federal Power Commission have clearly
7 excluded Alaska from the national rate, both in the appli-
8 cation of a national rate and secondly, in the calculation
9 of the proper national rate for new natural gas. Thus,
10 it's not clear, the precedent is not clear the calculation
11 of the procedures which will be applied under regulation
12 if regulation persists to this North Slope royalty gas.

13 In our report we've attempted to show that there
14 is a great deal of uncertainty, very significant uncer-
15 tainty about what this price might be. In 1980 if the
16 current pricing mechanism or the vintaging of 77-A, using
17 the vintaging of 77, and I'm sorry if I'm using some terms
18 with which you may not be familiar, the price which might
19 apply to new natural gas, a Dollar Fifty-Six a million
20 btu's. But Alaska has characteristics which are very
21 different from the characteristics of the Lower 48 States
22 in its gas production, and that is in the calculation of
23 the national rate the calculation is based upon the costs
24 of finding and developing non-associated gas. The reason
25 for this is the Federal Power Commission has had a very

1 great difficulty in pricing associated natural gas because
2 it had difficulty in allocating costs of drilling, explora-
3 tion and development between oil and gas.

4 Thus, the Federal Power Commission, and there's
5 an expert to my left and to your right who can describe it
6 more fully than I the reasons behind it; the Federal
7 Power Commission recently has said that the national
8 rates for non-associated gas, and it simply said that
9 the prices for associated gas will be equal to that
10 calculated for non-associated gas.

11 Non-associated gas comprises perhaps seventy per-
12 cent of the Lower 48 gas supply. Such is not true of
13 Alaska. The Prudhoe Bay field is the largest field in
14 North America and it has the predominance of the reserves
15 of Alaska, and it's an associated gas field. If the
16 Federal Power Commission were to apply cost based pricing
17 to Alaska, particularly to the Prudhoe Bay field, you
18 would have to face the issue of how to allocate the costs
19 of drilling, development and exploration between the
20 gas and the oil. The fact about the Prudhoe Bay field
21 which is very delightful for Alaska in its sales of
22 oil is that it is the largest field in the world. From
23 the point of view of selling gas, if a rate were to be
24 applied to Alaska, the fact that it's the largest field
25 in the world may not give you the highest price because

1 the costs of finding and developing the gas per thousand
2 cubic feet are relatively low.

3 We've calculated, using some very rough estimates,
4 and ignoring the costs of water flood that may be attributed
5 to the taking back of natural gas and the costs of
6 extraction of carbon dioxide, that the Alaska rate might
7 be somewhere between Twenty and Forty-Five Cents per
8 million btu.

9 The question remains, however, does this contract
10 protect your interests in your royalty gas, and I think
11 that we can safely say this contract is not going to
12 influence too greatly, with one exception (I'll talk
13 about that in a second) the regulated price of natural
14 gas. This contract can only adapt to prices set by the
15 Federal Power Commission or other regulatory bodies.

16 Under regulation, the contract clearly states
17 it will accept the regulated price (a), and (b) it says
18 that it can receive a price no less than the price received
19 by any working interest owner. Both clauses, I think,
20 protect your interests reasonably well.

21 However, there is one concern we had, which we
22 described in the report, which is that most royalty interest
23 owners, and certainly working interest owners, are
24 usually private investors. The State of Alaska is a body
25 different from the private investor. It has social

responsibilities to its citizens.

One question that has been raised is, could Alaska under regulation claim, because of its unique responsibilities as a state, get a higher price for its royalty gas than the price given to the working interest owners. If such were true, this contract does not distinguish Alaska from the working interest owners, it clearly states it will accept that price which will be received by the working interest owners. I think you need to assess, and I would like to help you assess, the probability that Alaska might receive a higher price for royalty gas under regulation than working interest owners.

Let's do it in the following way. If Alaska were to state that it will ask for a price different from the working interest owners, and if Alaska were to ask for a higher price, I think the response could be a varied response. One response might be, and I'm sure there are some people who would make it within the courts and certainly before the Federal Power Commission, is that since Alaska has incurred no costs whatsoever in the discovery and production of its natural gas that if it wishes to separate itself from the working interest owners, it should accept prices based upon its costs, and its costs were zero. This would be unfavorable to Alaska.

1 The other possibility is that Alaska would claim
2 it should receive a higher price for its gas because of
3 its unique responsibilities to the State, to its current
4 citizens and future generations. The likelihood of such
5 an argument being accepted is one which I have difficulty
6 judging. I think, however, that as we look at the decision
7 of Administrative Law Judge Litt, he did not appear to
8 have an attitude which would be favorable to giving the
9 State of Alaska higher prices for its royalty gas than
10 working interest owners were to receive under regulation.
11 You may wish to ask me some more questions about that
12 point later.

13 Let me go on. One of the concerns of the contract
14 that we had as we first read it was that since the State
15 of Alaska does not collect severance taxes from itself
16 that under regulation it might be possible for the pur-
17 chasers to pay a price higher to the working interest
18 owners, higher by the value of severance taxes, than the
19 State of Alaska. I think the testimony certainly before
20 these two committees by the purchasers was that right in
21 the contract they did not intend to not pay an amount
22 equal to severance taxes to the State of Alaska for
23 royalty gas. Your legal staffs may need to judge whether
24 or not you need to change your severance tax laws in order
25 to insure that under litigation and under regulation, if

1 regulation occurs, if in fact Alaska will be able to
2 accept a payment in lieu of certain taxes from the pur-
3 chasers under its current law.

4 At this point I think I have finished my summary
5 of the contract. The contract overall, I think, is a
6 very good contract. It does protect the interests of
7 Alaska. There has been one clause, which I've described
8 earlier, about Alaska separating itself from working
9 interest owners under regulation.

10 The thing, however, which is very clear in
11 examining this contract and your sale of natural gas
12 is that the provisions of this contract do not set a
13 price for natural gas. The price of natural gas is going
14 to be set by forces outside of this contract, perhaps
15 market prices. More important, they're going to be set
16 by regulation and legislation.

17 If Alaska wishes to return to itself favorable
18 revenues for its royalty gas it should, we think, focus
19 its attention more upon regulation and legislation than
20 upon the terms of this contract. The terms of this
21 contract will stand Alaska in good stead, but you need to
22 deal with regulation and legislation in order to increase
23 your revenues from the sale of royalty gas.

24 I would like to comment now on several issues,
25 three issues, that came up during the course of these

1 hearings if it's appropriate to do so at this time, or
2 would you like me to stop, Mr. Chairman, and entertain
3 questions about our review of the contract?

4 SENATOR RADER: Why don't you go ahead and answer those
5 questions that you think are pertinent and we will
6 question you later on it.

7 DR. SWANSON: Thank you, sir. Several of the witnesses,
8 including Natural Resources Commissioner Guy Martin,
9 stated that, and I believe I quote Commissioner Martin,
10 that very likely a higher price could have been attained
11 in this contract for the royalty natural gas. I thought
12 that was a very important statement that came out in his
13 testimony. A number of other witnesses made the same
14 statement.

15 I have asked myself can a higher price, in my
16 judgment, be obtained than under the terms of this contract,
17 and I must confess that I think it's highly unlikely. I
18 think the pricing terms of this contract have been very
19 well designed, again with that one proviso that I mentioned
20 earlier. Let me review with you why I came to that con-
21 clusion.

22 I think, first of all, we must understand that
23 royalty gas that Alaska has to sell now is 2.6 trillion
24 feet; it's a large package of gas. I think it is possible
25 in the future that Alaska could sell maybe a billion cubic

1 feet in a spot market for a higher price than you will
2 get under this contract. But a billion cubic feet is not
3 the same as 2.6 trillion cubic feet. It is possible,
4 for example, under certain shortage conditions to receive
5 a very high price, but not for the volumes of gas, I think,
6 that you have here.

7 It has been suggested by some other witnesses
8 that Alaska could have received a higher price for its
9 gas had it sold gas directly to gas distributors and then
10 had the gas transported by interstate pipelines, and
11 that gas distributors would be willing to pay a higher
12 price. I think Mr. Moody should discuss this with you
13 more than me, but it is my impression of the Natural
14 Gas Act that if a gas distributor in Boston or Chicago
15 who is not now subject to the jurisdiction of the Federal
16 Power Commission, if that person were to purchase gas
17 in Alaska, move that gas across state lines and resell
18 it in the Lower 48 states anywhere, that gas distributor
19 would be subject to the jurisdiction of the Federal
20 Power Administration. I think no gas distributor would
21 subject himself to such regulation and thus would not
22 purchase gas directly.

23 Secondly, it was stated that Alaska may be able
24 to receive a higher price for gas if they were to sell
25 it directly to an end user such as, I believe Pacific

1 Gas and Electric was mentioned, or large industrial
2 consumers of gas. Again, I think Mr. Moody can comment
3 on this with greater knowledge and with greater competence
4 than I. It's my impression, however, the Federal Power
5 Commission currently does not allow direct users of
6 natural gas to transport gas through interstate gas lines
7 for their own use except under Order Number 533. Order
8 Number 533 is a very highly restrictive order which sets
9 the term of any contract to two years and it says that
10 only industrial high priority direct end users of gas
11 may purchase the gas, and they may purchase the gas on
12 a monthly basis, or perhaps on a daily basis, only to
13 that extent of their high priority use is curtailed.
14 Thus, when a winter is very cold and many home owners
15 are burning a great deal of gas, such industrial purchasers
16 could buy a great deal of gas. In warm winters such as
17 we had in 1975 and '76, many industrial purchasers had
18 their full needs of high priority gas met and thus they
19 couldn't receive delivery of gas under direct purchase.

20 I don't think that any direct user of natural
21 gas will be willing to sign the term of this contract,
22 which says that they will take delivery as you receive
23 delivery from the working interest owners, depending upon
24 the gas production and upon the oil production, and pay
25 for it because the timing of their needs for gas under

1 Section 533 is probably quite different from the timing
2 of the delivery of gas from the working interest holders
3 to Alaska and thus to your purchasers.

4 Secondly, let me address one other possible
5 purchaser of your gas. It was suggested that an electric
6 power and generation utility might be willing to purchase
7 gas directly from you and burn it underneath its boilers.
8 I am very, very doubtful if the Federal Power Commission
9 would allow interstate transportation of gas to be burned,
10 purchased in such a way, under boilers.

11 In fact, in some of its opinions on the purchase
12 or the retention of gas by producers in the Gulf Coast
13 to be used in refineries, the Federal Power Commission has
14 very explicitly stated that gas may not be burned under
15 boilers; in fact, it went beyond that. But I think it's
16 unlikely that anyone who would burn gas under boilers
17 can buy substantial quantities from Alaska or anyone else
18 to be transported through interstate pipelines when high
19 priority users in parts of the pipeline system in units
20 are denied gas.

21 Let me go on to another issue. We have heard
22 from two or three witnesses descriptions about the setting
23 of price for natural gas under deregulation. The gist
24 of their testimony has been that it's very difficult to
25 set a price at the wellhead under deregulation. We have

1 been asked by a major pipeline and some liquids sellers.
2 to evaluate the industrial market for natural gas in the
3 future in order to help them make investment decisions,
4 in the case of one company in liquified natural gas and
5 goal gasefication and another company in import problems.

6 So we have gone around, I personally have inter-
7 viewed plant engineers, plant managers and energy buyers
8 of large and small companies to ask them what price will
9 they pay for natural gas. The price of natural gas
10 will be set by the next buyer who will buy from the
11 seller, the distribution company. If the seller, such
12 as Boston Gas, is really selling to homes, the person,
13 you and I, the home owner, will pay a higher price for
14 natural gas to be burned in our furnace, to cook with,
15 and heat hot water than will an industrial customer.
16 However, if the quantity of natural gas delivered by a
17 distributor is large enough so that he is delivering
18 gas to industrial consumers, the price that that person
19 can pay, that the distributor can pay, will be set by the
20 next industrial customer that he can sell gas to.

21 In our interviews with industrial consumers of
22 natural gas who were sometimes burning gas under their
23 boilers but more often using the gas in their processes --
24 by process use of gas I mean the melting of glass, the
25 keeping of glass warm as it moves into bottle making

1 machines or it moves from the annealing furnaces. The
2 use of gas in annealing furnaces and metal working,
3 the use of gas to heat metal for forging operations,
4 the use of gas to dry the paint on automobiles, these
5 are all processed high priority uses of gas.

6 In our review of the volumes of gas used in
7 various locations and in the prices that these industrial
8 consumers will pay for gas, we came to the very, very
9 clear conclusion that there is more than enough gas in
10 the United States, perhaps not well distributed, as
11 we've seen this winter -- but there is more than enough
12 gas in the United States to meet the needs of industrial
13 consumers who are willing to pay from forty to sixty
14 percent more per btu than they would have to pay for
15 number two oil.

16 Also it is very clear that natural gas is a very
17 easy fuel to handle, it's very clean burning fuel, it
18 has flame characteristics which are easier to control
19 in which one can use either fewer supervisory people or
20 less skilled supervisory people to control the process
21 such that industrial consumers will pay a premium for
22 natural gas, five or ten percent, maybe fifteen percent
23 in some cases, for process uses of natural gas.

24 We thus have concluded that, at least in the
25 northeast quadrant of the U.S., which I might point out is

1 relatively short at the moment, that in the long run
2 industrial consumers, many of whom have already converted
3 to dual fuel firing of many of their pieces of equipment,
4 will pay (to pick a number) ten percent more for natural
5 gas than they will pay for number two oil. Consequently,
6 when we, in our report, set prices that we believe under
7 free market, under net back calculations, will be received
8 by Alaska at the wellhead, what we asked is in 1980 and
9 1985 what will the price of number two oil be to the
10 industrial consumer.

11 We've estimated those prices essentially by taking
12 Arabian like oil, bringing it over to the United States
13 with a transportation charge, moving it either through
14 pipelines, or certainly through import terminals, moving
15 it to a refinery close to the consumer, putting refinery
16 margin on the number two oil and coming up with a price
17 per million btu of number two oil; adding ten percent,
18 and saying, "This is the competitive price for natural
19 gas at this industrial consumer," and then netting back,
20 subtracting the transportation costs to that industrial
21 consumer back to the Alaskan wellhead to come up with
22 some of our prices.

23 There have been witnesses before you who have
24 argued that such a calculation that I've just described
25 to you is inappropriate for determining the price of

1 natural gas, and they have argued that the so-called
2 market competition incremental value pricing that I have
3 just described to you doesn't apply because the Federal
4 Power Commission and the State regulatory commissions
5 allow new higher priced natural gas to be (so-called)
6 rolled in or cost averaged with the lower priced, lower
7 contractual, lower regulated price gas they receive such
8 that even if the price of Alaskan gas delivered to a
9 distribution company were to be higher than would be
10 competitive before sold separately, because the higher
11 price Alaskan gas (this is the theory) can be offset
12 by lower controlled price gas from other parts of the
13 Lower 48 States, that the distribution company could
14 pay more than competitive prices for Alaskan gas, and
15 still be able to sell its gas.

16 I understand the theory behind such an assertion,
17 and the theory is a sound theory. And to be sure, today,
18 in some fuels markets, propane specifically, where today
19 prices of propane are controlled for some companies far
20 below market values, those companies will go out and
21 buy high priced propane, foreign propane, mix it in
22 with their -- at least on their accounting bases, mix
23 it in with their cheap domestic propane and they will
24 be able to sell; they can pay a higher price for foreign
25 propane.

1 But these purchases are a purchase of a ship-
2 load, and they'll sell the high priced propane within
3 three months, purchase which may exist over a quarter,
4 the next calendar three months. The contract we're
5 talking about is a contract to purchasers of natural gas
6 which will begin close to 1985 and will run for twenty
7 years. So we really must look at the price of natural
8 gas between year 1985 and year 2005 in order to estimate
9 the applicability of so-called rolled in pricing to the
10 distributors to allow Alaska to receive a very high price,
11 a non-competitive, non-market based value price for its
12 gas.

13 You should be reminded that other sources of
14 natural gas, the distribution companies in the Lower 48,
15 are such projects as coal gasification, which is very
16 high priced. A number of transmission companies are now
17 importing liquefied natural gas. Some of the price
18 escalation clauses in those importation contracts for
19 liquefied natural gas, I believe, will generate some
20 fairly high prices for that liquefied natural gas. And
21 so on to rolled in pricing, the rolled in pricing of
22 Alaskan royalty gas will not be based solely upon Lower 48
23 conventional production of natural gas, but will be based
24 upon other alternate sources of natural gas.

25 I would submit that the rolled in pricing that

1 you are likely to receive will not be substantially higher
2 than a competitive net back price computed, as we have
3 done so in this report. Further, when I was assisting
4 in the negotiations of the pricing clauses a long-term
5 LNG import project, the clear position of at least the
6 customers was that they would not pay a higher price
7 for that LNG than would compete with two oil. They
8 were unwilling to take the risk that either (a) rolled
9 in pricing could not be applied to them or (b) that there
10 would be sufficient amount of cheap conventionally pro-
11 duced low price controlled, low contract price controlled
12 natural gas to offset higher than competitive price.

13 Thank you, I have finished. It turned out to
14 be a very long statement.

15 SENATOR RADER: Representative Gruening.

16 REP. GRUENING: I have one question I would like to get
17 answered. Is it your intention to start questioning
18 now or after lunch?

19 SENATOR RADER: It is ten after 12:00. I assume that the
20 committee would like to break for lunch and come back
21 at 1:30. That seems to be the consensus; we will recess
22 until 1:30.

23 (Whereupon the hearing recessed at 12:15 p.m.
24 and reconvened at 1:30 p.m.)

25 SENATOR RADER: The committee will come to order. I would

1 like to ask the page to be certain to advise any Legis-
2 lators that come in, they're welcome to seat themselves
3 up forward here for more convenient questioning of
4 witnesses and so forth -- and also to make certain that
5 we enforce the "no smoking" rule in the courtroom.

6 We will continue, unless there is some objection,
7 with the testimony of Dr. Carl Swanson. I believe we're
8 in a situation for questions. Senator Gruening, did you
9 wish to start off with that?

10 REP. GRUENING: I was waiting for the rest of the members
11 to get here.

12 SENATOR HUBER: In that case can we take a five-minute recess,
13 Mr. Chairman?

14 SENATOR RADER: I'm reluctant to do that because I'm afraid
15 we're going to run out of time today. I'm just reluctant
16 to do that, but I will wait so long as my Co-Chairman
17 thinks it necessary for additional members to show.

18 SENATOR HUBER: I know Senator Butrovich is on his way.

19 SENATOR RADER: There are several routine matters that we
20 can go through while we're waiting on other persons.
21 We're going to conclude today the joint hearings. There
22 will be additional testimony taken by the individual
23 committees at their discretion at a later time, but
24 the transcript of the record of these proceedings will
25 be concluded today.

1 I am going to ask the reporter -- she has already
2 been instructed to record some testimony out of order.
3 Whenever such a request is made, I want her to clear that
4 with Representative Gruening and myself. It's been
5 asked that the expert's testimony, Dr. Tussing, be
6 transcribed first and the other expert witnesses' testimony
7 hired by the committee be transcribed in order of their
8 presentation of testimony, then after that start at the
9 beginning of the proceedings and go through them as they
10 occur.

11 I'll want you to deliver -- the Department of
12 Natural Resources will not be able to give their wrap-up
13 testimony today, therefore, we will save the last exhibit
14 number for them. Their testimony will be submitted in
15 writing sometime next week. I will certify to it and
16 deliver it to the reporter, she will append it to the
17 original record and it will become a part of the official
18 transcript of these proceedings.

19 After the document has been printed, I will ask
20 the court reporter to certify one original copy for the
21 House and deliver it to Senator Gruening, one for the
22 Senate to be delivered to me, one for the Governor's
23 office, one for the Attorney General's office, one for
24 the Department of Natural Resources and one for each
25 of the purchasers, to be delivered to such other persons

1 as they may designate in writing in a communication to
2 my office. I will deliver them to them. Is there any
3 further suggestion as to how to handle the record?

4 REP. GRUENING: It might be good to put the applicable
5 statutes, the applicable statutes, someplace in the
6 supplements to refer to as you read the testimony, if
7 we could include it in the report. I have a stapled
8 copy here that would cover the statutes that deal with
9 the Royalty Board and surplus oil and gas.

10 SENATOR RADEF: Then we will leave open two exhibits, one
11 being the rebuttal and supplemental testimony of the
12 Department of Natural Resources, and the second will
13 be statutes, and I'll leave it up to Representative
14 Gruening and the staff to submit the statutes that you
15 want printed as an exhibit.

16 REP. GRUENING: I didn't realize you intended to include
17 further testimony as part of the joint hearings, in
18 which case maybe we ought to participate.

19 SENATOR RADER: Well, I think it's important that the
20 Department of Natural Resources respond to some of the
21 matters that have been raised and I was just going to
22 let them respond in writing as an exhibit. I don't know
23 what they're going to say.

24 REP. GRUENING: I see.

25 SENATOR RADER: Although we do intend to question them

1 personally, but our personal questioning of them
2 Monday morning would not be a part of these hearings.
3 But their written testimony, or their written response,
4 if they care to make any as a part of these hearings,
5 can merely be appended as an exhibit.

6 REP. GRUENING: We may show up Monday morning too.

7 SENATOR RADER: You're certainly welcome. We intend to go
8 on at 10:00 o'clock.

9 SENATOR HUBER: Mr. Chairman.

10 SENATOR RADER: Yes, Senator Huber.

11 SENATOR HUBER: I notice from the assignment of the exhibit
12 number 16 today, that that was the next number in line,
13 and I note that the J. McCutcheon written testimony which
14 I had requested be put in as an exhibit must not have
15 got in because number 16 was the next in line. Would
16 you please take care of that at this time, make sure
17 that it appears as an exhibit?

18 SENATOR RADER: I think yesterday that we established that
19 the secretary took the written statements of Mr. McCutcheon,
20 that he submitted them to her and that she had intended,
21 and does intend, to include his total statement as a part
22 of the transcript of the verbal testimony. Is that
23 not correct, Madam Reporter?

24 MRS. SANDERS: I believe that's correct.

25 SENATOR HUBER: We did deviate from it, Mr. Chairman, and

1 I wanted to make sure the written was in also.

2 SENATOR RADER: I just don't want you to type it twice. I
3 observed yesterday during the testimony of Mr. McCutcheon,
4 it was my observation that the reporter was not taking
5 notes and, therefore, I assumed she was relying upon
6 his statements and intended to include them in full as
7 a part of the oral testimony given. Is that correct?

8 MRS. SANDERS: Yes.

9 SENATOR RADER: Mr. McCutcheon, does that satisfy you?

10 MR. MCCUTCHEON: It wasn't my request.

11 SENATOR RADER: Senator Huber, does that satisfy you?

12 SENATOR HUBER: Yes.

13 SENATOR RADER: Then we will keep the exhibits numbered as
14 we presently have it, with the Economic Analysis, the
15 Jensen Report, as Exhibit No. 16, and Mr. McCutcheon's
16 testimony will be, as I say, reproduced verbatim as a
17 part of the verbatim transcript.

18 Should we proceed at this time? Any questions
19 of Dr. Swanson? Representative Gruening.

20 REP. GRUENING: Dr. Swanson, the last couple days you've
21 heard some concern expressed by the various members and
22 Legislators as to the reason why the producers have not
23 already entered into contracts, and various explanations
24 have been given.

25 Judge Litt, in a report to the Commission in

1 April of 1976 attributed, at least to the producers,
2 one of their reasons that they expressed to him for not
3 entering into contracts, and I'm going to introduce this
4 as an exhibit. It says, "They, the producers, expressed
5 distress that the Commission has not yet embarked on a
6 proceeding to establish a price for the gas and feared
7 that an early sales contract would lock them into an
8 adverse cutoff date under possible vintage pricing by
9 the Commission, or the possibility of a deregulation
10 statute being enacted by Congress." Now, would those
11 concerns that the producers expressed to Judge Litt
12 also apply to our entering into a contract at this time?

13 DR. SWANSON: The deregulation bills that have been introduced
14 into the Congress normally deregulate new gas, and there's
15 a definition for new gas. One of the definitions which
16 has -- the definition that has existed in the Pearson-
17 Benson Bill in the Senate and the Krueger Bill in the
18 House, which were the deregulation bills which proceeded
19 furthest in the past session, said new gas would be,
20 among other things, gas which was dedicated to interstate
21 commerce after some date.

22 Now, Mr. Moody is someone whom you should address
23 the same question to, and I would defer to his knowledge
24 and judgment. He is much more aware of the implications
25 of the definitions of energy than I am. The impression

1 that I have left, that taken away from reading some of
2 the bills, is that Alaskan gas which did not commence
3 flowing in interstate commerce until sometime in '85
4 would be classified as new gas. But it's entirely
5 possible that a bill could be introduced which has a
6 different definition of vintaging. For example, the
7 currently applicable opinion which sets the national
8 rate, 77-A, defines new gas as gas flowing from wells
9 which were spudded after January 1, I believe it's 1976,
10 or '75.

11 Some of the wells which will be producing gas
12 in Prudhoe Bay were spudded before that and would not
13 qualify as new gas under a spud date definition of new
14 gas. Under regulation, or under a deregulation bill
15 everyone runs the risk that part or all of gas will not
16 qualify as new gas.

17 Probably of greatest concern to this committee
18 would be a definition of new gas which says new gas
19 would be gas which flows into interstate commerce from
20 contracts which are dated after some date which would
21 be after the date of these contracts. Now, there is
22 some precedent for contract dating, I believe. The
23 applicable definition of new or old gas are set in
24 vintaging.

25 REP. GRUENING: This may be what the producers then are

1 concerned about in their concern not to enter into
2 contracts as of now.

3 DR. SWANSON: I would assume there are a number of questions
4 that the producers had in their mind. There may well
5 have been some questions about rolled in pricing versus
6 non rolled in pricing. Certainly there were questions
7 about vintaging, maybe some questions about deregulation.
8 They were prepared, when they felt it to be in their
9 economical advantage, to accept advance payments and to
10 commit gas as they have in the past. Even though all
11 of the same issues existed then, as they do now, they
12 didn't. But those contracts, I do believe, did not set
13 prices for the gas which will flow, even though they
14 committed gas in their advance payments.

15 REP. GRUENING: Well, is it fair to assume that they're
16 probably concerned about how the regulatory and legis-
17 lative enactments affect pricing arrangements under the
18 contract?

19 DR. SWANSON: I assume they are, and they may feel that they
20 can exact a higher price if they wait, although I'm not
21 sure that's the case. I think we should point out that
22 the working interest owners have seven-eighths of the
23 gas and the royalty interest is one-eighth of the gas.
24 One of your concerns may be, if you commit now you will
25 influence the price on the seven-eighths. I find that

1 dubious.

2 REP. GRUENING: That isn't -- really, my question goes to,
3 should we not have the same concerns in terms of dealing
4 with trying to write a contract which sets price terms
5 now as opposed to waiting, as the producers seem to be
6 waiting, until a time in the immediate future when
7 pricing arrangements under the FPC and, perhaps, Congress
8 will be more clear?

9 DR. SWANSON: I think the risks you run, the principal risk
10 you run is if a deregulation bill or a definition of new
11 gas or step price vintaging of gas were to use contract
12 date as the applicable vintage date or new gas date.
13 I am less qualified than Mr. Moody to describe issues
14 of vintaging and the probability that contract date
15 may become the applicable date of vintaging.

16 Another question that I think you raised was,
17 does this contract fail to protect the interests of
18 Alaska if the royalty gas committed under the contract
19 is treated in the same vintage as working interest owners'
20 gas. My reading of the provisions of the contract state
21 both under regulation and under deregulation that the price
22 of the royalty gas will be the highest price paid.

23 REP. GRUENING: Do you read that as meaning that vintaging,
24 if I understand that term correctly, is not important for
25 us to concern ourselves with? In other words, that concern

1 that I think the producers are expressing as to being
2 thrown into a special category because they enter into
3 a contract now doesn't apply to us, as a royalty owner.

4 DR. SWANSON: I think there is a concern. The degree to
5 which it is a realistic concern or merely one of those
6 very remote possibilities, I'm not able to judge except
7 by citing some history. The real concern that you should
8 have is the probability that vintaging will depend upon
9 not the date of initial deliveries of gas into interstate
10 commerce, but the date of the contract or the point the
11 contract comes in force.

12 There is, in fact, in our report on page 29 a
13 table listing ways in which gas can be defined, either
14 vintaged or different ways in which gas is put into
15 different price categories. In that table, and you may
16 wish to ask some of the other witnesses about this table
17 and its accuracy -- in this table a Permean base in
18 Opinion 468 of August 1965 did use contract date as a
19 method of vintaging gas.

20 In none of the recent national rate opinions
21 nor the Krueger nor the Pearson, and this is the Pearson-
22 Homes Bill, has contract date been, if I understand this
23 correctly, an applicable vintage definition.

24 So we must go back fairly far in order to find
25 contract date as applicable.

1 REP. GRUENING: I take it that it is possible there might
2 be some disadvantage then if contract date became important
3 as fixing a vintage on this gas?

4 DR. SWANSON: There is the possibility, yes.

5 REP. GRUENING: And what we're trying to establish here is
6 just what we're losing by entering the contract, and
7 the question I think that has been stated again and again
8 is, aside from what we're trying to accomplish outside
9 the pricing arrangements what could we be losing by
10 entering a contract now as opposed to later since we're
11 not actually at this time trying to get money for State
12 revenue, we're trying to protect ourselves from any
13 disadvantage by entering into this contract at this time.
14 I think you said timing and price were very important.

15 DR. SWANSON: Yes. In my opening remarks, I felt that the
16 State was well protected in this contract in the use
17 of liquids, in the ability to reserve gas for in-state
18 use, and I felt that the pricing provisions in the
19 contract protected the interests of the State. I think
20 you certainly have correctly identified a possible cost
21 of the contract; that is, if vintaging in future FPC
22 decisions or in possible deregulation bills or other bills
23 in Congress use contract date as the applicable vintaging
24 criteria, and contract date of this contract, and the
25 date of break point in vintaging were to be between the

1 contract date of these royalty gas contracts and the
2 working interest owners' contracts, that's a risk.
3 REP. GRUENING: The problem being an older vintage gets a
4 lower price?
5 DR. SWANSON: This has been historically true, yes.
6 REP. GRUENING: There are some other points the producers
7 make in here. I'd like to introduce this as an exhibit.
8 It's a report to the Commission by Judge Litt.
9 SENATOR RADER: All right. That will be Exhibit 17.
10 REP. GRUENING: This is my only copy of it.
11 SENATOR RADER: Report to the Commission by Judge Litt.
12 And the date of it?
13 REP. GRUENING: April 27, 1976.
14 SENATOR RADER: April 27, 1976, and you will deliver a copy
15 of that to the reporter, will you, Representative?
16 REP. GRUENING: Maybe she can make a copy for me.
17 SENATOR RADER: If you deliver the original to her she can
18 give you a copy back.
19 (Whereupon Exhibit 17 was duly marked.)
20 SENATOR RADER: Representative Parr.
21 REP. PARR: Mr. Swanson, we have heard testimony that, as
22 you know, the royalty gas price is tied to the price
23 the producers get.
24 DR. SWANSON: Yes.
25 REP. PARR: We have heard testimony that it may well be that

1 the dollar price, let's say, shown on the producers' con-
2 tracts may not be all they're really getting because
3 they have tie-ins with some of the people to whom they
4 will be selling and there may be, for example, a swap of
5 some oil or gas, and other kinds of things that will not
6 be directly a part of that contract and will not show
7 a dollar value, but which obviously will have value to
8 the producers. If that's true, do the contracts that
9 we presently have, these contracts before us, protect
10 our interests?

11 DR. SWANSON: I remember the testimony, I've forgotten who
12 testified, as you just described. The concern you have,
13 I believe, is under deregulation where there is somewhat
14 market pricing that might apply. The reason I say that
15 is, if regulation occurs probably the price will be held
16 below market price, the price for Alaskan gas will be
17 held below market price, and there would be no incentive
18 for a producer on the North Slope to keep their prices
19 below the regulated price, the allowable ceiling. So I
20 think you're talking about a case which might exist under
21 deregulation.

22 Now, on the North Slope or in the Prudhoe Bay
23 area there are at least three major working interest
24 owners, BP-SOHIO, Atlantic Richfield, and Exxon, plus
25 some of the working interest owners are consortiums of

1 Amarata, Hess, and five, or six or seven different oil
2 companies. Now, the contracts, under deregulation, in
3 Section 6.3 and 6.4 clearly state that the redetermination
4 shall be the highest price paid any working interest
5 owner on the North Slope. It may well be, though I think
6 the possibility remote, but it may well be that one
7 working interest holder may have a somewhat lower price,
8 stated price, in the contract under deregulation than
9 would be justified by an arm's length not around the back
10 deal.

11 However, in order that the highest price all be
12 held down below market justified pricing would require
13 at least six or seven oil companies to conspire to hold
14 that price down. There are people who argue that the
15 oil companies conspire frequently. It is my opinion that
16 they compete vigorously. I doubt very much -- I think
17 it highly improbable that six or seven oil companies
18 of quite different size, who operate in very different
19 areas of the world and very different areas of the United
20 States, with very different crude balances and very
21 different supplies of natural gas would find such a
22 commonality of interest that they could even structure
23 such a deal.

24 REP. PARR: I take it then, Dr. Swanson, that your answer
25 to my question is, yes, the contracts do protect us.

1 DR. SWANSON: Yes, they do.

2 REP. PARR: Thank you.

3 SENATOR RADER: Any further questions? Senator Huber?

4 SENATOR HUBER: Thank you, Mr. Chairman. Mr. Swanson, are
5 there any other reasons which you might be able to think
6 of that the producers appear to have for not committing
7 their gas at this time that might be worth the State's
8 consideration before we commit ourselves, other than you
9 have discussed already?

10 DR. SWANSON: I can't think of any at the moment. If I do
11 think of one while I'm on the stand, would it be
12 appropriate for me to so indicate and explain it to you?

13 SENATOR HUBER: Yes, I would appreciate that if you would.

14 SENATOR RADER: I had a couple questions, Doctor. You've
15 attended the hearings since they commenced last Monday
16 at 2:00 o'clock, is that not correct?

17 DR. SWANSON: Yes, I have been here all the time.

18 SENATOR RADER: You've been in constant attendance at all
19 times?

20 DR. SWANSON: Yes, I have.

21 SENATOR RADER: Doctor, considering all of the testimony
22 which you have heard and considering the difference between
23 possibilities and probabilities, how would you characterize
24 this contract as to whether or not it protects the State
25 in an overall manner or does not the possibilities of it --

1 not as against the probabilities of it not -- in other
2 words, I would like to have you use your expertise to
3 help us weigh the value of very conflicting testimony
4 and the statement of possibilities as against probabilities.

5 DR. SWANSON: In my opening remarks I attempted to deal with
6 some of the issues that were raised in the testimony which
7 precedes mine when I talked about the issue of, can a higher
8 price be obtained than would be obtained under these
9 contracts in the issue of pricing, royalty pricing.

10 It's my judgment that these are good contracts.
11 I think that they protect the interests of the State in
12 the use of liquids, in its ability to reserve gas and
13 obtaining a favorable price. Very well, given the
14 set of probable circumstances which may emerge in the
15 future, and there is a great deal of uncertainty about
16 the price of natural gas, to be sure, there is -- I think
17 Representative Gruening has identified one possible
18 event, that is the setting of vintage dates on contract
19 date, which hasn't happened recently, which is a risk.

20 SENATOR RADER: Would you weigh that risk for us as possible,
21 probable, improbable, or whatever terms you might choose
22 to use? Again, it's very difficult for me to know
23 whether that risk is something that is of such a nature
24 that we should reject the contracts or how to weight it.
25 In other words, place a value on this, recognizing again

1 that's really what you're hired for, is for your value
2 judgment on matters in which we are not experts, on which
3 there are conflicting possibilities and probabilities.

4 DR. SWANSON: I recognize that, and I think that's a valid
5 question. You're asking me to evaluate probability of
6 any legislative or regulatory event. Now, that is the
7 using of contract date as the appropriate time for
8 vintaging. If we look to recent history being in the
9 last ten years, contract date was not used in such a
10 way that the value of this contract to the State --
11 this contract compared to that with the State -- to be
12 sure, the course of regulation and legislation is
13 something which can be, particularly in the area of
14 natural gas, can be highly unpredictable, as it has
15 proven to be in the past two or three years. I would
16 say that the chances that contract date will be used
17 as a vintage date to the detriment of the State, if
18 this contract were to be approved now, is probably less
19 than fifty percent, and it may be quite a bit less than
20 that. I'm not sure I've answered your question.

21 SENATOR RADER: Well, does it approach fifty percent?

22 In other words, we signed this contract, we have a
23 fifty/fifty chance of having signed a disadvantageous
24 pricing contract because of vintaging.

25 DR. SWANSON: If I may just try to think through to myself

1 what the advantages to advocates of various positions
2 and the position of the Congress might be of a contract
3 date vintaging. Let me just pause a minute and think
4 about it, and I will respond.

5 Senator Rader, I frankly don't understand the
6 history or regulation well enough to know why a contract
7 date was used in the Permean base in case, rate case for
8 vintaging.

9 SENATOR RADER: Let me ask you this: I don't want to ask you
10 to go on record here on something on which you are not
11 prepared.

12 DR. SWANSON: I would like to continue, if I may, sir.

13 SENATOR RADER: All right.

14 DR. SWANSON: The reason for using vintages and defining
15 something called new gas is to raise the price of gas
16 to producers so that they are encouraged and have the
17 financial resources to explore and develop natural gas.

18 The reason there is vintaging is to keep the
19 price of flowing gas down, the theory being that one
20 does not increase the incentive to a producer to find
21 new gas by raising the price of old gas. That strikes
22 one as a reasonable theory.

23 Both Mr. Moody and Mr. Byrd have done a good
24 deal of natural gas contracting, but my understanding
25 of natural gas contracts (you might want to pose this

1 same question to them) -- my understanding of natural
2 gas contracts is that under contracts a whole reservoir,
3 where all the natural gas under a lease will be dedicated
4 to the sale, to the contract, often underneath the land
5 area there will be more than one reservoir of natural
6 gas, or often the reservoir may be sufficiently intimated
7 that after a while it makes sense to drill some additional
8 wells, or it may be that in a natural gas lease, a
9 natural gas reservoir, that after a while the well will
10 sand up, the casing will collapse, or the well will be
11 damaged, and thus a new well will have to be drilled; or
12 if there is a deeper reservoir a well will have to be
13 drilled or an old well re-entered in order to find the
14 gas in a deeper reservoir.

15 If the vintaging date were the date of the contract --
16 remember that the whole, all of the gas underneath the
17 lease, perhaps defined by depths, were to be dedicated
18 to the contract, then there would be no incentive for
19 the producer to repair the wells or to redrill the wells
20 or to search deeper for new reservoirs. Thus, it strikes
21 me -- the point I have is, and I guess you should ask
22 other witnesses, is that given some of the conventions
23 of natural gas contracting, that vintaging new gas by
24 date of contract may impair the discovery of additional
25 supplies of natural gas, which would be contrary to what

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1 I understand to be the purpose of deregulation or the
2 purpose of allowing a higher price for new gas, and
3 thus self-defeating. If the theory I have just expounded
4 is true, then I think that a vintaging gas generally
5 within the United States by contract date would be
6 unlikely.

7 SENATOR RADER: Any further questions? Senator Sumner.

8 SENATOR SUMNER: Mr. Chairman. Have you evaluated contracts
9 between states and oil companies in the past?

10 DR. SWANSON: No, sir, I have not.

11 SENATOR SUMNER: Do you have any basis to compare or to answer
12 a question of how does this contract for the sale of the
13 royalty gas compare with the sale of royalty gas between
14 other states and oil companies?

15 DR. SWANSON: I happen to have in my possession a very bad
16 photographic copy of a sale of royalty gas from New
17 Mexico to El Paso.

18 SENATOR SUMNER: How does this sale contract here compare
19 in favor of the State?

20 DR. SWANSON: I read that contract last night, the one between the
21 Royalty Board of New Mexico and El Paso, and I think
22 that the sale of Alaskan royalty gas compares well.
23 The other contract also was a soundly conceived contract,
24 and it did not have the reservations clause that Alaska
25 has.

1 SENATOR SUMNER: When you say compares well, is this contract
2 better than, in your view?

3 DR. SWANSON: The contract you have negotiated is a better
4 contract.

5 SENATOR SUMNER: There's some confusion in my mind. If the
6 contract says that Alaska is going to get paid as high
7 as any of the producers that are selling to the oil
8 companies for the seven-eighths supply, would the vintaging
9 determine the sale price that Alaska receives, or would
10 the contract dates on their contract with the users or
11 buyers determine the sale price that Alaska gets?

12 DR. SWANSON: I think you have posed a question which would
13 require legal interpretation and, frankly, I had not
14 thought of it, in response to the earlier questions of
15 Senator Rader and Representative Gruening, because what
16 you're arguing is that through the terms of this contract
17 the vintaging date applicable to this contract alone may
18 not apply. That's a very important question and I would
19 only like to say that I'm not a lawyer, I do not have
20 extensive Power Commission experience, and you have a
21 witness who does. I just am not qualified to answer
22 the question. I do understand the issue, and it's a good
23 point.

24 SENATOR RADER: Let me go back just a moment then to the
25 question I asked you. Does that change your answer to my

1 question as to whether or not it is likely in the future,
2 in view of the past policies, that contract date will be
3 the determining factor in vintaging? As I understood
4 your testimony, you said you thought it would be highly
5 unlikely the contract date would be the determining
6 factor in vintaging.

7 DR. SWANSON: Unlikely, yes.

8 SENATOR RADER: Now, the question raised by Mr. Sumner does
9 not affect your testimony in that regard, does it?

10 DR. SWANSON: No, it does not. In fact, if anything, it
11 suggests that at least within the terms of the contract
12 one does not know how those terms will be interpreted
13 in accordance with the Federal Power Commission, at
14 least within the terms of the contract, that there is
15 even less likelihood that contract date vintaging would
16 apply to the price.

17 SENATOR SUMNER: Mr. Chairman, in response to you, that's
18 the view that I thought.

19 SENATOR RADER: Senator Colletta, do you have a question?

20 SENATOR COLLETTA: I believe Senator Huber did.

21 SENATOR RADER: Oh, Senator Huber.

22 SENATOR HUBER: I had on your subject in response to Senator
23 Rader I want to get back in. Now there's a second one
24 since you came in. Senator Rader and I apparently didn't
25 hear exactly the same way. I thought I heard you say

1 that the chance that vintaging would be disadvantageous
2 or that it would happen to the State was on the order
3 of fifty percent, not very unlikely. So which way is it?
4 DR. SWANSON: Senator Huber, what I attempted to do was, when
5 I said that the probability that vintaging would be based
6 upon contract date, I said I thought the probability was
7 less than fifty percent. I chose a number where I felt
8 extraordinarily confident, and Senator Rader felt that,
9 in his judgment, he needed a finer definition, a more
10 precise statement of probabilities, and he pressed me
11 on the point, and upon thinking about the point, in
12 thinking about the use of contract date for setting
13 vintaging dates for pricing, given the traditions of
14 contracting in natural gas, did not strike me as too
15 sensible, given the purposes of national policy in the
16 use of vintaging. So I think that the probability
17 that contract date will be the applicable vintage
18 definition that dominates price under this contract is
19 quite a bit less, it is unlikely.

20 SENATOR HUBER: Would you like to give a percentage of
21 less than? You gave less than fifty before. Would you
22 like to give us less than something now?

23 DR. SWANSON: Less than fifteen, less than ten percent.

24 SENATOR HUBER: Less than ten percent. All right, that
25 goes on ---

1 DR. SWANSON: Now, the difficulty of a number -- excuse me,
2 Senator, I'm sorry.
3 SENATOR HUBER: Go ahead.
4 DR. SWANSON: The difficulty of a number given, such as that,
5 is that it's a number which can assume greater importance,
6 or it's an easy number to grab ahold of. You asked me
7 the question straight, and I answered it as straight as
8 I could. Maybe it's fifteen percent, maybe it's five
9 percent, maybe it's ten percent, maybe it's two percent;
10 I don't know, but I think when I state ten percent (maybe
11 it's less) I think that's a fair characterization of
12 unlikely. But remember that that ten percent would be
13 further reduced by the point that Senator Sumner has brought
14 up, which is that there are contract terms in the contract
15 you are examining now which might make the vintaging
16 which would allow working interest holders a higher
17 price than applicable, but that's something presumably
18 which will be worked out in the courts, and also it's
19 something that requires legal judgment, which I would
20 suggest you ask of Mr. Moody.
21 SENATOR HUBER: Mr. Chairman, that brings me to the second
22 half of my question. Mr. Swanson, your definition that
23 vintaging, I believe, was quite narrow here. In regard
24 to that, have you taken into consideration the precedent
25 that was set by the Federal Government action in disallowing

1 North Slope oil new status? Do you think that they might
2 use vintaging or some other mechanism there to do the
3 same thing with the gas that they have done with the
4 oil that might affect the status of these contracts?

5 DR. SWANSON: There are two questions, I think, which we
6 must address, and one question is, will these contracts
7 approved now put the State in a worse position than if
8 they were not approved, which is a very appropriate
9 question, to be sure. My judgment is that these contracts
10 are very good contracts and they do protect interests
11 of the State, and that if they are approved now the
12 chances that the State will suffer value are not great.

13 The second question arises, and I think it
14 comes out of your point about the Federal Government,
15 and that is, what are the risks to the State of Alaska
16 of receiving very favorable value for its royalty gas
17 and oil. Those risks are great, and I think they are
18 legislative and regulatory risks, but by and large they lie
19 outside of the contract.

20 SENATOR HUBER: Could I just draw you out a little more?

21 You said there wasn't disadvantages to the contract.
22 Could you conversely say , is there definitely advantages
23 to the contract?

24 DR. SWANSON: The theory of examining the contract at this
25 time, and many witnesses have testified to this, that by

1 approving these contracts at this time the likelihood
2 of the El Paso project being approved will be enhanced.
3 That's the theory. I, frankly, am not competent to judge.

4 SENATOR HUBER: And you don't want to make a judgment of
5 how much enhance them being chosen over Arctic?

6 DR. SWANSON: No, sir, I'm not competent, and if I were to
7 make a judgment I would be doing you a disservice.

8 SENATORY HUBER: Thank you, Mr. Swanson.

9 SENATOR RADER: Representative Gruening had a follow-up question.

10 REP. GRUENING: Are there any advantages to the State in
11 terms of pricing in these contracts? Let's say if we
12 do sell the gas at a later point under these contracts,
13 have we gained anything in terms of pricing, setting
14 aside the question of political gain that the contract
15 is based on?

16 DR. SWANSON: It's very hard to be actually sure about what
17 the course of events will be in the future. The contracts
18 do state -- let me step back a second. The question is
19 an important question and I must answer it.

20 Royalty gas comprises one-eighth of the gas in
21 the Prudhoe Bay field. The contracts are very clear, that
22 both under regulation and under deregulation that the
23 price received by the State will be the highest price.
24 The contracts are unambiguous. I do not believe that
25 one-eighth interest is sufficiently large to swing the

1 value of the gas such that the prices received by the
2 working interest owners will be less than if you waited.

3 For example, and let me expand on the point
4 because I'm not sure I'm being very clear. If the amount
5 of gas which you are selling now were enormous, more than
6 enough to satisfy the demands in the Lower 48 States.
7 then possibly by delaying, by not committing gas now
8 and by having these highest prices for other people to
9 obtain, you could depress future prices. But that's
10 not the situation to be faced. The royalty gas interest
11 is only one-eighth, and all of Prudhoe Bay gas, while
12 very large, is not sufficient to solve the lack of
13 natural gas supply in the Lower 48 States; so that your
14 committee now does not so change the balance of supply
15 and demand that future prices will be reduced by
16 your commitment now. Have I answered your question?

17 SEN. GRUENING: If I interpret it correctly, you were saying
18 that the contract protects us in most regards in your
19 view, but in terms of advantages outside the political
20 aspect of it, you don't see any -- it may be a good
21 contract but you don't see any advantages to entering
22 into a contract now as opposed to, say, trying to acquire
23 these same terms at a future date, and that may be
24 dependent upon whether, in your expert opinion, we could
25 get these terms at a future date.

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1 DR. SWANSON: You would require me to read the minds of the
2 purchasing companies to determine if you could get the
3 same terms that you have in these contracts at a future
4 date. I have difficulty doing that. I would like to
5 point to one section of the contract where you do have
6 some very favorable terms, I think, and that is the
7 purchasing companies have committed to pay the royalty
8 share expenses upstream of the delivery point whether
9 or not they are able to put those expenses into their
10 costs of service. That's a good term, I think. Whether
11 they'll agree to the same term in the future, I really
12 don't know.

13 SENATOR RADER: Representative Chatterton.

14 REP. CHATTERTON: Thank you, Mr. Chairman. Dr. Swanson, I
15 don't expect I'm going to ingratiate myself with you with
16 this line of questions, but nothing personal is intended.

17 DR. SWANSON: You have an obligation, sir, a very important
18 one.

19 REP. CHATTERTON: To bring everything into perspective, I have
20 before me and have not a little slower than hastily read
21 a November 30, 1976, letter addressed to Ms. Elke Kallab
22 and signed by you, regarding a proposal to make an
23 economic study of the gas sales contracts. That was
24 dated November 30, 1976. And I also have before me
25 a letter, or a document accepting your proposal that was

1 dated December 27, I believe, 1976, and unless you're
2 like some people who may think that they're willing to
3 commit course money to build a pipeline before you have
4 a contract, I doubt if you started to do much work on
5 this problem prior to the first of the year. I'm not
6 questioning you as to the fact that in context of what
7 you were asked for and what you have presented is, you've
8 fulfilled the obligation completely, and I do concur
9 with you, with slight exceptions of your findings, that
10 this contract permits Alaska to recall and use the gas.
11 It does have that, it does provide the LPG protection,
12 but you did state here that in your proposal you would
13 not involve an analysis of the sale of natural gas
14 liquids, in your economic analysis, does provide for a
15 favorable price. Now, I think it's equally important
16 to this committee to know things that you did not find
17 in arriving at this conclusion, and obviously within
18 the framework of thirty days there's a bunch of things
19 you did not find out.

20 DR. SWANSON: There's a very large number of things of concern
21 to this committee that we did not state, that's correct.

22 REP. CHATTERTON: And possibly even the economic considerations,
23 if you had studied these things, if we had paid you more
24 money and you had had more time, it's possible -- it
25 is possible, if you had studied possibly a trade in kind

1 of gas at Prudhoe Bay with like owned State gas some-
2 place else, or State owned crude with like State owned
3 crude someplace else, or looked to see if in any way
4 this would be jeopardizing the ultimate recovery of
5 hydrocarbons from the Arctic Slope, aiding and abetting
6 the jeopardy thereof, is it possible you could have
7 come up with a slightly different conclusion?

8 DR. SWANSON: Let me list for you a number of the things
9 which perhaps are of concern which we did not study.
10 I'm not a qualified reservoir engineer. Our firm are
11 not qualified reservoir engineers. We did not study the
12 question of the level of production of natural gas
13 from Prudhoe Bay from the sedilologic sands which are
14 appropriate. On the other hand, I would assume that, given
15 the terms of the contract, that the State is well pro-
16 tected, if it were determined that to maximize the
17 recovery of oil, gas production would need to be cut
18 back, because this contract does not specify any minimum
19 quantity of natural gas which must be delivered to the
20 purchasers.

21 This contract does specify very clearly that the
22 purchasers must pay for, whether or not they can pass on
23 in their cost of service, the royalty share of facilities
24 required prior to delivery. So I'm not really sure that
25 our lack of knowledge of the specific reservoir characteristics

1 apply too much to our analysis of this contract.

2 We did not study, and I have no judgment of the
3 relative merits of the three proposed gas lines, for
4 example. A good deal of testimony has been presented
5 here, and much more before the Federal Power Commission,
6 on that issue, and perhaps you may, as individuals, in
7 your judgment, in your decisions about this contract,
8 weigh the relative merits of the three gas proposals.
9 We have not examined them, and I have no opinion, no
10 professional opinion on it.

11 We did not attempt to uncover for the State of
12 Alaska other alternate buyers of royalty gas and attempt
13 to understand from them the terms that they might be
14 prepared to offer to you for the purchase of that royalty
15 gas. I presume that in a sense the Administration, under
16 Commissioner Martin, did explore with a variety of
17 purchasers the royalty gas and possible alternate terms;
18 we did not.

19 So the question you raised, Representative
20 Chatterton, was, is it conceivable, is it remotely
21 possible that our analysis would be altered had we
22 spent more time and more effort in examining these con-
23 tracts and the alternatives which are applicable to you.
24 And when I was studying physics I read in a book that
25 it's entirely possible, it is remotely possible that

1 all of the molecules of air in this room will suddenly
2 rush over into that corner and we will all explode; I
3 think that's remote.

4 In a contract such as this, one can over-study
5 it. One should study to a point where one thinks one has
6 a grasp and can offer sound judgment to a client. If
7 we were to study, and study and study we would charge
8 for that, and perhaps not give value for money received.
9 I'm confident that our analysis is sound, our conclusions
10 are sound; I can no more say that there is no possibility
11 whatsoever of something possibly changing than I can
12 that apples will fall up instead of down. Do I answer
13 your question, sir?

14 REP. CHATTERTON: Yes, thank you very much.

15 SENATOR RADER: Senator Colletta.

16 SENATOR COLLETTA: Dr. Swanson, we have had a lot of talk
17 about the possibility and probability of what could
18 happen, and just taking the one aspect, the contract
19 provisions (period), since you deal in that area what is,
20 not the possibility but the probability of duplicating
21 a contract verbatim to what is before us now if, in fact,
22 we wait and see who builds what and when? I make
23 specific reference to one section on the total take-back
24 that we're allowed.

25 DR. SWANSON: The provisions for reserving natural gas in this

1 contract are favorable to the State. The reason that
2 the purchasers signed this contract is, as I believe
3 Mr. Tomas of Tenneco stated very clearly, that they
4 frankly don't think that either (a) you're going to take
5 back that much or (b) if you do take back that much
6 they have a good deal of confidence that Alaska will
7 experience a number of additional discoveries of gas
8 and under the terms of this contract they can buy that
9 gas.

10 Now, if you waited so long that it became more
11 probable that Alaska would take back the gas or that
12 additional discoveries would not be found and other
13 discoveries were to be committed, then perhaps you
14 couldn't get exactly the same terms with the reservation
15 clause as in this contract. I think I'm grasping at
16 something that is relatively small, and I think you may
17 well be able to get reservation clauses in the future.
18 As good as these? I don't really know.

19 The pricing provisions? I think in the future --
20 if you were to wait I think you probably will have
21 pricing provisions which are as favorable as these.
22 Whether the purchasers would pay for, at their own risk,
23 the royalty share of the costs of gathering or whatever,
24 I just simply do not know. I think likely they might;
25 I don't know.

1 SENATOR RADER: Any further questions? Any questions on
2 this side? We'll go a second round here. Senator Huber.

3 SENATOR HUBER: Thank you, Mr. Chairman. I'm sure that
4 this question was asked of other people but it was not
5 asked of Dr. Swanson, and I would like to know his answer.

6 I refer generally to the provisions in the contracts
7 that head end money, premium money, whatever you want to
8 call it, will not be allowed or will not be paid to the
9 State, but that the highest unit field prices, in the
10 language that we're both familiar with is there to state
11 that, is used. Assume now that deregulation occurs,
12 which apparently some form of deregulation is going to
13 occur, and the working interests should negotiate large
14 lump sum or front end payments with smaller amounts per
15 mcf, wouldn't our contracts then have a good chance of
16 denying the State the same opportunity for these much
17 higher prices that might be paid, or likely would be
18 paid, would be unlikely to be paid?

19 DR. SWANSON: Senator Huber, with your indulgence may I
20 characterize what I think is concerning you and then see
21 if I have characterized it correctly and then proceed
22 from there?

23 SENATOR HUBER: Please do that.

24 DR. SWANSON: Would that be an appropriate way to proceed?
25 I believe what you're suggesting is that the provisions

1 of this contract clearly state it shall be the highest
2 price specified in some other contract, and that price
3 will be in so many cents per mcf to the working interest
4 owner. You were concerned, I believe, that potentially
5 the value given in a contract or an interest owner may
6 exceed the price stated in the contract, value being
7 given to the working interest owner by an advance payment
8 on an interest free loan.

9 SENATOR HUBER: Even if it's a separate document for advance
10 payment.

11 DR. SWANSON: Or whatever, yes. I believe that is your
12 concern.

13 SENATOR HUBER: That is my concern.

14 DR. SWANSON: We have the same concern in our analysis of
15 this contract. Specifically we were aware of advance
16 payments having been made for working interest holders
17 of Alaskan gas. We then reviewed, as best we could, the
18 outstanding advance payments, the ones that had not been
19 terminated, advance payment premiums, so we uncovered,
20 particularly the Columbia Gas advance payment agreement
21 with, I guess it's BP and SOHIO. I'm not sure. And we
22 asked exactly that question in our analysis. We addressed
23 exactly that question in our analysis, would the price
24 as quoted in the contract be lower because of a previous
25 advance payment to a producer and, thus, not give full

1 value to the State.

2 Our research, looking at the contracts between
3 SOHIO and Columbia led us to believe that the advance
4 payments given to the producers would not reduce the
5 price as quoted in the contract. That was the conclusion
6 of our research.

7 Let me continue. One question that can be raised
8 is, will advance payments be allowed in the future.
9 I think the Federal Power Commission has suggested that
10 they won't be. A pipeline will give an advance payment --
11 well, the Federal Power Commission says they're not
12 doing it now -- a pipeline will give an advance payment
13 only if it can somehow recover the cost of using that
14 money or that money in its rate base. If they can't put
15 it in their rate base or they can't somehow recover it
16 from their consumers, they're unlikely to make advance
17 payment, because they can recover an allowable price.

18 Secondly, in the repayment -- I would like to say
19 something and I think I'm going beyond my current research
20 and competence and I'm not sure whether I should say it,
21 subject to verification of Mr. Moody or simply not say it.
22 I'll proceed by your judgment.

23 SENATOR HUBER: If it's part of my question I wish that you
24 would.

25 DR. SWANSON: I'll do that, but I do want to warn the two

1 committees that my recollection of the regulation of the
2 law is shaky. My recollection is that the amount of gas
3 that must be delivered for the repayment of an advance
4 payment will depend upon the subsequently negotiated
5 price for the gas. Thus, it is in the interest of the
6 working interest owner to negotiate the highest possible
7 price he can get in order to repay the advance payment
8 as soon as he can.

9 If that theory or recollection were true, and you
10 can check this with Mr. Moody, then the granting of an
11 advance payment probably would not reduce the stated
12 price in the gas sales contract and, thus, would not
13 provide full value under the most favored nations clauses
14 or the clause of deregulation in them, and in the highest
15 price clauses under this contract.

16 SENATOR HUBER: Thank you, Mr. Chairman. I feel it is a
17 little better given, the answer, from our experts rather
18 than the oil company in this case on that one. I lay
19 that one to rest as far as I'm concerned.

20 SENATOR RADER: Any further questions of Mr. Swanson?

21 Mr. Swanson, I think you were trying to catch an airplane,
22 were you, this afternoon?

23 DR. SWANSON: No, sir, I'm going to catch the 8:30 plane
24 out tonight, so I'm at your service.

25 SENATOR RADER: Would you stay for the remainder of the

1 proceedings in case questions do come up later?

2 DR. SWANSON: Yes, sir.

3 SENATOR RADER: Thank you very much. I have no particular
4 preference of order myself. Mr. Moody, Dr. Kilgore, do
5 you gentlemen have any idea as to a preference of
6 testimony, your order?

7 MR. MOODY: Whatever the will of the committee, Mr. Chairman.

8 SENATOR RADER: Why don't we take a ten-minute break and
9 let me discuss with both of you the nature of your
10 testimony and make a decision?

11 (Whereupon the hearing recessed at 2:40 p.m.
12 and reconvened at 2:50 p.m.)

13 SENATOR RADER: The committee will come to order. During recess
14 I discussed with Mr. Moody and the Doctor the order
15 of testimony, and it was the feeling that the Doctor's
16 testimony would be more in line and more relevant to
17 that which has gone immediately preceding and, therefore,
18 it would be logically easier for him to testify at this
19 time along the same lines as indicated previously by
20 Dr. Swanson.

21 Doctor, of course, you're an old hand here.
22 We all know that you're with the Levy Lipton Associates,
23 but for the record, for those who do not know you, and
24 who may come across this record, would you give us a
25 full statement of your firm and yourself, and then proceed

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with the statement, which I presume then we would open
to questions.

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1 MR. KILGORE: All right, thank you, Senator. My name is
2 Richard Kilgore. I'm Director of Research for W. J.
3 Levy Consultants Corporation. Our firm has been economic
4 advisor on matters of oil and gas to the Legislature since
5 I believe, 1969. We are also consultants to a number of
6 oil companies, domestic and foreign, small and large.
7 We also are consultants to a number of chemical companies
8 on feed stock procurement and feed stock availability
9 and so on. We're also consultants to a number of major
10 oil users such as electric utilities, mining companies
11 and the like. In addition to the State of Alaska, we
12 are consultants to a number of other governments, at the
13 present time the Province of Alberta, for example, and
14 Pertamina, the state oil company of Indonesia, among
15 others.

16 As for myself, I'm an economist by training, a
17 Bachelors Degree in Economics from Rutgers University,
18 and a Masters Degree from Carnegie Mellon University.
19 Senator, you've been calling me Doctor; that is incorrect.
20 I'm one of those who passed Ph.D. exams and never wrote
21 a thesis, so I would like to correct that.

22 I've been with W. J. Levy since 1963, just about
23 fourteen years now. Prior to that I spent two years with
24 the National Bureau of Economic Research, which is a major
25 non-profit research organization. I was also with the

1 Econometric Institute for a short while, and also did
2 some work for the Committee for Economic Development.

3 I would like to make what I hope are relatively
4 brief opening remarks, and they really have to do with
5 how we, as your economic advisors, view what you're trying
6 to achieve through these contracts. At least my opening
7 remarks today are addressed primarily to the underlying
8 reasons for sale of Prudhoe Bay royalty gas.

9 I'm going to cover such things as what are the
10 interests of the State of Alaska, what issues can Alaska
11 properly decide for itself; set against these, what
12 are the broader national interests; and how do Alaska's
13 interests fit into the national decision making process
14 on this gas pipeline. And we'll try to put these in
15 the context of the contracts before you.

16 As I said, my initial remarks will have relatively
17 little to say about the contracts themselves. As an
18 opening statement, our view can be characterized this
19 way: if Alaska decides that sale of royalty gas is
20 essential to support of an all Alaska pipeline route,
21 we feel that the contracts, in general, are carefully
22 conceived to protect the State's interests.

23 The primary objective in entering into agreements
24 for sale of Prudhoe Bay royalty gas at this time is to
25 provide support for an all Alaska route. We would like

1 to review briefly the reasons for Alaska's interest in
2 that route and the importance of these reasons. As we
3 see it, there are basically two types of benefits to the
4 State in an all Alaska route. First, there appear to be
5 certain fairly clear-cut economic benefits, although
6 probably offset to some extent by some social costs.

7 And second, there is the question of the potential
8 availability of gas for State use with the El Paso route.

9 We would like to provide some perspectives on
10 both of these potential advantages. Among the pipeline
11 alternatives there are certain economic advantages to
12 the State that can be reasonably established. These
13 were reviewed by the Governor's Task Force, and then the
14 report, Comparative Evaluation of Prudhoe Bay Natural
15 Gas Pipeline Systems.

16 An all Alaska route, together with its liquefac-
17 tion facility, does appear to provide the greatest economic
18 advantages in certain key areas. Employment is an
19 obvious one; resulting income flows to Alaska's labor
20 force, although all these will obviously not be State
21 residents, there will be migrants too. Employment and
22 income should be higher, both in the construction and
23 operating phases of the El Paso facility, as against
24 others. The greater length of the line, and the LNG
25 facility virtually insure this will be the case.

1 Tax revenues to the State treasury should also be
2 higher, largely through the operation of your property
3 tax. Again, it's the greater length of the line and
4 the LNG facility that make this possible for you.

5 Now, another major source of State revenue from
6 Prudhoe Bay natural gas will be royalties and severance
7 tax, both of which are based on wellhead values, as you
8 know. The Governor's Task Force concluded that these
9 revenues would not be affected by alternative routings;
10 that is, that higher or lower transport costs to markets
11 would not bear on wellhead values.

12 Now, we agree that as long as sales of Alaskan
13 gas in interstate markets continue to be regulated by
14 the Federal Power Commission, this is likely to be the
15 case; that is, that wellhead values will probably be
16 established on a basis other than a net-back from markets,
17 that transportation would probably be added on to a
18 regulated wellhead price, and the final price would be
19 rolled into the final cost of gas to distribution
20 companies and to ultimate consumers.

21 The FPC staff, I believe, has recommended the
22 rolling in of high-cost gas supplies such as foreign
23 LNG and Alaskan Arctic gas, and I understand that Judge
24 Litt has also recommended this approach for high cost
25 sources.

1 Under deregulation this is not necessarily the
2 case, that the costs of transportation would not bear
3 on prices. Transport costs, in that case, would have
4 an ultimate bearing probably on the value of Prudhoe
5 Bay resources. But we basically feel that deregulation
6 is not a too likely event for some years to come.

7 We would caution, however, that Alaska cannot
8 always assume that the value of its resources will be
9 unaffected by the routing of its exports. In the long-run
10 this may be the case. I think Prudhoe Bay provides a
11 current example of some of the problems of transportation
12 costs on wellhead value. As you know, there is a problem
13 of potential crude surpluses on the West Coast, the major
14 market to which Prudhoe Bay crude will move. And there
15 is a possibility that some volumes of Alaskan crude may
16 have to move to quite distant markets, that is, beyond
17 the West Coast, around to the Gulf and East Coast of the
18 United States, and this would be at very high tanker
19 transportation costs since the oil must move in U.S. flag
20 vessels and the distances are very substantial.

21 And if this is the case, if Alaskan crude does
22 move in this direction in any kind of substantial volumes,
23 there will inevitably be a question of the value of Alaskan
24 crude in Alaska; that is, what market is its value
25 established in. We feel that over the long-run it is not

1 in the national interest, and probably not in Alaska's
2 interests either if its wellhead values are affected,
3 to funnel ever larger and larger volumes of Alaskan
4 energy supplies through California; that is, larger and
5 larger volumes beyond Alyeska crude and beyond the El Paso
6 route, if that is chosen.

7 If major oil reserves are found in Petroleum
8 Reserve No. 4 on the North Slope, for example, a strong
9 case will be made for a pipeline to move that oil through
10 Canada I think, despite the fact that you have a
11 pipeline corridor southward. Incidentally, if the gas
12 Arctic pipeline is not built and an oil line moves in
13 that direction, it would then be pioneering a corridor
14 rather than following a corridor which might be established
15 had the gas Arctic pipeline been constructed.

16 But this is somewhat aside. We believe it is
17 reasonable to assume that the value of Prudhoe Bay gas
18 will most likely be unaffected by the cost of alternative
19 pipeline routes, at least for many years ahead. And
20 let me also say that we've looked at the various studies
21 that have been made on the costs of transportation,
22 what the FPC has done, what other people have done, and
23 we are not entirely certain in our own minds which system
24 would, in fact, have the highest cost of transportation.
25 It looks like a very uncertain thing to us. A lot of the

1 cost estimates are based on probabilities of delays,
2 cost over-runs and so forth, that are very, very difficult
3 to assess, in our view.

4 Against positive advantages in terms of employ-
5 ment, income and tax revenues, there are other factors
6 to be considered as well by the State; and, as the
7 Governor's Task Force concluded, some of these may be
8 negative to the State in an all Alaska routing if one
9 looks at such things as social impacts, the effect on
10 the cost of living, prices in Alaska, and so on, and
11 also looking at environmental factors which are, obviously,
12 very difficult to assess. The all Alaska route also
13 involves an LNG facility, movement of LNG tankers out of
14 Alaska, and these pose new environmental concerns, and
15 ones we feel are very, very difficult to assess.

16 However, these are all factors that the State and
17 its citizens must evaluate and weigh with the more clear-
18 cut economic advantages from taxes, employment and so
19 on. Your own Task Force concluded that the positive
20 advantages outweighed the negatives, as you know.

21 The second reason for supporting an all Alaska
22 route is the potential availability of natural gas for
23 in-state use, and it is very clear -- I've been through
24 all the -- I've sat also through all the hearings -- it
25 is very clear from your questions that many of you

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consider that aspect very vital.

It is obvious that the potential availability of gas is quite different among the three pipeline alternatives. El Paso moves to tidewater, and this could be very important for uses of gas in industries which involve export of their products to Lower 48 markets, obviously; being on the water, near water transportation, is important.

Alcan, of course, moves gas to Fairbanks and then moves off in a southeasterly direction, and in directions which run through areas that are, obviously, not very populated.

Gas Arctic route, of course, provides gas essentially just on the North Slope.

It is difficult, however, to assess how much value to be placed on this greater potential availability of gas for in-state use. We should point out first that there may well be other gas available in the State over the years ahead. Exploration is beginning now in other areas, the Gulf of Alaska, Lower Cook Inlet, Bristol Bay and so on. Gas may be discovered in one or more of those areas, and it is possible also that gas may be available for in-state uses from these areas at lower costs, lower transport costs and the like.

As an aside, I think we should also mention

1 something that we have before, that to the extent that
2 the State of Alaska feels that in-state use of gas is
3 very important to it or may be important to it in the
4 future, they might consider in their leasing policy,
5 perhaps changing leases so that what they have available
6 to them, to the State, is not simply a royalty which
7 can be taken either in value in kind. Perhaps the State
8 should consider some sorts of options in leases which
9 provides the State's future ability to buy back gas if
10 the State feels that's necessary. This is not what is
11 under your consideration now, but I think I should say
12 again one should consider this if use of gas, you feel,
13 is important in your State.

14 In any event, all may not be lost in terms of
15 future availability of gas if the Gas Arctic route is
16 chosen. As for now, however, it is Prudhoe Bay gas
17 that is becoming available, and other potential supplies
18 are obviously very speculative. And El Paso clearly
19 has the potential to make more gas available to more
20 locations in the State of Alaska. But what then really
21 are the advantages in using gas within the State of
22 Alaska?

23 You have major oil resources in the state, as you
24 all know, and you're obviously not an energy short region.
25 I believe we've pointed this out before, but we would

1 like to again: there is likely to be an economic advantage
2 to using gas versus oil in an area such as Alaska, which
3 is a major exporter of energy and also an exporter which
4 is remote from its major markets. The reasons for this
5 is that the economics of transportation clearly favor
6 movement of oil over gas.

7 Gas transport costs per btu are roughly three to
8 four times that for oil when the gas is moving overland
9 by pipeline. Gas transport costs are roughly ten to
10 fifteen times higher when the gas is transported over
11 water as against transportation of crude oil over water.
12 Thus gas, which carries very high transport costs,
13 tends to have a lower value in an area such as Alaska,
14 an exporting area such as Alaska; and oil, a higher value.

15 In general then, the economics tend to favor
16 use of gas in Alaska and export of oil. To put it another
17 way, gas is a better btu bargain locally, oil a better
18 product to sell nationally. But we want to caution you
19 and point out that gas transportation within Alaska is
20 also, obviously, expensive if distances are very great
21 over which gas must move; it's possible that the general
22 economic advantage of using gas internally could be
23 wiped out. But in general, the distances that you're
24 likely to move gas to markets are likely to be compara-
25 tively short, at least as compared with the distances

1 you would be moving it to export markets in the Lower 48.
2 Thus, in general, we would expect that gas will be a
3 relatively attractive fuel for use in the State, as
4 against oil.

5 While there can be significant cost advantages
6 to using gas in Alaska, the potential volumes that might
7 actually be consumed, we believe, are very elusive.
8 We've looked at a number of studies that have been done
9 projecting these volumes, and we think it is by no
10 means certain that the volumes would be very large,
11 especially any time in the near future.

12 It is even difficult to estimate what future
13 residential, commercial and conventional industrial
14 fuel uses might be in Alaska. Realistically, as I said,
15 we believe that the volumes are not likely to be very,
16 very large. We would note that in the Anchorage area
17 where gas has been available for many years, as you know,
18 and which is the area's most populous region, Alaskan
19 consumers are now consuming something like two hundred
20 million cubic feet a day of natural gas. Your royalty
21 share of Prudhoe Bay gas might be on the order of three
22 hundred million cubic feet a day, or about fifty percent
23 more than is currently being consumed in Anchorage,
24 where it has been available for many years, and where
25 a large part of your population lives.

1 Now, new industries are possible. Copper, iron
2 ore, nickel were pointed out by the Governor's Task
3 Force, but they also were very candid in admitting
4 that, and I quote, "At the present time there have been
5 no large-scale, serious and detailed proposals by the
6 private sector to utilize Prudhoe Bay gas for in-state
7 use."

8 Non-conventional uses of gas, and we've heard
9 some testimony about these, such things as using gas
10 as a feed stock for petrochemicals or for methanol are
11 even more uncertain, we believe. If these do materialize
12 it seems likely that it would be many years down the road.
13 While the resources are available in Alaska for these
14 types of operations, the economics of scale and of
15 transport of products to other areas tend not to favor
16 Alaska and tend to work against the economics of
17 these industries in Alaska. We don't mean to say
18 nothing of this sort will ever come about, but what we
19 are saying is that one has to look very carefully at
20 the economics of these things, and it is uncertain,
21 quite uncertain as to what volumes would be used in
22 the foreseeable future for these unconventional uses.

23 So, as we see it, the State's interest in an
24 all Alaska route depends on, first, reasonably clear-cut
25 net economic and social benefits; second, the potential

1 availability of gas for in-state use which, in principle,
2 could provide economic advantages as against other fuels,
3 notably oil. But the volumes that might be used, and
4 their importance, is very difficult to judge and
5 uncertain.

6 But it is up to the State and its people to
7 decide how important these factors are to their interests,
8 and how vigorously, and by what means it wishes to
9 pursue these interests. We do not, however, feel that
10 the State of Alaska can really be the judge of what
11 pipeline route is in the best overall national interests.
12 There are a great many factors that bear on this beyond
13 the interests of the State. Alaskans should be aware
14 that other routes than an all Alaska route might have
15 greater overall advantages to the Nation.

16 On the other hand, if Alaska feels strongly
17 about what it sees are important advantages to the
18 State in the all Alaska route, what is important is
19 that these interests are considered and weighed in the
20 national decision making process that is now taking
21 place as to the routing of the pipeline.

22 We were struck, in reading the FPC staff report,
23 which strongly recommended the Gas Arctic route, that the
24 interests of Alaska and potential benefits to the State
25 were apparently not really considered at all. Judge Litt,

1 in his decision, and I haven't read it all, I haven't
2 read it in its entirety, acknowledges that -- and again
3 I quote, "Alaska's views are entitled to substantial
4 weight." However, I suspect that he is not as convinced
5 of the validity of Alaska's arguments and gives them
6 less weight than most Alaskans might wish.

7 If Alaska feels strongly about what it believes
8 are the interests of the State in an all Alaska gas
9 pipeline, it will want to work to insure that its views
10 get a very careful hearing in the nation's decision-
11 making process. The sale of Alaska's state royalty gas
12 is one way of attempting to do this. If this approach
13 is chosen, we believe that the contracts before you are,
14 in general, as I said before, carefully conceived and
15 effective in protecting the State's interests.

16 We are not legal advisors to the State, I want
17 to caution, and we have no legal expertise, and there
18 are others here who do. But I would like to make the
19 following general comments on the contracts.

20 Some questions have been raised about the pricing
21 provisions, and you will obviously have to consider
22 these very carefully. You obviously are by the nature
23 of your questions. In the end, it seems to me, you will
24 have to assess the likelihood of these contingencies that
25 are spoken about; that is, the likelihood that the State

1 might be able to get a higher price if it didn't sign
2 this contract. Various alternatives have been thrown
3 out. Some of them seem to involve sales of emergency
4 gas to industrial users, questions of whether the State
5 would be caught on a vintaging problem if it signed
6 the contract now, and get a lower price, and so on.
7 From your questions it's obvious also that you are taking
8 the approach that we would recommend, trying to assess
9 what the possibilities of these things happening are.
10 I'm sure you're going to ask me more questions on this.

11 In general, I've looked at these possibilities;
12 I think they're relatively unlikely. And second, if you
13 conclude that these things are possible, that is that it's
14 possible that the State might get a lower price by
15 entering this contract, and even if you assume that that
16 possibility is very small, you might want to consider
17 how could one protect oneself against this possibility.
18 You'll have to ask yourself, could you write contract
19 terms or modify this contract in a way which would pro-
20 tect you from these eventualities. Well, I don't know
21 whether I have the answer to this, but I suspect it's
22 probably doubtful that you could. I think there are
23 probably other witnesses who may be able to give you a
24 better answer to that.

25 Now, as to the other provisions, the recall

1 provisions seem to us to be very strong. It is difficult
2 for us to see how they really could be improved upon
3 very significantly.

4 We are also pleased with the State's ability
5 to get access to liquids under the contract. We have
6 always felt that liquids could be very important to the
7 State, if not as a petrochemical, or a feed stock, or
8 for methanol, or something rather exotic, we think that
9 they could be especially of value as a fuel to local
10 residents, especially to businesses and residents in
11 remote areas. So that we feel that liquids, in the end,
12 could perhaps be of even more benefit to the State for
13 in-state use than gas itself. It's a possibility, and
14 we're very pleased with the provisions of the contract
15 in that respect.

16 In sum, the Legislature will have to consider
17 carefully what its interests are and how to pursue those
18 interests. In the end, only you can decide whether the
19 contracts before you are an effective mechanism for
20 achieving your objectives. Thank you.

21 SENATOR RADER: Thank you, Mr. Kilgore. Any questions?

22 Mr. Gruening.

23 REP. GRUENING: Mr. Kilgore, when you mentioned studies that
24 you looked at for in-state use of royalty gas, which
25 studies were they?

1 MR. KILGORE: Well, there was one prepared by your Division
2 of Natural Resources.

3 REP. GRUENING: Could you identify it specifically?

4 MR. KILGORE: I think I have it with me. "Analysis of
5 Prudhoe Bay Royalty Natural Gas Demand & The Proposed
6 Prudhoe Bay Royalty Natural Gas Sale" dated January 1977.
7 It's a study done by the State of Alaska, Department of
8 Natural Resources, Division of Minerals and Energy
9 Management.

10 Now, I don't want my remarks to be construed
11 to mean I quarrel with this study. It's very difficult,
12 all I'm saying -- estimating future requirements is an
13 extremely difficult and uncertain thing, and this may be
14 as good a job as can be done, but the results are still
15 highly uncertain.

16 REP. GRUENING: Did you do an analysis of what projected
17 uses might be?

18 MR. KILGORE: No, we have not.

19 REP. GRUENING: In that regard, the testimony yesterday
20 from Mr. Thomas Stahr was that the Anchorage utility
21 saw that in 1985 their needs in Cook Inlet would be
22 exhausted. In your readings or studies have you
23 established that to be true?

24 MR. KILGORE: No, I really don't know whether that is true.
25 I do not know how much gas is committed to that pipeline.

1 REP. GRUENING: But the major part of that would be that
2 two hundred million cubic feet per day that you referred
3 to that's used there?
4 MR. KILGORE: Yes, a significant part of that does go for
5 generating electricity in the Anchorage area.
6 REP. GRUENING: And the total royalty share at peak capacity
7 is about two hundred-fifty to three hundred million
8 cubic feet per day?
9 MR. KILGORE: I said very roughly three hundred million cubic
10 feet a day. That's an eighth of 2.4 million cubic feet
11 a day, a very rough number.
12 REP. GRUENING: Did you run across a date at which at least
13 the present known reserves at Cook Inlet are exhausted?
14 MR. KILGORE: No, I haven't. The gas reserves data are
15 available. The American Gas Association has estimates
16 of reserves in the area.
17 REP. GRUENING: Do you recall whether that study of January
18 '77 covers that point?
19 MR. KILGORE: No, I don't recall. As I recall, it was
20 basically an analysis of potential gas demands along the
21 route of the pipeline.
22 REP. GRUENING: But it didn't take in total the gas demand
23 in the State?
24 MR. KILGORE: I believe not.
25 REP. GRUENING: Are you familiar with the provision that

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1 allows the companies that are purchasing to take one and
2 a half times new reserves that are discovered to replace
3 gas that we call back?

4 MR. KILGORE: Yes.

5 REP. GRUENING: Do you see any economic disadvantage to the
6 State in doing that? It was raised, I think by Mr.
7 Dallas, yesterday . He pointed out that, say, reserves
8 were found in Cook Inlet, new reserves or, say, Copper
9 River Basin, that we would be giving them lower priced
10 gas. In other words, because of the lower transportation
11 costs we would be giving them gas at a lower price than
12 we should.

13 MR. KILGORE: Well, frankly, I don't know the answer to that.
14 As I originally read the contract I thought it referred
15 to gas which traversed the whole length of the pipeline,
16 that this was gas they would have a call on. I was
17 thinking in terms of North Slope new discoveries or
18 more gas on the North Slope. I really don't know the
19 answer to that question.

20 SENATOR RADER: Representative Parr.

21 REP. PARR: Mr. Kilgore, you mentioned a while ago that one
22 of the possibilities was gas from OCS, you mentioned the
23 Gulf of Alaska, etc.

24 MR. KILGORE: Yes.

25 REP. PARR: And that this might be cheaper than what we could

1 get from the North Slope actually. As you know, of
2 course, the Supreme Court has held that all belongs to
3 the Federal Government and we don't have a claim on it.
4 So I suppose we would have to buy it from the producers.
5 Even considering the fact that we would be buying it
6 rather than using our own royalty gas, do you think the
7 economics are still such that we would do better by
8 taking OCS gas, assuming it is produced in reasonable
9 quantities?

10 MR. KILGORE: I think the answer to that is very uncertain.
11 It's impossible to really know. One doesn't know the
12 pricing of this gas, one doesn't know the physical cir-
13 cumstances under which it would be produced, what sort
14 of costs would be involved in bringing it to shore and
15 so on. I think the answer is, one cannot really determine
16 in advance whether that gas would be cheaper. It could be.

17 REP. PARR: Is it also possible, Mr. Kilgore, that the Federal
18 Power Commission could decide where the OCS gas would go,
19 it might say it would all go to Pennsylvania rather than
20 staying in Alaska at all?

21 MR. KILGORE: Yes.

22 REP. PARR: Thank you, Mr. Kilgore.

23 MR. KIGORE: Certainly.

24 REP. PARR: Two different points. You said a while ago
25 it didn't seem really that there was too good a potential

1 at least at the present for use in the State of the gas.
2 At least it seemed to be highly doubtful as far as you
3 were concerned.
4 MR. KILGORE: What I said was, it's very uncertain, it's
5 elusive, and we suspect that the volumes would not be too
6 large.
7 REP. PARR: Does that mean what you're saying is that you
8 don't anticipate, at least in the foreseeable future,
9 a sufficient demand; is that what you're saying; or are
10 you simply saying you can't tell? I'm not sure.
11 MR. KILGORE: What we're saying, it's very difficult to tell.
12 If you want a judgment, I suspect it's lower volumes
13 rather than higher volumes.
14 REP. PARR: Has your company ever done any kind of a study
15 as to the lowest economic threshold at which petrochemical
16 plants and so forth will become feasible, of the kind
17 that might be built, let's say, in Alaska using the
18 royalty gas?
19 MR. KILGORE: No, we have not made formal studies of that.
20 We know some of the problems of the economics involved
21 and so forth, but we have not done a formal -- this is
22 from broad knowledge chemicals and so on. It is not from
23 a detailed study of the potentials for petrochemical
24 uses in Alaska.
25 REP. PARR: Could we assume that the use of natural gas in

1 other communities in Alaska would be roughly comparable
2 to that being used in Anchorage? I'm not talking absolute
3 terms, of course, but in, say, relationship to the
4 population? Fairbanks, for example, is roughly --
5 the Fairbanks immediate area is roughly one-third the
6 size of Anchorage. Now, do we anticipate that they
7 would use about one-third as much as Anchorage, or does
8 that vary quite a bit?

9 MR. KILGORE: I think, if one has to make a guess, you might
10 guess that it might be lower per capita. Don't forget,
11 Anchorage is a populated area, you have a density of
12 population, and this provides advantages, economics of
13 scale of putting in distribution systems and things of
14 this sort. If you were going to put gas into Fairbanks
15 there would be a very, very high expense of putting in
16 a distribution system. If you look at other more remote
17 areas, the economics of just getting it there and the
18 scale of population, or the users in those areas, is
19 quite small and tends to work against the advantage of
20 gas use.

21 REP. PARR: That was going to be my next question. You did
22 say, I believe, something about the possibility of using,
23 I believe, butane and propane, which are the liquids
24 from the natural gas, especially for remote areas.
25 One thing you really didn't touch on very much was the

1 liquids. You said you thought it was desirable to the
2 State to have them. Do you have any idea of the economic
3 feasibility of taking liquids out in the State, let's
4 say propane and butane, and shipping those to remote
5 areas of the State to use?

6 MR. KILGORE: Some liquids, obviously, have to come out,
7 I guess there's been testimony here. On the North Slope
8 there will be some taken out for pipeline reasons. The
9 answer is no, we have not done detailed studies on the
10 economics of the use of propane as a fuel in areas.
11 The statements I made really come from our broad judgment
12 and from our knowledge of the industry, not from detailed
13 studies.

14 REP. PARR: Thank you, sir.

15 SENATOR RADER: Representative Hayes.

16 REP. HAYES: Mr. Kilgore, yesterday Mr. Thompson of the
17 Alcan Pipeline testified that in his opinion one of the
18 advantages of the Alcan route over the El Paso route
19 was an approximately Eight Hundred Million Dollars of
20 additional revenue to the State. From your testimony
21 I conclude that you don't agree with this, and if my
22 conclusion is correct is that because you don't agree
23 with their projected construction costs or you don't
24 agree with his statement that if construction cost is
25 less it will result in a better price to wellhead?

1 MR. KILGORE: It's the latter. I don't quarrel with his
2 or anybody else's construction costs because I don't
3 have my own estimates. What I'm saying, we really don't
4 know what the circumstances of pricing of Prudhoe Bay
5 gas are going to be. If it's still regulated by the
6 Federal Power Commission we don't know quite how they're
7 going to regulate it. We don't know whether there will
8 be regulation and so on.

9 We think the most likely thing is that we will
10 have continued wellhead gas regulation by the Federal
11 Power Commission and that it will set prices independently
12 of what the transportation costs are. That's the most
13 likely thing to happen.

14 If you're looking down the road and we really
15 have deregulation, then the cost of transportation could
16 have an impact on the value of gas at Prudhoe Bay.

17 REP. HAYES: If I might continue on that, we have had
18 testimony here that we can expect deregulation of some
19 sort down the line. Would you agree with that?

20 MR. KILGORE: Well, if far down the line is a very long
21 period of time, yes, I think you can't rule it out.
22 We think it unlikely it would come anywhere in the near
23 term.

24 REP. HAYES: Anytime during the life of the contract?

25 MR. KILGORE: The life of the contract is?

1 REP. HAYES: Twenty years.

2 MR. KILGORE: Twenty years. Well, near the end of the contract
3 I suppose the probabilities get higher.

4 REP. HAYES: But in any event, in your opinion, you don't
5 anticipate any regulation that would be beneficial to
6 the wellhead price in the next ten years.

7 MR. KILGORE: I think that's most likely, there will not be.

8 SENATOR RADER: Senator Sumner.

9 SENATOR SUMNER: My concerns lie primarily in the area, say,
10 of economic development potential, whichever line is
11 chosen. Which line, in your view, would provide more
12 economic development opportunities for the State of
13 Alaska?

14 MR. KILGORE: Well, I think the all Alaska; I think that's
15 reasonably clear.

16 SENATOR SUMNER: Do you think that petrochemical manufacturing
17 is a potentially viable interest for our future?

18 MR. KILGORE: I think it may be. I don't know at the present.
19 I think it might be and I think obviously this is something
20 you want to look at. You will want to get people,
21 chemical companies who do this kind of thing to look
22 at it very, very carefully for you. I don't want to
23 imply, anything that I've said, that you shouldn't pursue
24 economic development.

25 SENATOR SUMNER: There seemed to be some doubt in your mind

1 as to whether it might not be feasible, and yet the
2 primary interest in using the Alcan line, or the all
3 Alaska line, would be for that primary benefit. Yet
4 you seem to have a fair amount of hesitancy as to
5 whether that's ---

6 MR. KILGORE: I think this is something that you're obviously
7 interested in. I guess, yes -- what I'm really saying
8 is I wouldn't overdo my expectations as to what you will
9 get because you have gas available.

10 SENATOR SUMNER: If we don't get the all Alaska line what
11 opportunity in the future do you see where there might
12 be a possibility of getting gas to tidewater or an Alaska
13 line bringing the gas down?

14 MR. KILGORE: Is your question where else one might get gas?

15 SENATOR SUMNER: What is the opportunity of getting gas to
16 tidewater in the future if we don't get the Alaska line
17 that's proposed?

18 MR. KILGORE: That depends on what the chances are of finding
19 gas in the area close to tidewater, and there are a number
20 of prospective areas where gas could be found. But
21 there isn't anyone, including myself, I'm not a geologist,
22 but one who really knows geology, who can tell you for sure
23 exactly what the probabilities are of finding gas in
24 these areas because there has been, as you know, virtually
25 no exploratory work in many of these areas. So you just

1 can't assess in advance how much you might get or what
2 the chances are.

3 SENATOR SUMNER: Are you aware of any interest at the moment
4 from different chemical companies that might have an
5 interest in Alaska in the petrochemical area?

6 MR. KILGORE: No specific knowledge. In the past -- as I
7 say, we have some chemical company clients -- we have
8 very broadly suggested they might want to look into this
9 possibility. But I don't know of any detailed proposals
10 of looks at the present time.

11 SENATOR SUMNER: And if I've drawn the right conclusions,
12 you're saying that the Arctic line provides virtually
13 no economic benefit or development benefit for the
14 State of Alaska except money; the all Alaska line provides
15 the most opportunity of the three lines; is that correct?

16 MR. KILGORE: In terms of economic advantage and potential
17 availability of gas.

18 SENATOR SUMNER: Thank you very much.

19 SENATOR RADER: Senator Butrovich.

20 SENATOR BUTROVICH: Mr. Kilgore, in your work for the State,
21 have you people projected changes in population down
22 the road?

23 MR. KILGORE: No, we have not, Senator. We have not been
24 asked to do that.

25 SENATOR BUTROVICH: Are you aware of what is happening in the

1 way of population in Alaska?

2 MR. KILGORE: I know that it's growing rapidly, yes.

3 SENATOR BUTROVICH: Can you see any difference in shipping
4 a product by water, say, from an Alaska port to the
5 South 48 than from Alaska to Japan or from South America
6 to the United States?

7 MR. KILGORE: Well, obviously the costs of transportation
8 depend upon the distances involved, but in the case of
9 Alaskan shipments to the Lower 48, they also involve
10 the use of U.S. flag vessels, which are considerably
11 higher on cost than foreign flag vessels. Shipments
12 from Alaska, for example, to Japan would not have to
13 move in U. S. Flag vessels.

14 SENATOR BUTROVICH: You are aware, however, I assume, or are
15 you aware that when the consumer in Alaska buys something
16 he is generally paying the freight up and the freight
17 back because of the fact that there is no back haul?

18 MR. KILGORE: Yes, sir.

19 SENATOR BUTROVICH: Wouldn't you consider the possibility
20 of a petrochemical industry in Alaska greatly reducing
21 that span of cost to the people living up here if,
22 indeed, there was a back haul?

23 MR. KILGORE: Yes. I think it's obviously something you have
24 to look at. It's an important objective for you to
25 pursue. You see a problem and you obviously should

1 pursue it. The problem may be that -- I said may be --
2 certain types of chemical processing, you're talking
3 about a plant on a very large scale, and a very small
4 part of the output of that plant may be consumed locally
5 in Alaska, which means that a very large part of the
6 output may have to go to other markets, and you have to
7 look very carefully at how competitive that big part
8 that goes elsewhere is with supplies from other sources.
9 I don't want to prejudge the answer.

10 SENATOR BUTROVICH: No, I'm sure you don't. It's awfully
11 hard for me to reconcile, in this day and age, why it
12 is not as practical to ship by water from Alaska as it
13 is to ship by water anywhere else. There's no such
14 thing anymore anywhere that I know of where such a thing
15 as cheap labor exists. That used to be a great argument,
16 but it certainly doesn't exist in the United States today.
17 I, for one, don't think that enough emphasis and enough
18 study has been developed on the petrochemical side of
19 this question.

20 MR. KILGORE: I would agree with that.

21 SENATOR RADER: Senator Huber.

22 SENATOR HUBER: Mr. Chairman, I do have a couple. Dick,
23 do you believe that the contracts that we have before
24 us are attractive enough to disregard the earlier
25 admonitions of Walter Levy and Milt Lipton to be very

1 cautious about committing our future oil and gas supplies
2 before delivery systems actually exist that are able
3 to transport them? We've heard that many times from
4 Milt and Walter, and can you expound on it?

5 MR. KILGORE: I think, as a general proposition, I would
6 probably agree with that, but what one has to do is --
7 here you have a new objective, something else which you
8 are trying to do with these contracts. You obviously
9 have a purpose for doing it; it's to help promote a
10 line which you seem to be quite interested in having,
11 and you just have to assess that against a more general
12 position that perhaps waiting is better. You really
13 have to assess the value of it.

14 SENATOR HUBER: Leading to my next question, Dick. Do you
15 believe the contracts will decide which route is chosen,
16 and would you please try to give us a percentage of
17 chance for El Paso against Artic Gas, for instance?

18 MR. KILGORE: Senator, I'm really not able to give you that
19 kind -- it obviously provides some positive support.
20 I really don't know what the odds of it are. I think
21 that's beyond the scope of my competence as an economic
22 advisor.

23 SENATOR HUBER: My last question fits in with it. Leaving
24 political considerations aside, if you remove the
25 political considerations from the contracts, do you believe

1 we could get more money if we held off selling our gas
2 until a transportation system is ready instead of
3 using it for political clout? If so, what magnitude
4 would you project?

5 MR. KILGORE: As I said before, we don't really know what
6 future pricing is going to be like. We don't know
7 whether it's going to be regulated pricing, or deregulation
8 and so on. So there is an uncertain future. It has been
9 suggested there is at least a possibility that the State
10 could get a higher price by not signing this contract
11 and waiting. But when I look at the circumstances under
12 which this possibility might happen, I think it's
13 unlikely.

14 SENATOR HUBER: You think it's not the most likely scenario?

15 MR. KILGORE: That's correct.

16 SENATOR HUBER: Thank you, Mr. Chairman.

17 SENATOR RADER: Any further questions? Mr. Chatterton?

18 It's about time for a break. I assume we're just about
19 through with this witness, but go ahead.

20 REP. CHATTERTON: There are three questions, and I don't
21 know how long he's going to take to answer them.

22 SENATOR RADER: Why don't you go ahead, let's try it.

23 REP. CHATTERTON: Sir, Mr. Kilgore, let's take an assumption
24 that here last week there was a natural gas transportation
25 system between Prudhoe Bay and the South 48 and, at least

1 we will take that premise right now. Now, apparently
2 a crisis occurred in the northeastern sector of the
3 United States that has led the President to take near
4 national emergency situations, at least for transporting
5 liquefied methane between American ports in foreign
6 bottoms and Heaven knows what all we are doing, quite
7 an upset. On the premise that that straw existed, do you
8 believe that the President might even have been able
9 to legally, and I'm sure he would have, demanded Alaska
10 gas from Prudhoe Bay even though it might have made the
11 people of Alaska suffer?

12 MR. KILGORE: Yes, I think it's a possibility. In an
13 emergency situation you can't rule out that if he doesn't
14 have the power now that the Congress will legislate
15 such powers.

16 REP. CHATTERTON: Without that straw he can't do much about
17 it, can he?

18 MR. KILGORE: No, there's no way he can move the gas to the
19 Lower 48.

20 REP. CHATTERTON: You indicated, when you were giving your
21 reasons for being hired by the Legislature here and so
22 forth and so on, that you did do consulting work for,
23 I think you said, transmission companies, other foreign
24 governments. I don't know whether I singled out of
25 context transmission companies, but would any time,

1 keeping in mind the powers of the Alaska Oil and Gas
2 Conservation Commission, would you recommend to a client
3 or do you think that a client, even if you recommended
4 that he proceed to look for financing, could possibly
5 get financing for a Six to Nine Billion Dollar pipeline
6 in view of the powers of the Alaska Oil and Gas Con-
7 servation Committee?

8 MR. KILGORE: What your're asking, are these powers likely
9 to be an important stumbling block to ---

10 REP. CHATTERTON: To the financing.

11 MR. KILGORE: To the financing? No. I think those powers,
12 in and of themselves, no.

13 REP. CHATTERTON: Even though they can turn the valve and
14 shut the gas off in two years?

15 MR. KILGORE: I think if the lenders were reasonably assured
16 from their own looks and so forth at the reserves and so
17 forth, and carefully considered what they felt were
18 reasonable flows of gas without loss of pressure and
19 so on, without loss of oil, I think they would go ahead,
20 yes.

21 REP. CHATTERTON: You, yourself, or your associates have
22 not so done, have you -- made that determination?

23 MR. KILGORE: No. We are purely economic consultants.

24 REP. CHATTERTON: One more question and I'll close. Do you
25 think, by any chance, that the transmission system between

1 Prudhoe Bay and the South 48 would be financed by public
2 money?
3 MR. KILGORE: Do I think is there a possibility that in the
4 end public money or some sorts of guarantees, or something?
5 REP. CHATTERTON: Yes.
6 MR. KILGORE: I think there is a possibility, yes.
7 REP. CHATTERTON: Thank you, sir. Thank you, Mr. Chairman.
8 SENATOR RADER: Representative Hayes.
9 REP. HAYES: Thank you, Senator Rader. I want to get back
10 on the question that I was asking you about, the timing
11 for deregulation. I didn't quite pose the question
12 correctly. I think you said that you didn't think there
13 would be deregulation in the next ten years, but within
14 somewhere between ten and twenty years from now. The
15 contract actually starts on the date of delivery, isn't
16 that correct?
17 MR. KILGORE: Yes.
18 REP. HAYES: So that during the first ten years of the
19 life of the contract we might expect deregulation, going
20 back to your previous answer?
21 MR. KILGORE: It's possible, yes.
22 REP. HAYES: Thank you.
23 SENATOR RADER: Any further questions?
24 SENATOR HUBER: I have a short one that comes from a question
25 Mr. Chatterton asked.

1 SENATOR RADER: Go ahead, sir.

2 SENATOR HUBER: I just wondered, Dick, I thought maybe you
3 might have some idea. Well, here's the question.
4 How much is the reasonable flow of gas without reducing
5 oil recovery? That's in answer to the way you used it
6 in answering Mr. Chatterton.

7 MR. KILGORE: Would you repeat that, Senator?

8 SENATOR HUBER: In your opinion, how much is the reasonable
9 flow of gas without reducing oil recovery in the content
10 that you used it in answering Mr. Chatterton's question?

11 MR. KILGORE: As I said, I'm not an engineer, I don't know
12 technically the answer to that. My answer to the question
13 was, if the lenders and other people in their own analysis
14 were assured of this fact that they probably would be
15 willing to go ahead. I have no opinion of my own as
16 to what the volumes would be.

17 SENATOR HUBER: I thought it indicated to me you had some
18 knowledge that we didn't have, from your work with
19 other companies.

20 MR. KILGORE: No, sir.

21 SENATOR RADER: I think you stated, Mr. Kilgore, when you
22 started, that you've been in attendance constantly
23 during the hearings which started Monday, and that the
24 value judgments you have given us today, you have taken
25 into consideration the testimony that you have heard

1 at these hearings thus far?

2 MR. KILGORE: Yes, Senator.

3 SENATOR RADER: Are there any other questions of Mr. Kilgore?

4 Mr. Kilgore, will you be available the rest of the
5 afternoon?

6 MR. KILGORE: Yes.

7 SENATOR RADER: We'd appreciate it very much if you could
8 keep yourself available for the committee if they have
9 any questions.

10 MR. KILGORE: I intend to. I'll be happy to do so.

11 SENATOR RADER: We'll take a break and then hear from Mr.
12 Rush Moody. Ten minutes.

13 (Whereupon the hearing recessed at 3:45 p.m.
14 and reconvened at 4:00 p.m.)

15 SENATOR RADER: The committee will come back to order. Mr.
16 Jerry McCutcheon has handed me a two-page document dated
17 April 4, which he has asked to be inserted into the
18 record as an extension of his remarks as Exhibit 18
19 instead of requiring him to verbally testify. Unless
20 there is objection, we will have those remarks placed
21 in the record as Exhibit 18.

22 REP. CHATTERTON: Objection. Would you change the date to
23 February 4, please, from April 4?

24 SENATOR RADER: I'm sorry, did I say April 4? It's February 4.
25 (Whereupon Exhibit 18 was duly marked.)

1 Our next witness -- before he starts to give us his
2 own statement of qualifications, I just thought I might
3 direct the attention of the people present, as well
4 as for the record, that the February 7, 1977 Newsweek
5 entitled "The Gas Crisis" in the National Affairs
6 section, Mr. Rush Moody, a former Federal Power Commis-
7 sioner, is extensively quoted. So I want you to know
8 that Mr. Rush Moody has a national audience for sure
9 and perhaps a national constituency. I don't know about
10 that.

11 MR. MOODY: If nominated, I will not run.

12 SENATOR RADER: But, at any rate, I want to say one thing
13 about the Alaska Legislature; we go first-class when
14 we hire consultants. That's February 7, 1977 on page
15 twenty.

16 Mr. Moody, would you please -- as many of you
17 know, Mr. Moody was first retained by the State of Alaska
18 last year by the Joint House-Senate Gas Impact Pipeline
19 Committee, which was a statutory committee chaired by
20 myself and Representative Gruening as Co-Chairman.
21 Mr. Moody gave that committee extensive testimony last
22 year on some of the same matters that we're considering
23 now. The committee went out of existence as of January 1
24 of this year, the statutory committee. As I say, he
25 was retained by that committee, as was Mr. Swanson,

1 from funds appropriated to that committee, with the
2 thought that some committee of this Legislature would
3 need his advice and his counsel in this matter.

4 So, Mr. Moody, with that, would you please
5 read into the record first, sir, your background quali-
6 fications, and then I assume you will make a statement
7 and open yourself for questions.
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1 MR. MOODY: Thank you, Mr. Chairman, to both Chairmen, and
2 to the Members of the Committee, I wish to express my
3 appreciation for the opportunity of being here. I have
4 been most impressed over the course of the past five
5 days with the attention and the concern which each of
6 you expressed. I wish that the Congress of the United
7 States would take as seriously some of the problems they
8 have as you obviously take seriously this problem before
9 you.

10 I am a lawyer by trade. I attended the University
11 of Texas, with a Bachelor of Business Administration,
12 University of Texas Law School, licensed to practice
13 in the State of Texas in '56, in private practice from
14 1956 until 1971. I was appointed to the Federal Power
15 Commission as a Democratic member by a Republican President.
16 I served on the Federal Power Commission from 1971 until
17 March 15, 1975. I was Vice-Chairman of the Commission
18 for two of those years.

19 I resigned from the Commission in March of 1975
20 because of my belief that the structure of Federal
21 regulation was injuring the consuming public of the
22 United States and that very serious regulatory reform
23 was necessary if the country wasn't going to get in a
24 lot worse shape than it was already in.

25 Following my resignation I represented the

1 Governor of the State of Texas in Washington, as his
2 special counsel on energy affairs. In January of 1976
3 I became a managing partner of the Washington office of
4 the law firm of Vinson and Elkins. The firm, of which I
5 am a member, has offices in Houston, Washington, Fort
6 Worth and London.

7 I hesitate to claim to be an expert in any
8 area, but I am more than fifty miles from home and I
9 do have a briefcase, so I guess I qualify.

10 Mr. Chairman, I would start out, I suppose, by
11 saying that I attempted to prepare for the committees
12 a summary of the contracts together with some analyses,
13 or attempted analyses, of what I perceive to be the major
14 strengths and major weaknesses.

15 SENATOR RADER: Let me interrupt you, Mr. Moody, so we be
16 sure we don't miss that. Make certain that the remarks,
17 your analyses and your covering letter of January 28 is
18 entered in full as an exhibit to the hearings, and that
19 would be Exhibit 19; is that not correct, Reporter?

20 MRS. SANDERS: Yes.

21 SENATOR RADER: Be assured that your full remarks are in
22 the supplement.

23 (Whereupon Exhibit 19 was duly marked.)

24 MR. MOODY: Thank you, Mr. Chairman. I realized after I
25 got here and after I listened to the course of the

1 hearings over the past several days that, in many
2 instances, the issues that were being explored related
3 to whether or not any contract should be signed, whether
4 it was appropriate use of the State's resources to commit
5 to these contracts, these particular purchasers, under
6 these particular circumstances at this particular time.

7 I will, if I might, go through the more formal
8 part of my contract analysis first and then turn, if it
9 is the committee's will, to some of the other issues
10 that have been addressed during the course of the hearing,
11 and then finally respond to whatever questions the
12 committee will have.

13 With respect to the contracts themselves, I should
14 start out by saying that it is very difficult to make
15 a comparison with any other gas sales contract because
16 you have a unique situation, and much of what I can
17 offer to you, other than with reference to the technical
18 side of the contract in terms of measurement, metering,
19 and that sort of thing, I can tell you whether that's
20 standard or whether it's not standard. But there's much
21 that's in the contracts that reflect the unique nature
22 of the transaction, and so when I offer thoughts on that
23 I hope that you gentlemen and ladies will understand I'm
24 having to offer you value judgments of a sort. I didn't
25 perceive it to be my job to say this is the best of all

1 arrangements that could be made, but rather to take what
2 the Administration had negotiated and brought to you and
3 try to offer some thoughts as to where those contracts
4 seemed beneficial and where there might be questions.

5 I would speak first on the positive side with
6 reference to the contracts themselves. I find four areas
7 where I think an excellent bargain has been struck, in
8 several instances much better than I would have expected
9 in trying to plat out what course this all might have
10 taken when we first started discussing it a year ago.

11 I think one of the principal strengths of the
12 contract lies in the provisions that the State will not
13 suffer monetary loss by reason of an in-kind taking,
14 compared to what expenses the State would be out, which
15 would be none, if it just took in value. When the State
16 takes in-kind there has to be a point in the production
17 cycle when title to the gas passes. It cannot be, in
18 my judgment, at a point after all of the processing has
19 occurred and all liquids have been stripped out, and the
20 State just walk in and say, "All right, we want one-eighth
21 of the residue gas and we want one-eighth of the liquids
22 free of any costs."

23 I don't believe that's the way it's going to work
24 under your leases and under the practicalities of the
25 arrangement. But since the gathering lines haven't been

1 built and the processing plants have not been designed
2 or constructed, no one knows what those costs will be,
3 and I think it very important that the contract nego-
4 tiators realized that there was a risk, a substantial
5 financial exposure on the part of the State, and that
6 they undertook to protect the State against those costs.
7 This, in my judgment, they have done in Article II,
8 Sections 2.2 and 2.3 wherein, in effect, the buyers say
9 whatever it is that the State is out in terms of out-of-
10 pocket costs by reason of this in-kind taking, that the
11 State would not have been out if it were value taking,
12 then we, the buyers, agree to reimburse the State in full.

13 I think that was a significant concession on the
14 part of the buyers to the State, and I think it's an
15 important element of protection in the contracts.

16 Secondly, I think it is very much in favor of
17 the contracts that the arrangements have been structured
18 so that the State is selling one hundred percent of its
19 present deliverability, but not one hundred percent of
20 its Prudhoe Bay reserves. You will notice as you go
21 through the contracts that of the three buyers, one is
22 to receive twenty-five percent of the gas that flows
23 that belongs to the State, another twenty-five percent,
24 and then the third fifty percent.

25 Well, obviously, that's the full one hundred

1 percent of the deliverability as it is produced. But
2 because the volumetric limitations are written into the
3 contract in Article III, what we have is a situation
4 that the State is not selling what it really believes
5 that it has in totality. In this instance I operate on
6 the strength of what I was told last year when I was
7 up here, that the State's royalty share of recoverable
8 reserve was anticipated to be in the order of 3.2 trillion
9 cubic feet, and these contracts obviously sell less than
10 that. So it's less than a complete sale of all of the
11 royalty gas that the State expects to recover from Prudhoe
12 Bay.

13 Personal judgment, I think that is prudent
14 because it gives you an opportunity to have some operating
15 experience behind you, it lets you see what the market
16 conditions are like at that point in time when the total
17 volumes have been delivered under these contracts, and
18 permits you the flexibility and freedom to make new
19 contractual arrangements if that appears to be in the
20 best interests of the State.

21 Third, I think the arrangements for withdrawal
22 of gas for in-State needs are very favorable. I think
23 the protection there is quite good. I will express to
24 you the view that these provisions may almost be too
25 good when it comes time to try to finance construction

1 of a pipeline. It's going to be a little bit hard for
2 a financial institution to look at a situation where
3 the State has a right to pull back out one hundred per-
4 cent of one-eighth of the gas stream, so that that through-
5 put is not available to stand behind the generation of
6 revenues for the line.

7 From a contractual standpoint, I see no reason
8 in the world not to insist upon this bargain as far as
9 the State is concerned. What I'm suggesting to you is
10 that there may come a moment of truth further down the
11 line when the financial institutions come to the State
12 and say, "If you insist on this we can't finance it."
13 To me, I'm trying to underscore what I believe to be
14 the strength of the withdrawal provisions because I think
15 they are very favorable to the State.

16 I am impressed with the provisions in the contracts
17 relating to the retention of the State's rights in natural
18 gas liquids. You've heard a number of people say, and
19 certainly I agree with them completely, that the liquid
20 content of this gas may be of greater value to the State
21 than residue gas itself. I do think that the State has
22 retained fully the right to remove the liquids, process
23 them and do with them as they will.

24 You're not forced to do that. It's an option
25 under Article IX. If you leave any part of the liquids

1 in the stream the buyer has to take them; you, the State,
2 will be compensated on the basis of the increase in btu
3 content of the gas that comes about by reason of leaving
4 the liquids in the stream. So you, in effect, have an
5 option as to whether to pull the liquids out or to leave
6 them in. If you pull them out, they are yours to sell
7 on the open market or to devote to uses within the State.
8 If you leave them in you will be paid for the btu content.
9 I think those provisions are quite protective of the
10 State's interests.

11 Finally, I read with interest the different places
12 in the contracts where the State has the right to with-
13 draw or terminate because, since we are dealing in such
14 such a flexible fluid situation, I would think it
15 important to the State to know that they were not forever
16 bound to these contracts, that if certain things happen
17 that you might walk away from them without incurring any
18 obligation or liability.

19 There are, I believe, four instances where the
20 State can withdraw from the contract without penalty.
21 It may do so if it is prevented by a Federal action
22 from taking its royalty gas in-kind. The contracts may
23 be terminated if a decline in production results in
24 non-profitability to the State. The sales agreements may
25 be terminated by the State if the State so elects after

1 the FPC makes a routing decision that is adverse to an
2 all Alaskan line, and finally, the State may terminate
3 if by January 1, 1979, all approvals necessary, authoriza-
4 tions, that the State feels necessary to get the benefits
5 under this contract, if all of those approvals have not
6 been received.

7 I think the latter quite a good provision. I
8 think it lets you look at the decisional process at the
9 Federal level. If it's something that the State could
10 live with, you may do so; if you don't like the way it's
11 structured, you've got the right to terminate the agree-
12 ments. I think those provisions are all quite sound,
13 quite protective of the State, and I think they are
14 major sources of strength in the contracts.

15 The principal areas of difficulty that I have
16 with the contract all relate to Article VI, dealing with
17 pricing. There are several problems here. I've tried
18 to be as exhaustive as I could in thinking up the problem
19 areas that you need to be aware of. In the course of
20 talking about them though, I'd like to give you an
21 assessment as to whether I think they're problems of
22 great magnitude or problems of lesser magnitude -- because
23 any lawyer can find anything in a contract, you know, and
24 say, "This might not work out too well." So I'll do the
25 best that I can to give you an assessment of how bad

1 it is as we touch upon each one of them.

2 The first one relates almost directly, Representa-
3 tive Gruening, to the line of questions you were asking
4 about the possibilities of a deregulation bill or any
5 action that would result in a vintaging situation that
6 would be hurtful to the State. The structure of Article
7 VI is such that there is a proviso in Section 6.1 which
8 has overriding effect on the pricing structure. I'm
9 sure that each of you have read these contracts carefully,
10 and you will recall that Section 6.2 provides a pricing
11 mechanism if regulation continues.

12 6.3 provides a pricing mechanism if there is no
13 Federal regulation, and 6.4 provides a pricing mechanism
14 if Federal regulation starts, deliveries commence, and then
15 Federal regulation terminates. So there are three
16 alternatives, really, in terms of pricing, and then
17 you pick up Section 6.5, which is important and which
18 gives redetermination rights.

19 But Section 6.1, the last clause makes it clear
20 that there is one condition that cuts across all of the
21 pricing alternatives, and it is that so long as the
22 pipeline buyers are subject to the jurisdiction of the
23 Federal Power Commission, so long as their rates are
24 subject to the jurisdiction of the Federal Power
25 Commission, then the price that they will pay to the State

1 shall be no higher than the price which they are per-
2 mitted to recover in their jurisdictional rates at the
3 FPC.

4 I'm not surprised to find that the pipelines
5 wanted that, because certainly you can understand that
6 they don't want to pay you more than they can get back
7 from their customers and, indeed, I would be surprised
8 if all pipeline purchasers didn't bargain most strenuously
9 for this type of provision. But I do want you to be
10 aware that the effect of it is to say that so long as
11 deregulation does not occur the Federal Power Commission
12 is going to be setting the price for your gas.

13 So far the State has taken the position that it
14 is not a person within the meaning of the Natural Gas
15 Act, that it is not subject to direct rate regulation
16 by the FPC. I concur in those positions, but the effect
17 of Article 6.1 is to consent to indirect rate regulation
18 by the FPC because you are saying that the pipelines
19 do not have to pay to you more than the FPC will permit
20 them to flow through in their jurisdictional rate structure.

21 That problem disappears if appropriate deregula-
22 tion legislation is passed. But if it does not pass, if
23 we are with substantially the same form of pricing that
24 we now have for some period into the future, then it seems
25 to me that the 6.1 proviso does override the other pricing

1 alternatives that appear in the contract. Because of
2 that, Representative Gruening, you can postulate a situa-
3 tion where a deregulation bill passes that deregulates
4 the producer but does not deregulate vintage of gas that
5 the State would be selling under this contract. That
6 would occur if a deregulation bill were drawn so as to
7 deregulate gas sold under a contract dated after a
8 certain date.

9 I offer you the value judgment that that is a most
10 unlikely occurrence. The Commission moved away from
11 contract date vintaging in 1969 in the Southern Louisiana
12 Two decision and has never returned to it. I believe
13 that I have read every piece of gas legislation that's
14 been offered in either House for the last four years,
15 and I can recall no bill offered in either House that
16 went to deregulation on the basis of contract alone.
17 They are mostly cast in terms of new gas being defined
18 as gas sold under a contract or delivered after a certain
19 date, and it's an "or" delivery test. I don't really
20 think it's likely at all that a deregulation bill would
21 be cast so that it would be harmful to you.

22 As a practical matter, so that you will under-
23 stand why the Congressional reasoning and the FPC
24 reasoning seems to be moving in this direction, away
25 from contract vintaging, it is simply because if you

1 permit a deregulated price to a producer on the basis
2 of when he contracts to bring the gas to market, if that
3 producer has been guilty of withholding his gas from
4 market in anticipation of deregulation, then you have
5 rewarded his wrongful conduct.

6 So, to me, it's not likely that people are going
7 to go back to contract date vintaging as a test for
8 deregulation. So my answer to the line of questions
9 you posed is that there is, yes, a theoretic possibility
10 that the State could be hurt by contract date vintaging in
11 deregulation, but I do not believe that that possibility
12 is substantial.

13 I do think that the present language of Section
14 6.1 is unclear in one respect. In my opinion letter,
15 on pages six and seven, I attempted to spell out why
16 I thought there was an ambiguity. I think, from my
17 discussions with Mr. Byrd, that the parties did not
18 intend the ambiguity to exist and it would be probable
19 that the buyers would enter into whatever type of
20 letter modification or letter of explanation that is
21 necessary to straighten this out.

22 It seems to me that it must be made clear
23 that Section 6.1's limitation goes out the window,
24 becomes totally inoperative, if an appropriate deregulation
25 bill is passed. I just don't think that the language

1 is altogether as clear as it could be on that point,
2 but I don't think it's a major burden or a major obstacle
3 to the contracts if the purchasers will agree as to what
4 the proper construction of that provision is.

5 Other witnesses have advised you, and certainly
6 I agree, that you cannot determine a sales price under
7 these contracts as drawn. Section 6.2 will not give you
8 a sales price because the FPC has set no price for Alaska.

9 Section 6.3 and 6.4 will not give you a price
10 because they're conditioned precedent, deregulation, has
11 not occurred. And so you have before you a contract that
12 is indefinite as to price, and you have a contract where
13 your price will ultimately be determined by someone other
14 than the State. In the event of continued regulation
15 your sales price will be determined by the FPC. In the
16 event of deregulation your sales price will be determined
17 by the prices which producers, working interest owners,
18 obtain in their contracts.

19 So, I would want you to understand that you
20 are giving up direct State control over the sales price
21 through the pricing mechanism embodied in Article VI.

22 There have been a number of comments about
23 whether we will or will not have deregulation, and if we
24 have continued regulation, what is likely -- I'm mentioning
25 at this point, because it's structured into my opinion

1 and I think it is a major concern.

2 So many things have happened so fast in the Lower
3 48 States in the natural gas business over the course
4 of the past three or four weeks that I don't think any-
5 body can give you an informed guess as to the likelihood
6 of deregulation or not. We've seen two and a half
7 million people out of work on a given day in the Lower
8 48 States because there wasn't enough natural gas to go
9 around. We've seen the Congress in three days' time
10 pass an emergency allocation bill that for the first time
11 gives the President of the United States the right
12 to reach into one interstate pipeline supply sources
13 and move the gas to another interstate pipeline.

14 We've seen as of, I think it was Wednesday night,
15 the President authorized Two Dollars and Twenty-Five
16 Cents as an emergency purchase price that any interstate
17 pipeline could pay for one hundred and eighty day emergency
18 purchases of gas anywhere in the Lower 48 States.

19 All of this says to me that it is a time of
20 great uncertainty. We will nationally, I suppose, sooner
21 or later arrive at a decision whether we're going to move
22 toward greater regulation and allocation on a national
23 scale, or whether we move to less regulation and honoring
24 of private contracts. I wish I had an answer for you,
25 because I think if you knew what the future held, it would

1 make your job a lot easier.

2 But I cannot, in honesty and in good conscience,
3 tell you that I'm confident what the future will bring.
4 If deregulation continues, or if a deregulation bill is
5 passed that is not appropriate to Alaska, and by that
6 I have reference to the possibility that a bill might
7 be structured like FPC and go to commencement date of
8 a well rather than date of first deliveries. So you
9 might have some gas up there that continues to be regu-
10 lated even though a deregulation bill passes. But if
11 some or all of your gas remains regulated, I hate to say
12 it but I must say it, brace yourselves -- my judgment
13 would be that the Federal Power Commission will determine
14 a rate for Alaska as a separate producing area, that
15 they will not treat you on the same basis with the
16 national rate, as they treat the rest of the country.
17 They have specifically excluded Alaska from applicability
18 of their last set or rate orders, they have specifically
19 excluded Alaska data from the calculation of a national
20 rate, and to me that indicates that when the time comes
21 for the setting of an Alaskan rate, it will be a rate
22 peculiar to Alaska.

23 I am concerned, and I would want you to understand
24 the reason for my concern, that an FPC separate for the
25 State of Alaska will probably be not as high as Judge Litt

1 and they came up with a very low rate, relatively
2 speaking, for associated gas. You can understand it.
3 Gas was their responsibility, they could keep the price
4 down and make everybody happy by putting the costs over
5 on the oil side; so that's what they did.

6 The second factor that you've got going against
7 you is that you do have a major, huge discovery up here,
8 and obviously the more units of gas you have in terms
9 of reserves added, the more units that you have to spread
10 these costs over, then you come up with a lower per unit
11 cost figure. So the arithmetic of FPC methodology is
12 against you if they're going to set the rate for you. I
13 can't really do much more than say that the structure
14 and the methodology is just going to work against you;
15 that's all there is to it.

16 But that is a condition beyond my control, or
17 yours. It is only one of those things that you need to
18 be aware of. That condition would exist whether or not
19 you sign these contracts. The existence or the absence
20 in the Federal regulation is not, obviously, going to
21 turn on whether these contracts are signed or whether
22 they are not. But in speaking with you today, I at least
23 want to mention to you that it would appear to me that
24 the State of Alaska needs to be very active at the FPC
25 in any rate matters affecting Alaskan gas, because if you

1 mentioned in his opinion, of a Dollar, probably not be
2 as high as some of the economic projections that have
3 been laid before you over the course of this past week.
4 And the problem essentially arises because of the structure
5 of rate making methodology at the FPC. They try to set
6 a rate for natural gas on the basis of what they perceive
7 the cost of production to be, the cost of finding and
8 production, and a reasonable rate of return to the
9 producer.

10 They have, since 1968, been costing gas well gas
11 where they could find a data series and they could
12 determine how many feet were drilled in gas well explora-
13 tion, what gas reserves were found, what the costs of
14 gas production were. So their national rate determina-
15 tions since 1968 have essentially been for new gas well
16 gas.

17 You go back to the early Commission efforts at
18 rate regulation when they tried to price associated
19 gas, and they became enormously tangled up with the
20 problem of cost allocation. Here are two joint products,
21 oil and gas, they come out of the same hole in the ground,
22 you spent a certain number of dollars to find it and
23 produce it, so how do you allocate the cost between the
24 two products. The FPC, since they had jurisdiction over
25 gas, allocated a very heavy burden of costs to the oil,

1 leave it to them to do it for you without some evidence,
2 and some input and some argument from you, you are
3 probably not going to like the results.

4 I did have a problem with the redetermination
5 provisions under Section 6.5. They were the same concerns
6 that Mr. Swanson raised with Chairman Rader the second
7 day of the hearing; and with the purchasers' representa-
8 tions about their meaning of Section 6.5, I no longer
9 find an objection in that area.

10 Over all, to get back to the general structure
11 of the thing, since your rate is going to be determined
12 by somebody else, one consequence of entry into these
13 contracts will be the necessity that the State partici-
14 pate in some FPC proceedings. Your rate, under this
15 structure, in the event of continued regulation will
16 be set either in a national or an Alaskan rate proceeding
17 where the FPC determines by rule-making a rate applicable
18 to the whole state, or it will come up in an independent
19 individual producer's certificate case where one of the
20 North Slope producers goes finally into the FPC with a
21 contract and says, "Here is the price I bargained for.
22 Let me charge it." And the FPC can approach the rate
23 issue in that context.

24 Or, finally, if neither of those two things
25 occur and deliveries commence, the pipelines that buy

1 from the State will take to the FPC their rate structure
2 and ask for approval of what they paid to the State.
3 There are three possible procedural mechanisms where the
4 pricing problem can be reached by the FPC. Whichever
5 of those three comes to pass, it seems to me absolutely
6 essential that the State be there to participate fully.
7 I don't think you can rely on other people to carry
8 this important issue for you in that fort.

9 On the whole, if you asked me whether the pricing
10 problems that I've tried to outline for you are sufficient
11 to condemn the contract, I'm going to give you one of
12 those "either/or" answers, I think. I'm not sure that
13 what we're talking about here is a pricing issue, in
14 terms of what the Legislature is going to be asked to do.
15 I think it's a routing issue.

16 Having already stated that these contracts are
17 unique and that, therefore, there's not much I can compare
18 them with, I offer you the value judgment that I don't
19 think you'll get better terms than this from anybody
20 at this time and under these circumstances. I think
21 that on the whole they're as good a contracts as you are
22 likely to get.

23 The real question, it seems to me, and here I
24 need to, I guess, go back a little bit -- I did come up
25 here this time thinking that the State had already made a

1 decision about which route it supported and that the
2 sale of the gas was an appropriate means to try to help
3 influence a favorable decision on the routing. I can
4 well understand it, because a lot of things that have
5 occurred in the last year that many members of the
6 Legislature and many citizens in the State might want
7 to think through again, whether those are both questions
8 that you would still answer in the affirmative. But if
9 you come to the same answers and you say, "We do think
10 that the routing decision is important to the State,
11 we do think that the State should do all that it can
12 to influence a favorable routing decision," then I sus-
13 pect that the pricing provisions here should not be a
14 bar to your approval. But I can't -- and I'd make it
15 perfectly clear to you, you've got a third applicant
16 in the game since I was here a year ago. I carry no
17 brief for El Paso or for Alcan, I carry no brief for
18 the individual purchasers under these contracts. Pick
19 Tenneco, Southern, anybody else -- I'm just trying to
20 speak to the concepts of what are you doing with the
21 State's resource and is this a good time to do it.

22 I think there is a risk in not doing anything.
23 I cannot tell you, and I don't think anybody else can
24 tell you, how much it will influence the routing decision
25 if these contracts are approved. I think, as Mr. Ward

1 said the other day, that most people would recognize
2 that it will have some impact. I don't think, and this
3 kind of disturbed me, about the way things sounded a
4 time or two. I don't think what we're talking about is
5 the State trading its royalty gas for lobbying efforts
6 by two companies.

7 It seems to me what I was talking about a year
8 ago and, hopefully, what everybody is thinking about,
9 is that the State is holding out to a number of states
10 in the Lower 48, "We will share our gas with you if you
11 will help us get the route that we need." I have a
12 jaundiced and prejudiced view, I suppose, of lobbying
13 as such, if a corporate vice president thinks he's
14 going to influence a Legislator's vote. I don't think
15 that happens very often. I don't think that's the way
16 to get things done anyway.

17 But I don't perceive these contracts as a means
18 where you buy a corporate lobbying support and expect
19 you're going to get anything. If you look at it that
20 way, I don't think you will get anything. But if these
21 purchasers, in your judgment, are responsible companies
22 that know their business and can reach to their customers,
23 and go to their customers and say, "We have the promise
24 here in writing of some gas from Alaska if we help
25 Alaska on getting the right route," then it seems to me

1 you've got to have some influence on the routing decision.

2 I think Judge Litt has spoken the first word,
3 but most assuredly, he has not spoken the last word
4 on the routing problem. An Administrative Law Judge
5 of the FPC, and particularly Judge Litt, is respected
6 by the Commissioners. They will believe him to be an
7 honest man who has worked diligently with the record
8 over many months, and I would anticipate that they would
9 think that he is infinitely more familiar with the record
10 than any of them can hope to become. But they will not
11 abdicate their responsibilities to Judge Litt. I say
12 that institutionally and I say it knowing the individuals.
13 I think they will try their best to reach a decision on
14 what they perceive to be truly in the national interest.

15 Certainly I think the same will be true when it
16 moves over to the White House for Executive Agency decision.
17 So I don't think the routing decision dies with Judge
18 Litt's decision. I think it's still an open issue. I
19 think it's possible that some persuasiveness can still
20 be brought to bear on the issue.

21 Really, I don't ask myself so much, "Is it too
22 early to enter into these contracts," as do I ask myself,
23 "Is it too late that we entered into these contracts?"
24 Once again, I'm not talking about individual buyers
25 (I hope you all understand that), I'm talking about

1 the concept of the use of the State's royalty gas as a
2 means of trying to influence what you believe to be in
3 the State's best interest, and whether you come down
4 on the side of Alcan or El Paso, that's beyond my concern
5 and beyond my knowledge.

6 Whatever you do, it seems to me, perfectly legi-
7 timate that you use the State's resource in a manner
8 that helps you get the best benefit for your State.

9 I preach a lot, I apologize. I guess I feel
10 strongly about your situation up here because you're
11 one of the few places that still has the opportunity
12 of controlling your own destiny.

13 There are a couple other things that I guess are
14 worth mentioning. I don't try to characterize them as
15 good or bad since I think that your perception of them
16 depends on things other than legal analysis. But I think
17 the provisions of 11.4 are noteworthy, which grants to
18 the Governor the right, in effect, to make a switch in
19 the State's support. I really can't offer any judgment
20 as to that provision. Certainly you have to be aware
21 of it.

22 The contracts do contain certain options on
23 State royalty gas that are triggered if the State effects
24 a withdrawal of some of the gas covered by these contracts
25 for in-State use. I think the option provisions, themselves,

1 are not remarkable and are understandable. I suspect
2 that they reflect the necessary bargaining process of
3 what State negotiators had to give up in order to get
4 some of the stronger elements in the contract that I
5 covered earlier. So I mention it only to make sure that
6 I've tried to make you aware at least of the major pro-
7 visions in the contract.

8 The contract is silent on one thing that I think
9 is significant, and I'm probably beyond my depth here
10 and, therefore, going to make a mistake or two. But
11 my recollection of your severance tax structure is that
12 if you take your gas in-kind, the one-eighth taken in-kind
13 will probably not bear a severance tax. That is a sub-
14 stantial revenue loss that occurs by reason of an in-kind
15 taking that would not occur if you took in value, and I
16 don't think the contract deals with that. I don't think
17 that the questions asked to the purchasers the other
18 day, in effect were, "If you pay a severance tax com-
19 ponent to a working interest owner will you match that
20 and will you pay it to the State," and they said, "Yes,"
21 and that's fine.

22 In the event of the continuance of regulation
23 they will be permitted to pay a severance tax component
24 only as reimbursement for severance tax pay. So I don't
25 think that the FPC will let them pay you the equivalent

1 of a severance tax component. So I do suggest, as I
2 think one of the other folks did this morning, that it
3 might be appropriate for the State to give some thought
4 to its severance tax structure in conjunction with these
5 sales arrangements.

6 One or two general thoughts, if I might, maybe
7 it would save some time, before we get to individual
8 questions.

9 I think several of you have indicated an interest
10 in knowing whether or not these same or better terms
11 could be obtained if the State waits until a later date
12 to make a sale. I suspect that if the routing decision
13 is adverse, if Arctic Gas is selected, I don't think
14 you'll get these favorable terms because I don't think
15 that your rights of withdrawal will be meaningful to you,
16 and I'm not sure that a purchaser through that system
17 would consent to it.

18 I'm not sure that you could get the same provisions
19 on the reimbursement of costs incident to your in-kind
20 taking. In essence, the four areas that I thought
21 represented real bargaining pluses in the contracts, it
22 seems to me if you're talking about a buyer through the
23 Gas Arctic system, they have little reason to offer you
24 those favorable terms. So it may be that waiting until
25 a later date, in the event of an adverse routing decision,

1 you might not see terms as favorable as these again.

2 Some questions have been asked as to whether or
3 not the State could obtain a higher price if they pursued
4 some other type of sales arrangement. Again I have to
5 offer you a value judgment because I haven't surveyed
6 the market. There's not any real way that I could do
7 that, but I can speak with reference to how sales arrange-
8 ments are structured under FPC regulation. And I will
9 say that any sale that you make to someone in the Lower
10 48, or in the State of Alaska, is going to involve FPC
11 transportation jurisdiction and, in a sense, that sale
12 is going to be subject to FPC review.

13 If you attempt to find a distribution company
14 in the State of Alaska or outside the State of Alaska
15 to sell to, yours will be a sale for resale in interstate
16 commerce, and the transportation of the gas will be in
17 interstate commerce. So I don't really think that you
18 move beyond where you are now by looking for that type
19 of purchaser. There are not many purchasers that are
20 able to take the volumes of gas that you all are talking
21 about delivering, so you've got, in one sense, a limited
22 market.

23 Electric utilities, I'm sure, would love to have
24 it to burn under boilers, but I am quite positive that
25 the FPC would never grant transportation authority for

1 that type of use.

2 The FPC does have a procedure whereby high
3 priority users can purchase gas from a producer. It's
4 called Order 533(a). It is limited to two years. The
5 buyer is supposed to receive only those volumes that
6 offset his curtailment in high priority two and three
7 usage, and I think it's just simply not applicable to
8 the type of sale that the State would be looking to.

9 So, while I will not absolutely rule out any
10 possibility of a sale at a higher price, I offer you
11 the value judgment that you probably won't find one.

12 One of the Representatives the other day indicated
13 that perhaps Section 13-B of the Alaska Natural Gas
14 Transportation Act rendered the desirability of these
15 contracts somewhat less than might have been true before
16 the passage of that act. It seems to me that 13-B is
17 helpful to the State only if the right route is selected.
18 If the gas moves out of the State north of the Arctic
19 Circle I don't know how you would ever implement your
20 rights of withdrawal. You're just not going to have a
21 means of getting it down to where your people are and
22 where you hope your industry is. So it will look good
23 on paper. It doesn't vanish if the Gas Arctic route
24 is chosen, but it is hard to see how it is of much
25 practical help to you.

1 I will confess to a certain academic interest
2 over the last few days in the discussions that you all
3 have heard with reference to the effect of transportation
4 costs on wellhead prices. It's a very confusing area,
5 and I will offer you my perception if you want it.

6 In a regulated market, transportation costs are
7 not going to have a thing to do with wellhead price.
8 The FPC is going to set a wellhead price based on what
9 they perceive to be the costs of finding and production,
10 and a reasonable rate of return to the producer, and they
11 simply have no mechanism for looking at transportation
12 costs as a function of that rate. I know of no instance
13 that the FPC has ever set a producer rate based upon any
14 consideration of transportation costs.

15 In the event of a non-regulated market, I think
16 that what I have heard over the last several days with
17 two sides of the argument, I've heard some truth on
18 both sides, but I'm not sure that I've heard the complete
19 truth from either side, and I mean no disrespect,
20 obviously, by saying that. In a deregulated market
21 transportation costs do have an influence, but they are
22 not the only factor that influences wellhead prices.

23 The nature of the use to which the gas is going
24 to be put determines whether it is appropriate to look
25 at a number two fuel oil equivalency price. For some

1 uses a user will pay much more than a number two fuel
2 oil price. So you have to look at the market to which
3 the gas is going before you know what is your base point
4 for comparison backwards, and in the absence of a funda-
5 mental change in regulation the average cost of purchased
6 gas on a pipeline system is buying from you has an
7 influence on the wellhead price in the sense that, indeed,
8 regulatory agencies now tell a pipeline or distributor,
9 seller, to roll in or average his costs. And if you're
10 dealing with a buyer that has a low average cost to
11 purchase gas, then what he pays you is influenced by
12 the fact that he's working against a lower averaging base.

13 I guess what I'm saying is that in the event
14 of deregulation, if you tried to determine wellhead
15 price only by looking at transportation costs and only
16 by equivalencies with number two fuel oil, I suggest
17 that's less than all of the factors that will enter into
18 it. I suspect that as of right now, trying to determine
19 what wellhead price will be in the event of deregulation
20 is largely a metaphysical exercise. I'm just not sure
21 that it's productive. You'll get as many guesses as you
22 get economists up here.

23 Now, we lawyers are more definite, you see.
24 I'm sorry I've taken more of your time than I intended
25 to. I guess, Mr. Chairmen, it would be appropriate

1 to offer myself sacrificially.

2 SENATOR RADER: Representative Rudd.

3 REP. RUDD: Mr. Moody, this morning Mr. Swanson mentioned
4 the possibility of storing our gas in place for some time,
5 until we have a need for it. Is that a possibility if
6 we don't approve these contracts? Is that a possibility?

7 MR. MOODY: Well, I guess there are two sides to the question.
8 Is it possible mechanically, physically?

9 REP. RUDD: I was going to ask both questions.

10 MR. MOODY: And is it possible ---

11 REP. RUDD: By law.

12 MR. MOODY: Regulatory. I better not make a guess on the
13 first one because I really don't know enough about your
14 reservoir and its mechanics, that I really couldn't give
15 you anything of value other than to guess on it. On the
16 other side of it, once again you've got to make a judgment
17 as to whether we're going to be deregulated or continue
18 to be regulated. Since my personal feeling is that we
19 probably are going to face regulation, I think I'll deal
20 with that one first.

21 If the producers start selling the gas stream
22 into interstate commerce you would have to be most careful
23 that some type of balancing arrangement or under-lifting
24 arrangement with the producers had been reduced to writing
25 and had been approved by the FPC, because in my judgment,

1 if eight-eighths of the gas stream starts flowing in
2 interstate commerce without some advance approval for
3 the State to be storing its gas having been had and
4 obtained from the FPC, you would be met with the argument
5 when you later wanted to change the flows that you were
6 trying to work an abandonment and that Section 7-B of
7 the Natural Gas Act would interfere with what you wanted
8 to do.

9 I think it's something that perhaps could work
10 but I think you need specific agreements and, to be on
11 the safe side, I think you'd want to go for regulatory
12 proof.

13 REP. RUDD: Could you give us your appraisal as to how
14 likely it is the FPC would agree to such an arrangement?

15 MR. MOODY: I'd guess they wouldn't. I think they want your
16 gas.

17 REP. RUDD: Would this hold true under both conditions of
18 the Alaska exemption, whether it's in effect or not in
19 effect? Would that have any bearing, do you think,
20 on their decision?

21 MR. MOODY: I read Section 13-B to apply to withdrawal from
22 the system after deliveries have once commenced. Maybe
23 that's too narrow a reading. Assuming 13-B stays in the
24 Act and your arrangements for storage were structured as
25 part of a royalty sales contract, I guess you could

1 bring it within 13-B.

2 REP. RUDD: Thank you. I have one more question on another
3 subject.

4 SENATOR RADER: Go right ahead.

5 REP. RUDD: I think it was Mr. Thompson who mentioned yester-
6 day or the day before, that he felt that a lobbying
7 effort in Washington would not really be a very important
8 thing to do at this time because it is now a decision
9 that is before the FPC and then the President, and
10 Congress only gets into it after those two have made
11 their decisions, and only has a very short time to
12 evaluate the President's decision and, therefore, probably
13 will not go against the President's decision. But
14 you're a former Commissioner on the FPC, and you just
15 mentioned that you thought that lobbying efforts would
16 be valuable. Are you talking about influencing the
17 decision of the FPC and the President and the Congress,
18 or at what point do you think the lobbying would be most
19 effective?

20 MR. MOODY: I'm going to, if I may, take exception to the
21 word "lobbying".

22 REP. RUDD: I'm sorry.

23 MR. MOODY: No, really. Because to me it has a specific
24 connotation; perhaps it doesn't to others. What I
25 suggest will happen is that the Federal Power Commission

1 has been told to gather all the information they can
2 in order to make the most advised recommendation to the
3 President as they can, and the President and the Executive
4 Branch has been told to gather all the information that
5 they can, talk to as many people as they can.

6 I think those people are genuinely interested
7 in arriving at the best decision they can. I would not want
8 to believe, and I do not believe, that their minds are
9 made up. I don't think that there is anything wrong
10 with offering the views of concerned people, both at the
11 FPC and to the people in the Executive Branch that are
12 charged with this responsibility. I think that the
13 opportunity still exists for people other than the State
14 of Alaska and people other than El Paso, who have made
15 their record, to go in and say, "We do have an interest
16 and here's what it is, and we'd like for you to take us
17 into consideration," and I think the opportunity exists
18 both at the FPC and in the White House.

19 REP. RUDD: Thank you.

20 SENATOR RADER: Any further questions? Representative Hayes.

21 REP. HAYES: Thank you. Mr. Moody, you mentioned that one
22 of four pluses that these contracts have -- interested me.
23 One in particular that's of interest to many of us here
24 is the right to withdraw our royalty gas for in-State
25 use after it's originally injected into the pipeline

1 system. Then you mentioned that when we get around to
2 the financing that Alaska may have to face a moment of
3 truth. Does that mean that we may have to subordinate
4 that particular clause in order to make it possible for
5 the pipeline companies to build this line and, if so,
6 what do you think the chances are that we'll have to do
7 that?

8 MR. MOODY: Well, I hate to borrow trouble, but I can see
9 that a financial institution wouldn't be too wild about
10 lending on an eight-eighths pipeline knowing that one-
11 eighth of the through-put can be withdrawn at any time,
12 because it's the through-put that generates the revenues
13 that pay back the debt.

14 I guess I'd just be guessing if I said I know
15 they're going to come to you and make you give it back.
16 The best I can do is offer you the view that to me,
17 representing the lender, you know, I'd say, "Gee, we'd
18 better go get this straightened out some way, we'd better
19 get some means of determining that the whole financing
20 of the line is not going to be in jeopardy."

21 REP. HAYES: So we have three pluses and a possible plus.

22 MR. MOODY: From a contractual standpoint you've got a very
23 good plus. My point is that it may be too strong a plus.
24 You may have to give some of it back.

25 SENATOR RADER: That was my understanding of what you were

1 saying too, that we drove such a hard bargain that these
2 people may not be able to finance the pipeline with what
3 they have left.

4 MR. MOODY: To me it's quite conceivable it could deveop
5 that way.

6 SENATOR RADER: Representative Gruening.

7 REP. GRUENING: Is the project so marginal in your view
8 that what we do with our one-eighth will kill the project?
9 I mean, can I fairly infer that from what you said?

10 MR. MOODY: No, I have no judgment about the economics of
11 any of the three projects. I've never sat down to study
12 them.

13 REP. GRUENING: But you're saying as it relates to private
14 financing that our one-eighth is crucial.

15 MR. MOODY: I'm saying that from the standpoint of a lawyer
16 who has done a little bit of work in representing lenders
17 that any time you see something that threatens the
18 revenue flow that you're looking to for repayment of
19 your debt, you raise a red flag. But then I don't know,
20 I have no judgment as to whether the difference between
21 your one-eighth and eight-eighths is the difference in
22 "go" or "no go" on the line. I'm sorry, I have never
23 done any economic studies on it.

24 REP. GRUENING: But what you are saying though, it is the
25 difference between "go" and "no go" as to whether a

1 private financier backs that line?

2 MR. MOODY: I think they're going to look at this provision
3 very carefully, and a prudent lender is going to look
4 at the reserves and he's going to look at the capacity
5 of the line and the cost and everything else, and maybe
6 this won't be a problem. But somehow I kind of suspect
7 that some day somebody is going to knock on the door
8 and say, "We need to discuss these withdrawal provisions
9 with you."

10 REP. GRUENING: You mentioned that if the Arctic route is
11 chosen we wouldn't get as favorable a contract. Let's
12 say we don't enter into a contract and the El Paso route
13 is chosen, do we stand to get as favorable a contract?

14 MR. MOODY: They struck their deal with you once. I guess
15 they'd stick by the same deal, but I don't know them
16 that well and I haven't asked them.

17 REP. GRUENING: You heard Mr. Tussing's testimony yesterday
18 as to what he thought the international ramifications ---

19 MR. MOODY: I was enthralled with it.

20 REP. GRUENING: Yeah, I think the headline should have been
21 "Members Entertained by Testimony," but I think what he
22 says may have some merit. But I want you to comment
23 on his view that the Canadians are going to make the choice
24 and that if they do, in fact, make that choice, or cannot
25 make that choice, isn't the El Paso route inevitable

1 if they can't make it, and what we do in this contract
2 won't make any difference in that international decision
3 making process?

4 MR. MOODY: I really had the feeling, listening to Arlon,
5 that if I had his prescience about what our government
6 was going to do, and what the Canadians were going to do,
7 and Congress was going to do, and the FPC was going to do,
8 I ought to be making a lot more money than I'm making.
9 I suspect that an awful lot of what Arlon was saying
10 were very well educated guesses as to what he believed
11 would develop or might develop and, certainly I respect
12 his judgment and the knowledge that he has and the facts
13 from which he draws.

14 I don't come to the same conclusion about
15 everything being cut and dried and that it's only the
16 Canadians that have something left to say. It's not
17 that I know that that's true, it's just that I am unwilling
18 to recommend to you that you pass up the possibility
19 that you've still got a way to do something. You see,
20 I don't know, and all I've got to do is assume that the
21 FPC and the White House will operate in good faith,
22 that they still have open minds, that they're still
23 willing to listen to reason, to rational arguments from
24 responsible people, and if those assumptions are correct
25 then there is still a way to try to make this routing

1 decision come out better than it has so far.

2 REP. GRUENING: I think what you say in terms of rational
3 arguments having some effect is persuasive, I cannot
4 believe anyone who says we can't have any effect on this
5 decision. But the question before us is whether the
6 commitment under this contract will have an effect on
7 the rational part of the decision making. You described
8 earlier that you thought it could have an effect in
9 terms of, I think, the way that the public would perceive
10 what we're doing here. In terms of the amount of gas
11 and date of delivery that could occur under this contract
12 what should we be telling, truthfully telling the
13 American people they're getting under this contract
14 so that they'll be persuaded that they should press
15 their representatives for an all Alaska route?

16 MR. MOODY: That you're offering a share of your resource,
17 and you're offering it under written contracts with
18 responsible people that operate as buyers, sellers and
19 transporters of gas, and that if the correct route is
20 selected then you fully intend to abide by the terms
21 of this contract.

22 REP. GRUENING: But can we say that in any other document
23 or any other way and saying in effect that -- is there
24 a more appropriate document than this to say, or a more
25 appropriate spokesman to say this than the gas company?

1 MR. MOODY: I've forgotten which Justice it was on the English
2 bench that once wrote, "As a man binds himself, so shall
3 he be bound." It seems to me that the most appropriate
4 way to express your sharing of your resource is in a
5 contract. It's very easy for people to say, "Oh, we'll
6 share with you, trust us." But, you know, you're to the
7 point of the State committing itself in writing by
8 solemn legislative and administrative acts that say,
9 "Yes, we will share the resource." It seems to me that's
10 appropriate.

11 REP. GRUENING: Do you think there is any danger, as long
12 as you're making these political assessments -- could
13 you tell us, is there any danger in assuming that the
14 public is willing to go both ways; in other words, we'll
15 allow you to take it back for any in-State use you want
16 and we'll give you special legislative consideration
17 for it, plus we're going to go along with your route
18 decision? I mean, maybe we're asking for too much;
19 I don't know.

20 MR. MOODY: It's a valid concern.

21 REP. GRUENING: One other question. You mentioned the
22 provisions that you've analyzed although, in other words,
23 if you were writing the contract out of the context of
24 trying to affect some political decision you might try
25 to renegotiate it to cover some of these.

1 MR. MOODY: Representative, I have tried to express in one
2 of the opening paragraphs of this letter. It is very
3 difficult to go in and pick up an executed contract and
4 assess accurately whether it's the best deal that could
5 have been struck or not. Those people who negotiate
6 for you and against you have to go through a process
7 of give and take, and unless you have been a party to
8 the negotiation process and you know where you compro-
9 mised and where they compromised, and where were the
10 absolute points of no give at all, then you really don't
11 know whether this is the best deal that could have been
12 arranged.

13 I've read summaries of the contract negotiations.
14 I don't know whether in any particular instance I or
15 anyone else could have driven a better bargain for you,
16 and I just wouldn't want to be in the position of saying
17 that I don't think your negotiators did a good job.

18 REP. GRUENING: You mentioned that under these contract
19 provisions a letter of agreement, especially 6.1 and
20 I think 6.5 ---

21 MR. MOODY: Yes.

22 REP. GRUENING: -- could be corrected by getting a letter
23 agreement or something on the record to clarify the
24 possible ambiguity. As an attorney, wouldn't you
25 recommend to actually get that into the contract?

1 MR. MOODY: It can be part of the contract by supplement
2 so long as it's been done and properly agreed to by all
3 parties before the Legislature is asked to vote on it.
4 It seems to me that would be the determinative thing.
5 They've laid a proposal before you but I don't see
6 why it could not be supplemented with an additional
7 paragraph or so before the Legislature votes.

8 REP. GRUENING: Thank you.

9 SENATOR RADER: Representative Parr.

10 REP. PARR: Thank you, Mr. Chairman. Mr. Moody, this contract
11 is a twenty-year contract, and you've had a lot of
12 experience with the FPC; what is sort of a rule of
13 thumb, if there is any, on the length of contracts
14 across the country in selling natural gas?

15 MR. MOODY: Yes, sir. Up until three years ago I would say
16 twenty years was the industry standard contract. About
17 three years ago the Commission went through kind of an
18 evolution in its manner of determining to what gas certain
19 rates would apply, and they permitted a higher price
20 after the expiration of a contract if a new contract
21 was entered into, called roll-over contracts.

22 You have a contract that expires, you would by
23 FPC vintaging be held at a certain level, but the
24 Commission kind of restructured and they said, "If you
25 enter into a new contract we will permit you a higher rate."

1 Leaving aside why that happened, whether it was good or
2 whether it was bad, one practical consequence was that
3 contract term shortened because people saw that by
4 contracting for a shorter period of time they would have
5 an opportunity to roll over the contracts and move to a
6 higher price. As a consequence of that trend, the Com-
7 mission, in Opinion 770-A, abandoned the roll-over
8 contract concept and they refused to permit the higher
9 rate for roll-over contracts. So we may now see a
10 restoration of longer term contracts.

11 REP. PARR: In this last three-year period you're talking about,
12 what would be sort of a guess as to the usual length?

13 MR. MOODY: There were still some twenty, some fifteen.
14 The FPC does an every six month analysis on contract
15 terms, and some were as low as two and three years.
16 It would be hard really to say what the industry average
17 was because it was such a short transition period and
18 it really didn't shake out before it got changed again.

19 REP. PARR: I would like to, Mr. Chairman. You said also
20 a while ago, Mr. Moody, in answer I believe to somebody's
21 question, that we're not likely to get a better contract
22 if we were to wait. Can I assume that you were talking
23 about a regulated, as opposed to a non-regulated,
24 situation in making that statement?

25 MR. MOODY: Yes.

1 REP. PARR: You said, when you first started talking, that
2 nobody can really guess whether deregulation is going
3 to come or not; and then just a couple minutes ago
4 you said your own belief is that we will continue to
5 have regulation. Am I quoting you right?

6 MR. MOODY: Yes, I'm afraid so. I'd like not to be quoted
7 too widely.

8 REP. PARR: One last question, Mr. Chairman. You said that
9 we might be able to offer some of our resource to some
10 of these states through valid companies with good
11 contractual arrangements, etc., and get their support.
12 Can't we assume that the states which are going to profit
13 by the other route, such as Arctic, are going to be
14 throwing their support behind that route and you're going
15 to wind up, perhaps, with simply a matter of counting
16 the number of votes in Congress in favor of each one,
17 and each one going for the one that seems in its own
18 best interests, Illinois versus (shall we say) Alabama,
19 and Texas versus New Jersey, and so forth?

20 MR. MOODY: Yes, sir. I would have thought that's the way
21 it was going to develop. But you've got, it seems to
22 me, something kind of unusual operating in your favor
23 on this question. The producers are not entering into
24 contracts because they're concerned about where they're
25 going to be on the price structure. So as of right now

1 nobody is making a commitment of their gas that they can
2 promise and that the Gas Arctic people can go state by
3 state and say, "You're going to get so much, you're
4 going to get so much." As long as the producers don't
5 contract, you are the one party in a position to say,
6 "We're going to share our resource with you on a specific
7 basis."

8 REP. PARR: You don't think, Mr. Moody, that the companies
9 such as Michigan/Wisconsin who talked to us the other
10 day, or other big companies in the Midwest, are going
11 to have their people believing they profit by Arctic Gas
12 because there are no signed contracts? Is that what
13 you're saying?

14 MR. MOODY: No. You know, human nature is a funny thing,
15 and part of what's involved in this whole routing
16 process are certain perceptions in the Lower 48 States.
17 There is a perception that Arctic Gas will bring gas
18 to the Midwest and to the Northeast at a lower cost;
19 there is a perception that El Paso takes gas to the
20 West Coast, that's already afloat in oil; there is a
21 perception that Alcan started too late and hasn't studied
22 their project properly and didn't make as strong a
23 presentation as they could have under other circumstances.

24 You're dealing with perceptions when you are
25 trying to get people to become involved enough to go to

1 the FPC or to the White HOuse and say, "Gee, this route
2 would certainly help us." It seems to me that the
3 commitment of specific volumes, even with your oil rights,
4 so specific companies that reach specific states might
5 be of some help in altering those perceptions.

6 REP. PARR: Thank you, sir.

7 SENATOR RADER: Senator Sumner.

8 SENATOR SUMNER: Inasmuch as I get the impression that price
9 is probably going to be determined outside of what the
10 State of Alaska is going to be able to do, doesn't it
11 really come down to a very simplified option that in the
12 end what we are able to provide for Alaskans, or the
13 citizens of Alaska, will depend on whether we have an
14 option of sending part of our royalty gas to an in-State
15 petrochemical type of operation or whether it goes
16 out of the State? Is it that simple?

17 MR. MOODY: Senator, I offer the judgment that from the
18 very beginning price was of less importance to the State
19 than was retention of the control of the resource.

20 SENATOR SUMNER: In your view is the Alcan project in a first,
21 second or third running position?

22 MR. MOODY: I really never have gone into any of them, and I
23 don't mean to dodge you, but the first of these applica-
24 tions were filed when I was on the Commission and some
25 of the evidence came in while I was on the Commission,

1 and I really have hesitated and don't want to be put in
2 the posture of endorsing one versus the other.

3 SENATOR SUMNER: And you're here to try as best you can to
4 equip us with the knowledge that you have so that we can
5 punch a button to decide whether we ratify a contract
6 or whether we don't. If you had to punch a button and
7 it comes down to no discussion or no nothing, one day a
8 button has got to be punched; if you had to punch that
9 button, would it be yes or no?

10 MR. MOODY: Was it Mr. Levy that said, "Elect me to the
11 Legislature and I'll tell you"?

12 SENATOR SUMNER: But before we let you escape from us today
13 we're going to keep you pretty close to that position.
14 What is your recommendation to the Legislature?

15 MR. MOODY: I think you've got to go back to where you stand
16 on the routing problem.

17 SENATOR SUMNER: That goes back to where the option is, and
18 we're now down to the point where our destiny is pretty
19 much controlled as to whether we have the option of using
20 our gas in-State or sending it out.

21 MR. MOODY: Senator, obviously I have an opinion.

22 SENATOR SUMNER: Yes, sir, and that's what I'm trying to get.

23 MR. MOODY: My problem is, I feel very presumptuous, as
24 somebody who grew up in Texas and has been in Washington
25 the past five years, being in the position of saying to

1 men and women like you, who are elected to and who do
2 represent your constituents, and who know your State,
3 what their needs are and what their concerns are -- you
4 know, how can I tell you what to do?

5 SENATOR SUMNER: No, that isn't what I'm asking you. I'm
6 not asking you to tell me what to do, I'm asking you to
7 tell me, on the basis of what you know, which you've
8 got lots of years of experience, you're an expert,
9 acknowledged, self-professed, being out of town with
10 a briefcase, and I'm trying to determine in your mind
11 which way would you go if it was your decision, if you
12 were one of those people making a decision.

13 MR. MOODY: Maybe I ought to put it this way.

14 SENATOR SUMNER: Sometimes I wish the little button had a
15 message like that.

16 MR. MOODY: If I lived in Alaska I would probably write my
17 Representative and Senator and express the view that the
18 routing decision was of terrible importance to the State,
19 that this offered a means of perhaps arriving at a happy
20 answer to the routing decision and that, therefore,
21 my Representative would vote for it.

22 SENATOR SUMNER: Thank you very much. That's all I have,
23 Mr. Chairman.

24 SENATOR RADER: Mr. Chatterton.

25 REP. CHATTERTON: Thank you, Mr. Chairman. Mr. Moody, I'm

1 looking for a value judgment on your part somewhat akin
2 to the question you just had. Let's say that Chat
3 Chatterton takes the position that he just doesn't want
4 any straw, any conduit at all from Prudhoe Bay to
5 Washington, D.C. where they can turn a switch, he wants
6 to delay it as long as he possibly can; do you think
7 that the approval of these gas sales contracts will
8 change, will accelerate it? If I want to delay it, will
9 I be accelerating the issue?

10 MR. MOODY: Having said that I think that the contracts
11 would be of some benefit in the routing decision, I
12 think it necessarily follows that if you have no contracts,
13 it kind of just may help Gas Arctic, I don't know.
14 I just don't know, and I don't mean to be flip or
15 presumptuous.

16 REP. CHATTERTON: I'm not worrying about any route, I don't
17 want any route.

18 MR. MOODY: I can recognize what you're saying and I would
19 have said, "Now, Chat, don't worry about that," a few
20 days ago, but I saw the Congress of the United States
21 pass an allocation bill and, as you know, it was conven-
22 tional wisdom that the pipeline industry producing states
23 would just never let it happen. But emergency situations
24 came up, the pressure was there, and the bill went
25 through both Houses, and was signed by the President in

1 three days' time. I recognize your concern.

2 REP. CHATTERTON: Thank you.

3 SENATOR RADER: Representative Hayes.

4 REP. HAYES: Since we've discussed and mentioned several
5 times that the most important aspect of this whole
6 thing is the future in-State use of Alaska's royalty gas,
7 do you think that by signing these contracts that we are
8 in any way jeopardizing that opportunity in the future,
9 as opposed to not signing any contracts?

10 MR. MOODY: No, sir, because I think the withdrawal rights
11 are clear.

12 REP. HAYES: But we get into the situation of -- well, first
13 of all, we've got the financing problem that we talked
14 about. So, you know, we're going to be back to the
15 drawing board, possibly.

16 MR. MOODY: Maybe I shouldn't have mentioned that.

17 REP. HAYES: The second problem is that once you get it
18 into the system, once it starts flowing out for sale,
19 they may decide that it's in the best interests to the
20 country -- once it starts flowing out it's awfully
21 hard to turn it back around again. That's another
22 possibility of losing it. So it would appear that
23 signing the contracts would put us in a more hazardous
24 situation, could be more jeopardy on the possibility in
25 the future of having our royalty gas available for in-State

1 use than if we didn't sign anything, we just waited a
2 while.

3 MR. MOODY: It seems to me that turns on the perception of
4 the same answer that Representative Chatterton asked.
5 If you believe that not signing delays the construction
6 of any pipeline system or transportation system, then
7 what you suggest would follow. But if failure to sign
8 or signing does not slow up the selection on the building
9 of a transportation system, then you are vulnerable to
10 the taking, whether or not you sign the contract.

11 SENATOR RADER: Any further questions? Senator Huber.

12 SENATOR HUBER: Most of my questions have been asked, or
13 almost asked, Mr. Moody. One hasn't as yet. The change
14 that you recommend in our severance tax structure, should
15 we rush and make this effective before we get into a
16 contract, from a legal viewpoint?

17 MR. MOODY: Senator, I'm not an expert on your structure,
18 but I don't think so. I think my answer is that you
19 have time to do it but it ought to be done before gas
20 starts to flow. I don't think you want to tie it to the
21 flow of gas. Somehow that seems like it's too late to do it.

22 SENATOR HUBER: The time structure then is that we should do
23 it before the flow of gas, but it's not necessary to do it
24 before we enter into the contracts, if we're going to do
25 it?

1 MR. MOODY: If you will take the word of a Texas lawyer on
2 Alaskan tax matters.

3 SENATOR HUBER: Would you care to speculate just a little
4 bit further on Charlie Parr's question to you? It got
5 very closely to what I wanted to get into, and the part
6 that it didn't cover is, maybe in what magnitude of
7 lobbying do you think it might take to change the per-
8 ception of the people in the East that the Canada route
9 is going to bring it to them; the perception in the
10 Northwest that the Alcan route dumps it into them; and
11 the perception in the Southwest, Arizona, California and
12 so forth, that El Paso brings it to them with the first
13 crack? Would you care to speculate briefly on what
14 you think what might be the -- what kind of effort,
15 how big an effort might be needed to overcome those
16 ideas?

17 MR. MOODY: Senator, I wish I could be some help to you.
18 You know, I think you're talking about a question of
19 political science, or polling, or something I know I don't
20 know, and forgive me, I just can't be of any help to you
21 on that.

22 SENATOR HUBER: In that question, would you go along with
23 me one more? Would you have any feeling in the area
24 where you are living right now, Washington, D.C., if
25 you and your neighbors feel that, for instance, the

1 Trans-Arctic Canada route might not give them the best
2 bite on the gas or not? Do you know of any perception
3 like that?

4 MR. MOODY: No. I think it's still probably as an issue
5 that is being discussed not at the individual consumer
6 level so much as at the State Commission, State Government,
7 certainly involved industry level, but I doubt that
8 Alaskan routing has become a matter about which
9 individual consumers have views at this time.

10 SENATOR HUBER: I was getting into the end, of course,
11 from necessary lobbying to convince Congress, based
12 upon your earlier remarks. You haven't then noticed
13 this, yourself?

14 MR. MOODY: No, I haven't, and, you know, you get involved
15 in a certain area yourself and you begin to lose objectiv-
16 ity, because that's all you think about or all you talk
17 about, and I'd be a very poor person to ask what people
18 in Washington, D.C. feel about this, because I would
19 necessarily reflect my own thoughts.

20 SENATOR RADER: Any further questions of Mr. Moody?

21 Mr. Moody, we thank you very much, and I know that Mr.
22 Kilgore and Mr. Swanson both have reservations out, so
23 I think that we'll excuse you gentlemen from further
24 attendance this afternoon, although we still do have
25 some members of the public to be heard.

1 You're welcome to stay if you wish, but as far
2 as the committee is concerned I think it would be well
3 to excuse you to try to make your plane connections.

4 MR. MOODY: Thank you.

5 SENATOR RADER: Let me find out before we take our ten-minute
6 break where we stand. I have a list of witnesses that
7 are possibly here or possibly not. Is Mr. Heinmiller
8 here to testify? I see Mr. Penney and Paula Easley. Do
9 you wish to testify?

10 MR. PENNEY: Yes.

11 SENATOR RADER: Carolyn Berg, is she here? Dennis Schlofeldt,
12 from the Fairbanks Chamber of Commerce. I'll assume
13 that he's not going to testify. Is there someone here
14 from the Associated General Contractors who is going to
15 testify? There's no one from the Associated General
16 Contractors.

17 Under those circumstances, we have Mr. Penney
18 and Ms. Easley from OMAR here to testify, the only
19 remaining witnesses. Does the committee wish to take
20 a ten-minute recess, or shall we take their testimony?

21 SENATOR HUBER: Let's take five minutes.

22 SENATOR RADER: Let's take a five-minute break.

23 (Whereupon the hearing recessed at 5:25 p.m.
24 and reconvened at 5:35 p.m.) .

25 SENATOR RADER: Would the committee come to order here?

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We have Mr. Robert Penney and Ms. Paula Easley. Would you identify yourselves and who you represent? I suppose you would like to make a statement and then open yourselves to questions. Would that be the way to proceed, Mr. Penney?

1 MR. PENNEY: Yes, that would be fine, Mr. Chairman. Chair-
2 people, if that is the correct term, my name is Bob
3 Penney, and I'm President of the Organization for the
4 Management of Alaska's Resources. On my left is Ms.
5 Paula Easley, she is our Executive Director.

6 This month OMAR is two years old. It was started
7 some two years ago, with the idea of having some citizenry
8 input into what happens to the development and/or the
9 management of Alaska's resources. One of the first goals
10 and projects that we took on was the issue of this
11 natural gas line, and since then we've spent many, many
12 hours and an awful lot of time trying to at least get
13 a layman's understanding of what's really happening.

14 We have an office in Anchorage. The address is
15 the Fourth Avenue Theater Building. We have a one-man
16 office in Fairbanks, Alaska National Bank, and this
17 next month we'll have an office in Seattle, and we have
18 an associate office in Washington, D.C. under USA, Alaska.
19 We have forty-nine directors from all over the State,
20 and we have an executive board of eleven people, and the
21 executive board meets once a week. We have public
22 meetings once every Thursday in the Anchorage office.

23 I'd like to start off by saying OMAR doesn't
24 really say who builds the gas line, we never have.
25 We don't care where it goes, through what cities it may

1 pass; we just say it must go to a tidewater, ice-free
2 port within the State of Alaska. And our second point,
3 in our estimation, Prudhoe Bay gas is going to be
4 produced. Now, it's produced with the oil and, as we
5 understand it, we don't own one-eighth of the gas,
6 we own one-eighth of the production and initially,
7 unless we take it in like kind, we own one-eighth of
8 the revenue. And, as we understand it, if we elect
9 to take it in like kind, as Commissioner Martin has done,
10 we then can take one-eighth of that production of that
11 gas in like kind or take the gas itself.

12 (b) Per Atlantic Richfield Company engineers
13 (Chat was at the meeting) it will cost nine to ten and
14 a half percent of the gas to reinject it into the ground.

15 (c) It's against the law to flare it, as it
16 should be.

17 (d) Eighty-seven and a half percent of the gas
18 is already sold to others. It will leave the State,
19 the rest of the country will demand it. There is a
20 Federal law that sets a time frame for delivery of this
21 gas. The gas is going to be produced.

22 Our share, as brought out by Mr. Moody, of the
23 estimated three and a quarter trillion cubic feet,
24 we have in this contract before you sold or are endeavoring
25 to sell eighty percent of that gas, or 2.6 trillion feet,

1 and that amounts to eighty percent of the gas. Somebody
2 said the other day they thought only seventy-five percent
3 should be sold, and this is approximately eighty.

4 Our surplus royalty gas has to be sold for a
5 period of time; that's what our observations have given
6 us. We can't use it all right now in the State. I
7 believe the State of Alaska looked for four and a half
8 months trying to find a user for that gas specifically
9 within our State. OMAR really feels this, and the reason
10 we feel we're for this line is as follows.

11 We feel that the eventual use of the royalty gas
12 within our State is the number one reason and benefit
13 that Alaskans will accrue from this gas line.

14 (b) At a flow of three hundred million cubic
15 feet a day, this royalty share equals, according to our
16 figures, 2.2 times the amount of gas presently being
17 used by forty percent of our population, the Anchorage
18 Bull.

19 Last year the State could not find, nor is there
20 a user at this time, who will agree to use or develop
21 all the gas within our State.

22 (d) OMAR concluded over a year ago that we have
23 to sell our surplus gas in order to have it back again
24 some day. The eventual use in our State, as we stated
25 before, the eventual use in our State of that gas should

1 be our number one priority.

2 Number Four: Prudhoe gas is going to market
3 and the routing of that gas line will be a political
4 decision finally decided by the Congress of the United
5 States of America.

6 (a) We initially started working for a royalty
7 gas contract at the recommendation of Senator Stevens
8 and Representative Young over one year ago. They told
9 us the route would probably be a political decision,
10 just as the oil line one was.

11 (b) El Paso's application, in our opinion, is
12 the overall number one choice for Alaska. Let's face
13 it, they're a pretty small company in the big picture,
14 when compared to the forces and money behind Arctic Gas
15 at this time.

16 (c) We have been urging Commissioner Martin
17 and the Administration since last February to conclude
18 a royalty gas sale as recommended by the Congressional
19 Delegation. As far as we're concerned, Guy Martin
20 took a long time, worked on it very thoroughly, and
21 went through extensive negotiations. We believe that
22 last April 14 the contracts were almost signed and would
23 have possibly been included for review by the last
24 Legislature, but they were not completed until this
25 November.

1 A sale, to be most effective for our State,
2 should have been concluded, in our estimation, last
3 spring. It has taken twelve months to get this contract
4 before you in the steps it's in. Six to eight months
5 from now it will all be over, the decision for the
6 routing will have been made.

7 (d) The FPC Judge stated many times during the
8 testimony and asked, "What's Alaska going to do with its
9 gas? Is their gas going to go into the system? Are
10 they going to keep it?" This contract you have before
11 you was entered into the FPC record in its rough draft
12 on the last afternoon of the last day before public
13 testimony was closed.

14 (e) If all the gas goes to Arctic and if our
15 State found no new reserves for some reason, wouldn't
16 it be something if Alaska ended up some day like
17 Louisiana, some years hence, with a shortage of gas? It's
18 not probable, but it is conceivable.

19 (f) A political decision? Alaska is using all
20 the forces we can to affect a Congressional decision.
21 Do you mean like we did for the oil line? Or like we
22 did for Statehood? You bet we are! If we don't stick
23 up for our own state, I don't really think anybody else
24 is going to.

25 Here are some of the letters we have received

1 from Senator Stevens, Senator Gravel and Representative
2 Young dated November 2, November 5 and November 17, 1976,
3 mandating a royalty gas contract.

4 MS. EASLEY: Last fall when we were getting pretty nervous
5 about whether the royalty gas contracts would be concluded
6 in time to be included in the FPC record, we asked Don
7 Young and Ted Stevens and Mike Gravel to meet with us,
8 and we did separately. And we asked them each a very
9 important question. We said, "Do you still consider the
10 royalty gas contract critical to the success of the
11 Trans-Alaska gas line."

12 Ted Stevens told us that if we did not have the
13 royalty gas contracts we didn't have a chance to win.
14 Don Young said the same thing, and Mike Gravel said
15 the same thing in different words. So we were convinced
16 then, as we are now, that that is the most important
17 thing that we need in order to do our job in committing
18 the funds that have been contributed to our organization
19 to carry this fight to the nation.

20 MR. PENNEY: November 2 in a letter to Honorable Jay Hammond
21 from Mike Gravel: "In response to a request from the
22 Organization of Management of Alaska Resources, I am
23 putting on paper my position with respect to the commit-
24 ment of Alaska's royalty gas. I have enunciated this
25 position on numerous public occasions, both in Alaska and

1 Washington, D.C. Without doubt, the commitment of
2 Alaska's share of the Prudhoe Bay natural gas could
3 bring us allies in our cause if only because the
4 beneficiaries would thereby have a proprietary interest
5 in the success of our endeavor, designation of an all-
6 Alaskan gas line."

7 November 5, in a letter from Senator Stevens,
8 to Paula Easley at OMAR: "Dear Paula: I am writing
9 to confirm to you my feelings that Alaska's royalty gas
10 should be committed so as to pick up as much support
11 as we possibly can gain in the Congress, in the South
12 and in the Southwest. As you know, I have not expressed
13 any opinion on the question of that share that any
14 respective purchaser receives. However, these commitments
15 will only make sense if they are associated with support
16 for the all Alaskan line, and to get that the share to
17 the new supporters must be credible." That's the time
18 when we were being asked by, for instance, Senator Stevens
19 wanted to see Tenneco, I think, at the time get it all,
20 and Senator Gravel was thinking that El Paso should have
21 gotten half. But it was a decision of what the percentages
22 was, was left up to the State Administration. In fact,
23 we didn't make any comments because we don't think that's
24 within our vein.

25 "The recent report of the Berger Commission's

1 staff recommendations (continuing with the Senator's
2 letter) reinforces my feeling that we have a real chance
3 to win, and when the review of Alaska's gas transportation
4 system comes before Congress we will need all the help
5 we can get."

6 November 17 from Don Young to the Honorable Jay
7 Hammond, in addition to a wire he had sent the prior day.
8 "It is timely that the State has taken this action to
9 achieve the goal of an all Alaskan route and to preserve
10 the State's option for use of its royalty gas in the
11 State. In the past, FPC Hearing Judge Nathan Litt has
12 repeatedly inquired about the disposition of the State's
13 royalty gas. It has been argued that if the State sold
14 its gas it would be an unrefutable indication that the
15 State is willing to do all that is in its power to
16 commit itself to an all Alaskan route. Now at last
17 this is the case and any reservations on this point can
18 be swept aside."

19 Political decision? It is. If we don't listen
20 to and seek the feelings of our Congressional Delegation
21 as to what should be done on an issue decided in
22 Congress, then who should you ask.

23 Number A: I would like to take a moment out
24 at this time to do the same thing that Russ did, and I
25 would like to publicly say how much I thought Bob Ward's

1 testimony was really right on the button yesterday, and
2 he renewed my respect for him so much -- that he just
3 told it like he really thought it was. I thought that
4 was probably one of the nicest presentations I ever
5 heard anybody give, particularly when they've got to
6 have the least desired position of anybody involved.
7 I thought it was well done.

8 We concur with that thinking. We thoroughly
9 endorse the concept of these contracts. As we said,
10 it's taken twelve months to get this far. We weren't
11 privy to the negotiations. When last April we asked
12 Commissioner Martin how negotiations were to be handled
13 he told us no one was going to be involved but the
14 four companies and the State. We understood and agreed.
15 It took almost seven months to conclude these negotiations.

16 We really can't answer the questions as to the
17 technical terms and things that you've heard now. The
18 only thing that we can do is address ourselves to the
19 concept of the contracts, which was initially told to us
20 by the Congressional Delegation.

21 We have some concerns about the switching
22 clause, and we've dicussed it at some length. We have
23 a couple of suggestions after, if you want to. It's
24 hard now for us to judge what's going to be hindsight
25 in two to three years from now, and I'm sure it was

1 awfully hard for Commissioner Martin and the attorneys
2 to judge now the best contract to draw for probably
3 1982. But I think from testimony I've heard here, I
4 think the contract is probably as well done as it could
5 have possibly been.

6 After all our encouraging Commissioner Martin
7 to finally conclude a sale, we have to admit we think
8 on an overall basis the contract really exceeds in many
9 ways our best expectations. We think overall that he's
10 done a fine job and actually has done the best he possibly
11 could for our State, particularly under the circumstances.

12 One of the points that, as we understand it --
13 in essence if this contract is inked and it goes for
14 approval, or if it doesn't go for approval but if Congress
15 eventually approves the all Alaskan route as it's pro-
16 posed, as we understand the contract, the next day our
17 Governor could say, "We have the route now; however, we
18 have an in-State use for the gas and two years from
19 now we're going to take it back," and then two years
20 hence, even before the line is even built, before it's
21 ever constructed, we can cancel out the terms of the
22 contract. I just have a feeling that there's got to
23 be a little faith on both sides, because I don't know
24 how I'd sign it if I were a gas company. But evidently
25 they did think it was all right.

1 One other point that hasn't been brought out
2 and I don't know why they don't want to talk about it,
3 but I'm going to talk about it because I think it's
4 very important. But El Paso, in essence, and I think
5 you'll find that as we go into this the next six months
6 and some more testimony, if you want it, will show
7 that the financing of either one of these three routes
8 is going to be one of the major critical things, and
9 we think at this time it is the major critical stumbling
10 block for Arctic Gas. And we have testimony, if you
11 want to review that further.

12 But El Paso, in essence, has already got twenty-
13 five percent of their system financed, as we understand
14 it. Their tankers are going to cost 1.6 Billion Dollars,
15 which is a quarter of their project, and under the
16 Maritime Act (I don't remember the name of the Act) there
17 is a low interest rate available for that, and also
18 in a Federal insurance. So, in essence, they've already got
19 twenty-five percent of their package cut and done. I
20 don't know if that's been brought out before, I don't
21 think it has.

22 In summation, don't forget, we won't have any
23 accessible surplus of royalty gas if Arctic is certified,
24 and I really think people lose sight of that. We will
25 just have dollars of revenue from then on, because Mrs.

1 Jones is going to be cooking eggs in Ohio for the next
2 twenty-five years with our royalty gas.

3 And (b), we think this is almost as important:
4 if either Canadian line gains approval, you will then
5 have an established corridor from the heartland of our
6 State funneled directly to the South 48. If we ever
7 want or choose then to see Pet 4 or other resources used
8 or developed within our State, the chances of doing so
9 will become much, much more remote. Whatever you do
10 with this contract, somebody, some day is going to buy
11 a portion of our surplus royalty gas, and we think that
12 if El Paso, Southern and Tenneco would be foolish enough --
13 they would be foolish, they'd be unfair to their stock-
14 holders, and less effective for Alaska if they publicly
15 review their game plan for approval of the Trans Alaska
16 line. If they do, they're almost sure to read again
17 about it in Jack Anderson's column or else somewhere else
18 in national print. If you haven't heard about the
19 column, I'll tell you about that.

20 They are large companies, they need the gas,
21 and "no ticket, no laundry." If they don't work with
22 us they very probably will get no gas. So we have to
23 have some reliance on their ability to perform.

24 (e) To me, personally, this contract is also
25 important nationally, as it's like the tapping of a pencil

1 on the negotiating table by the State of the Far North,
2 that we're not asleep, we are interested in our own
3 destiny, we do want a say in the use of our own natural
4 resources, in our way of life, we do want to get off
5 the Federal dole, and we do want to direct our own
6 heritage.

7 We have over one hundred and fifty press
8 clippings. Somebody asked if this was going to be
9 news across the nation, and I'll let Paula enunciate
10 on that. This news of the royalty gas sales has already
11 been in most of the major papers in the United States.

12 MS. EASLEY: I'm sure most of you are aware of that, and
13 unfortunately it has been reported and accepted as an
14 already concluded situation, and quite a few of the
15 articles have mentioned that the contracts do have to
16 have the stamp of approval of the Alaska Legislature.
17 But the way it is stated, it's just been that it is an
18 assumed fact. And we are concerned about this element
19 of it, should the contracts not be approved, the effect
20 of that at the national level in indicating to the public
21 and to the Congress that Alaska is not behind the pro-
22 posal that it professes to be, and that eighty-five
23 percent of its citizens say they are.

24 MR. PENNEY: Last, review, assess, discuss, make sure it's
25 right for all of us, if you have to, this contract. The

1 final terms are in your hands. But, if you will, pass
2 it out as soon as you can with a large majority. Affirm
3 and then make it your first step in the fight for our
4 own gas line.

5 Then second, (that's the first step) pass an
6 appropriation bill to be used nationally in an effort
7 to tell the Alaskan side of the story, that the all
8 Alaskan U.S. route is the best one for all of the United
9 States.

10 Then thirdly, we respectfully ask that you do
11 everything you can legislatively to see that it's
12 "easier" to go through Alaska with our gas than through
13 the middle of another country.

14 SENATOR RADER: Thank you both. Any questions? Senator
15 Huber.

16 SENATOR HUBER: One short one. Bob, you didn't agree with
17 Bob Ward's testimony so much as to agree with his bottom
18 line, did you, that it wouldn't make any difference?

19 MR. PENNEY: No, John, but if you'd like to -- some of the
20 points he brought out we think were very valid, partic-
21 ularly as far as the part that gets into problems in
22 Canada, and we researched those very thoroughly. We
23 subscribe to two clipping services from Canada, and it
24 keeps one person busy just reviewing those, and we think
25 we have a pretty good grasp or feeling for what is taking

1 place in Canada, at least as far as the press reports.
2 And if you want to get in and talk with some of that,
3 we can tell you where we think some of the tough parts
4 and some of the good parts will be.

5 SENATOR HUBER: You at least agree that he was very candid?

6 MR. PENNEY: Yes, sir.

7 SENATOR HUBER: As far as the last line -- I wanted to be
8 sure you didn't agree with his last line.

9 MR. PENNEY: That's true, John, but I was very impressed
10 with his testimony. One other aside, there has been
11 some mention in talk made about the treaty here, and
12 last February 1, I believe, Aron Tussing brought this
13 up, so we will be able to see how his suggestion worked.
14 But February 1 we sent a letter to Senator Gravel,
15 Senator Stevens and Don Young, and in essence said this,
16 that while we understand that the U. S. and Canada are
17 agreeing to the treaty in which no line will be taxed
18 any different than somebody else's line, as we all
19 know the -- just let me read the paragraph. "We at OMAR
20 are concerned that the provinces through which the Arctic
21 Gas or Alcan Pipeline might pass have not ratified nor
22 endorsed this treaty between U.S. and Canada. We are
23 all aware the provinces of Canada have unusual taxing
24 powers when compared to those enjoyed by each of the
25 states of the United States. We ask that you consider

1 a proposal requiring each province through which a
2 Prudhoe Bay gas line might pass to give a written pledge
3 to support these treaty provisions before the U. S.
4 Senate ratifies the treaty itself."

5 SENATOR RADER: Any further questions? Senator Sumner.

6 SENATOR SUMNER: You mentioned an appropriation. Did you
7 have a figure in mind or have you gone through some
8 other channels with that?

9 MR. PENNEY: Senator Sumner, Mr. Chairman, yes, we have.
10 We've projected out two or three different things that
11 could be done. But if the State were to hold down its
12 expenses as closely as possible, we think it's going
13 to require a Three Hundred Thousand Dollar contribution
14 just on the part of the State itself to do any kind of
15 effective job. But there are so many things we could be
16 doing in the next six months to try and win this thing.
17 There are so many avenues we could explore. We've asked
18 the Governor, and Lowell Thomas is going to take another
19 trip now for thirty days. We have to raise the funds
20 to take care of his airplane tickets. He was very
21 effective last time. He's written letters to every one
22 of the other Attorney Generals throughout the United
23 States -- or Lt. Governors, excuse me, asking them about
24 the Alaska route. There's an awful lot we could be
25 doing. We're going to have two more flights going back

1 to Washington, D.C., about a hundred and ten people,
2 later on this spring and early summer, as soon as our
3 Delegation tells us. And there is so much we could be
4 doing, but if we don't start doing it, and if we don't
5 start doing it right away, and really if we do nothing,
6 and we get nothing, that's just about what we deserve.

7 SENATOR RADER: Any further questions?

8 MR. PENNEY: Thank you very much.

9 SENATOR RADER: Thank you very much. We have a number of
10 exhibits that we need to introduce. Let me just identify
11 them. We have a letter from United States Senator Mike
12 Gravel supplementing his wire of several days ago. That
13 will be Exhibit 20. I won't read it, it will be attached.
14 Exhibit 21 is a series of correspondence including
15 a letter from the Lt. Governor of the State of Alabama,
16 a letter from George E. Smith, Alaska Chapter of
17 Associated General Contractors, a letter from Robert L.
18 Hardick, Anchorage Chamber of Commerce, a telegram from
19 A. L. Swalling of Anchorage, Alaska, a telegram from J.
20 A. Sproul, a telegram from Richard L. Maullin, a letter
21 from Mrs. Jeanne Wilson, President of Greater Fairbanks
22 Chamber of Commerce, a letter from George Easley,
23 President of the Easley Construction Company, a telegram
24 from James T. Jefferson, of Jefferson Enterprises,
25 Detroit, Michigan. Most of these were responses to our

1 invitation to come and testify, and they sent written
2 letters or telegrams expressing approval or disapproval
3 of what we were doing. I don't intend to read them but
4 I intend to make them a part of the record; so that will
5 be Exhibit No. 21, called miscellaneous correspondence.

6 (Whereupon Exhibits 20 and 21 were duly marked.)

7 Do we have any other ---

8 SENATOR HUBER: Mr. President, may the list to whom
9 invitations were sent to be a part of the record?

10 SENATOR RADER: Senator, I don't know that we can do that.

11 Representative Gruening's office, I know, sent out some
12 and my office sent out some in two different groups that
13 had some overlap. I'd invite you to come to my office.
14 We've got the letter from the Legislative Affairs people,
15 and, Elke, maybe you know more about those lists than
16 anyone. Would you explain to us what ---

17 MS. KALLAB: Yes, to the extent that I can. As far as on
18 the Senate side, the list that we initially began with
19 was furnished to us by the Department of Natural Resources,
20 which are used as lists as far as Oil, Gas and Royalty
21 Board invitation lists. Those are the three lists we
22 worked from.

23 As it turned out, in the confusion, everybody
24 got an invitation. So I don't think we've lost anybody
25 from the Department of Natural Resources that has been

1 on that side.

2 On the House side, as far as Representative
3 Gruening is concerned, I know that he invited several
4 people that were also invited by Senator Rader, namely
5 Dr. Tussing, and in addition he invited Dr. Michael Scott
6 to testify for the joint hearings here. I don't know,
7 but I'm sure aide, Brian Rogers, will have a complete
8 listing as to what other invitations were issued, either
9 verbally or by writing.

10 The material that went out through Senator
11 Rader's office is very readily available and could be
12 very easily made a part of the record.

13 SENATOR RADER: Without objection, I will make available
14 a list of the invitations sent out by my office, and it
15 will be marked Exhibit No. 22. Representative Gruening,
16 do you want to supply such a list for Exhibit 23?

17 REP. GRUENING: That's fine.

18 (Whereupon Exhibits 22 and 23 were duly marked.)

19 SENATOR HUBER: My only reason for the request was so that
20 the record should show that we had invited a large cross
21 section of people so it couldn't be said that we had a
22 selected list later on.

23 SENATOR RADER: Fine.

24 REP. GRUENING: Mr. Chairman, in that regard you might want
25 to put another exhibit, and that is newspaper ads that

1 were run by the joint committees, and we might even get
2 a proof from the paper to attach so they know the dates.
3 SENATOR RADER: How many newspaper ads were run and in what
4 newspapers?
5 REP. GRUENING: Daily News Miner, the Anchorage Times and
6 the Daily News.
7 SENATOR RADER: One ad or several ads?
8 REP. GRUENING: Two days in each paper.
9 SENATOR RADER: If we can find a copy of that, that will
10 be supplied to the reporter as Exhibit No. 24.
11 (Whereupon Exhibit 24 was duly marked.)
12 SENATOR RADER: Do we have any other requests for exhibits
13 to be attached? We have one final exhibit, No. 25,
14 which will be supplied by the Department of Natural
15 Resources, and with that I take it that concludes our
16 joint hearings; is that correct?
17 (Whereupon Exhibit 25 was duly marked.)
18 REP. GRUENING: Do we have the relevant statutes attached
19 in there?
20 SENATOR RADER: No, we do not. Exhibit 26, would your office
21 supply what you consider to be the relevant statutes?
22 REP. GRUENING: Sure.
23 SENATOR RADER: Exhibit 26 will be the relevant statutes,
24 to be supplied by Representative Gruening's office to
25 the reporter.

1 (Whereupon Exhibit 26 was duly marked.)

2 SENATOR RADER: Ms. Easley.

3 MS. EASLEY: I'm sorry, I just gave the reporter some
4 telegrams and letters from other organizations that had
5 asked us to speak on their behalf. Can she just do that,
6 write them in?

7 SENATOR RADER: I'll make that Exhibit 27, it will be called
8 miscellaneous correspondence and written testimony
9 submitted by OMAR on behalf of others.

10 (Whereupon Exhibit 27 was duly marked.)

11 SENATOR RADER: Are there any other exhibits that should be
12 made a part of this written record? Ladies and gentlemen--

13 REP. GRUENING: John?

14 SENATOR RADER: Yes.

15 REP. GRUENING: I know you want to get out, but what are
16 your plans for talking to the Department of Resources
17 people?

18 SENATOR RADER: Mr. Boness was scheduled to leave Sunday
19 for Washington, D.C. and be gone for several weeks to
20 work on the Federal Power Commission brief. Commissioner
21 Martin has submitted to both you and I a schedule of his
22 activities. It appeared to me that if we did not meet
23 with him Monday -- Mr. Boness agreed to stay over and
24 Mr. Martin agreed that Mr. Boness' presence was important
25 if he was going to submit any rebuttal testimony -- it

1 appeared to me that if we did not meet Monday it might
2 be several weeks before we could meet again.

3 It was my judgment and it was my feeling, as
4 the chairman of our committee, and I've announced it in
5 the Senate, that we will meet with Commissioner Martin
6 and Mr. Boness of the Attorney General's office, and
7 whomever of their staff that they deem important, to take
8 any supplemental, rebuttal or additional testimony that
9 they think has been brought out by any of the testimony
10 that has been presented thus far.

11 REP. GRUENING: What time?

12 SENATOR RADER: 10:00 o'clock, here.

13 REP. GRUENING: We normally have a session. We'd like to
14 attend.

15 SENATOR RADER: Our problem is our session. I scheduled
16 it for 2:00 o'clock. As I recall, I talked to you and
17 I thought that you were not interested in this, so I
18 scheduled our session for 2:00 o'clock.

19 REP. GRUENING: It was my understanding it wouldn't be part
20 of the record.

21 SENATOR RADER: It will not be a part of the record.

22 REP. GRUENING: But it is from your prior statement that
23 they will be submitting something and you're taking
24 testimony.

25 SENATOR RADER: They will submit written testimony or whatever

1 they think is important for this record, and I don't
2 know what that's going to be. But our committee wanted
3 to hear from them and didn't want to wait two weeks
4 for it.

5 REP. GRUENING: Well, I'm wondering -- I haven't talked to
6 the rest of the committee, but there might be some
7 interest in talking to these folks if it's going to be
8 on the record.

9 SENATOR RADER: I did not plan to have the reporter here;
10 in fact, the reporter had asked to be relieved. I did
11 not intend that it would be a part of the written record.
12 If you are interested, let's make it 10:30, if we
13 could do that.

14 REP. GRUENING: Whenever.

15 SENATOR RADER: All right. Now let me ask you this: if you
16 wish, we can make that a part of the joint hearings and
17 ask the reporter to come back. I don't know whether
18 the reporter can or not.

19 REP. GRUENING: I don't know if that's necessary, but as long
20 as Mr. Boness is going to be here especially for that,
21 we might as well make it a half an hour later and we'll
22 all attend.

23 SENATOR RADER: All right. Then I think we should continue
24 the joint hearing, and I will ask the reporter then to
25 come back at that time. I understand we have the

1 courtroom committed to us at that time, 10:30 Monday,
2 and I'd like to ask the staff if they will make certain
3 that is posted on the bulletin board; my own staff if
4 they will contact the Department of Natural Resources
5 and, inform them, and try to get a page over here from
6 the Senate, or send a page over here at a quarter to
7 10:00 to inform people who come here for that purpose
8 that the hearings will not commence until 10:30, and
9 to see that order is preserved in the courtroom.

10 We will adjourn until 10:30 then Monday.

11 (Whereupon the hearing adjourned at

12 6:05 p.m.)
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