

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86/2

501 SCOMM15: HOUSE/SEN. SP. COMM. SALT ROYALTY GAS 1977-78 501

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 co,
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?

1 We have Mr. Robert Penney and Ms. Paula Easley. Would
2 you identify yourselves and who you represent? I suppose
3 you would like to make a statement and then open your-
4 selves to questions. Would that be the way to proceed,
5 Mr. Penney?
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

TAKU REPORTERS
DEPOSITIONS · HEARINGS · GENERAL REPORTING
JUNEAU, ALASKA 99801

220

AGO 799614

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.)
13
14
15
16
17
18
19
20
21
22
23
24
25

RADER

2/4/77

FEBRUARY 4, 1977

1
2 SENATOR RADER: The joint hearings of the Alaska State Legis-
3 lature relative to the sale of royalty gas will come to
4 order.

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

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

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

TAKU REPORTERS
DEPOSITIONS - HEARINGS - GENERAL REPORTING
JUNEAU, ALASKA 99801

61

AGO 799639

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 Mr. 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 1985 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, exploration
3 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

1 responsibilities to its citizens.

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

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