

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86/2

520 SCOM115: HOUSE/SEN. SP. COMM. SALE ROYALTY GAS 1977-78 520

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 and I think it is a major concern.

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

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

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

1 make your job a lot easier.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 that type of use.

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

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

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

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

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

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

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

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

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

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

1 to offer myself sacrificially.

2 SENATOR RADER: Representative Rudd.

3 REP. RUDD: Mr. Moody, this morning Mr. Swanson mentioned

4 the possibility of storing our gas in place for some time,

5 until we have a need for it. Is that a possibility if

6 we don't approve these contracts? Is that a possibility?

7 MR. MOODY: Well, I guess there are two sides to the question.

8 Is it possible mechanically, physically?

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

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

11 REP. RUDD: By law.

12 MR. MOODY: Regulatory. I better not make a guess on the

13 first one because I really don't know enough about your

14 reservoir and its mechanics, that I really couldn't give

15 you anything of value other than to guess on it. On the

16 other side of it, once again you've got to make a judgment

17 as to whether we're going to be deregulated or continue

18 to be regulated. Since my personal feeling is that we

19 probably are going to face regulation, I think I'll deal

20 with that one first.

21 If the producers start selling the gas stream

22 into interstate commerce you would have to be most careful

23 that some type of balancing arrangement or under-lifting

24 arrangement with the producers had been reduced to writing

25 and had been approved by the FPC, because in my judgment,

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

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

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

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

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

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

1 bring it within 13-B.

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

4 SENATOR RADER: Go right ahead.

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

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

22 REP. RUDD: I'm sorry.

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

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

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

19 REP. RUDD: Thank you.

20 SENATOR RADER: Any further questions? Representative Hayes.

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

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

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

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

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

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

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

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

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

6 SENATOR RADER: Representative Gruening.

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

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

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

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

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

1 private financier backs that line?

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

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

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

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

19 MR. MOODY: I was enthralled with it.

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

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

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

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

1 decision come out better than it has so far.

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

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

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

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

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

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

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

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

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

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

21 MR. MOODY: Yes.

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

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

8 REP. GRUENING: Thank you.

9 SENATOR RADER: Representative Parr.

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

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

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

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

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

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

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

25 MR. MOODY: Yes.

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

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

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

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

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

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

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

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

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

6 REP. PARR: Thank you, sir.

7 SENATOR RADER: Senator Sumner.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

24 SENATOR RADER: Mr. Chatterton.

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

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

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

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

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

1 three days' time. I recognize your concern.

2 REP. CHATTERTON: Thank you.

3 SENATOR RADER: Representative Hayes.

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

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

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

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

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

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

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

11 SENATOR RADER: Any further questions? Senator Huber.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

4 MR. MOODY: Thank you.

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

10 MR. PENNEY: Yes.

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

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

21 SENATOR HUBER: Let's take five minutes.

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

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

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

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?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 be our number one priority.

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

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

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

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

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

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

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

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

25 Here are some of the letters we have received

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

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

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

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

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

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

25 "The recent report of the Berger Commission's

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

6 MR. PENNEY: Yes, sir.

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

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

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

5 SENATOR RADER: Any further questions? Senator Sumner.

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

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

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

7 SENATOR RADER: Any further questions?

8 MR. PENNEY: Thank you very much.

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

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

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

7 Do we have any other ---

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

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

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

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

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

1 on that side.

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

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

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

17 REP. GRUENING: That's fine.

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

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

23 SENATOR RADER: Fine.

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

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

1 (Whereupon Exhibit 26 was duly marked.)

2 SENATOR RADER: Ms. Easley.

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

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

10 (Whereupon Exhibit 27 was duly marked.)

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

13 REP. GRUENING: John?

14 SENATOR RADER: Yes.

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

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

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

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

11 REP. GRUENING: What time?

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

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

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

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

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

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

25 SENATOR RADER: They will submit written testimony or whatever

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

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

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

14 REP. GRUENING: Whenever.

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

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

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

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

10 We will adjourn until 10:30 then Monday.

11 (Whereupon the hearing adjourned at

12 6:05 p.m.)
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SCOMM

#15:7

WORLD AND NATIONAL BACKGROUND
OIL AND PETROCHEMICALS

PART I: OIL

1. ERDA estimates that the annual world output of oil is currently 20 billion barrels (200 gallons for every person on earth). Of that, the United States consumes 30% (about 1,100 gallons per person per year).
2. ERDA estimates that the United States now has 8 percent of the world's remaining recoverable oil. The Mid-East has 62 percent. Of that 62 percent, 25 percent is in Saudi Arabia.
3. The Wall Street Journal of 12/23/77 feels that the world oil markets could experience surplus conditions through 1982, possibly up to 1985. According to the Wall Street Journal of 12/23/77 proven reserves have risen 15 billion barrels since early 1974, outpacing world consumption of oil by an average of 5 billion barrels a year. New reserves are likely to be identified in the North Sea and Mexico expanding proven reserves at least into the 1980's.
4. According to the New York Times of 12/23/77, the oil glut will last through 1981 and 1982 and will put to 3 million more barrels per day on the market than needed.
5. The New York Times of 12/23/77 states that the International Energy Agency predicts that by the mid 1980's, the world will face a physical shortage of oil and sharply higher prices.
6. Walter Levy and Associates estimated the non-communist world energy consumption in 1977 was the equivalent of 92.2 million barrels of oil per day. They estimate that consumption will rise to 121.3 million barrels of oil a day equivalent. This slow rate of growth (3.5 percent per annum for non-communist oil consumption) is due to a reduction in overall quantity, increase in cost, and conservation efforts in the industrial sector. During that period, the actual oil consumption increase from 1977 through 1985 is 2.5 percent annually.

World and National Background
Oil and Petrochemicals

7. Walter Levy and Associates estimates that the total OPEC production for crude oil was 22 million barrels per day in 1977; they expect this to rise to 26.3 barrels of oil per day in 1985. The major difference will be the increase of Saudi Arabian portion of the production which will increase from 9.4 million barrels per day in 1977 to 11.5 million barrels per day in 1985.

The current world surplus which causes OPEC to keep the price low, will narrow by 1985. With a lower surplus, there will be less of a pricing problem. From 1985 to 1990 there will be increased tightening of supply. Since the Saudis said "no" to a price increase, the real price of crude oil has gone down over the past couple of years...that is, it has not kept up the rate of inflation. Levy and Associates expect that situation to continue through 1981 or 1982. After 1982, the price will rise at the rate of inflation plus 2 to 3 percent annually.

8. According to ERDA, (currently, 44 percent of the U. S. energy requirements are supplied by petroleum. Half of that is used in transportation (cars, planes, trains and boats.)
9. According to ERDA, the U. S. is consuming 17 million barrels of oil a day currently.
10. According to ERDA, the U. S. now has only 8 percent of the world's remaining recoverable oil.
11. The USGS states that America's remaining economically recoverable resources of crude oil (identified reserves plus oil yet to be discovered, but soon to be producible) is estimated at 112 to 189 billion barrels or another 33 to 60 years supply, assuming domestic production remains at current levels.
12. In 1900, 9 percent of America's energy consumption was in oil; in 1950, 54 percent was in oil; in 1973, 77 percent was in oil.
13. The U. S. News and World Report feels that the current glut of oil was developed because of the following six factors.
 - A. Alaskan Oil
 - B. North Sea Production
 - C. New Mexican Discoveries
 - D. New Indian Discoveries
 - E. Saudis refused to raise prices early in 1977
 - F. Some exporting countries are cutting prices

PART II. PETROCHEMICALS

There seems to be a general agreement that a very significant number of petrochemical facilities are coming on line around the world. This obviously has impact on an in-state petrochemical facility.

1. Arlon Tussing feels that the Saudis may price their feedstock very low so that their petrochemical operations stay valuable.
2. Milton Lipton indicated that Japan would rather have Saudi feedstock than Alaskan, all things being equal, for the simple reason that the Saudis just have more feedstock.
3. The foreign petrochemical markets are most difficult and elusive according to Milton Lipton. Areas outside of Alaska are just more appealing.
4. Joe Moore makes two points about the Japanese in the world situation:
 - a. Japan is somewhat afraid of OPEC because of its instability, and
 - b. Japan has only small older plants using naptha as a feedstock.
5. Joe Moore also indicates that Japan is negotiating with other suppliers including Singapore and Saudi Arabia. Negotiations have been on and off for some time.
6. The Oil and Gas Journal of March 6, 1978 indicates that four major world scale petrochemical facilities will be going on stream in mid 1982. Saudi officials insist "The projects will be needed by then, despite fears of a worldwide petrochemical glut."

In addition to the four ethylene based complexes, two giant methanol plants are planned.

The article indicates that "the projects are economically viable, but if they weren't, Saudi Arabia would go it all alone." This seems to agree with statements made by Arlon Tussing that the Saudis would reduce feedstock prices to these facilities to make them economically viable in world markets.

JOBS

1. "In our opinion, therefore, the potential for job creation offered by one of the proposed refineries or petrochemical complexes should be evaluated in light of (1) secondary job creation on the order of 2 - 5 new secondary jobs for each ten new refinery jobs and (2) the fact that at best only 50 - 60% of the new refinery petrochemical jobs are likely to be filled by Alaskans."

(From Report to the Alaska Royalty Oil and Gas Development Advisory Board, David M. Reaume, Principle Economist, Division of Economic Enterprise, State of Alaska, December 14, 1977.)

2. Ed, Patton, head of the Alyeska Pipeline Service Company, said in January that the State could find itself paying \$240,000 per year for each job created at a refinery. Patton warned that the notion of an in-state refinery using royalty oil was a "boon doggle of immense proportions."
3. "Additionally, the petrochemical industry brings substantial benefits far beyond those of many other industries. It is highly capital intensive and one of the lowest labor intensive industry of any of our nation's basic industries. Therefore, expansion by the petrochemical industry results in very little population impact. The highly automated petrochemical operation requires very few workers and therefore imposes very little additional burden on public services such as schools, hospitals, highways, etc."

(From Royalty Oil Decision by Robert R. Richards, The Anchorage Times, February 19, 1978.)

4. "Summary of Additional Employment. New Jobs:

Construction phase (3 1/2 years)	3,500	-	4,000
Operations phase (20 years)			
Petrochemical Facility	1,900		2,500
Shipping (ACS)	250		350
Total permanent jobs	2,150		2,850

(From Outline of ALPETCO's Presentation, March 13 -14, 1978.)

SUBSIDIES

1. "There is substantial evidence available which makes questionable the project potential for a large scale refinery operation dependent upon an export market for a major portion of its products. We are concerned that the threat of job loss and financial reversals may generate future political pressure aimed at maintaining an inefficient refinery operation."

(From the Report to the Alaska Royalty Oil and Gas Development Advisory Board, David Reaume, Principle Economist, Division of Economic Enterprise, State of Alaska, December 14, 1977.)

2. "At the same time however, ALPETCO itself has an important way out. The contract stipulates that if the consortium needs a break in royalty oil prices at a later date, the firm can get it with direct approval of the voters. That ringer raises the spector of voters possibly having to choose between subsidizing an industry or wrecking the economy of the area in which it's settled."

(Alaska Advocate, March 16, 1978)

3. The contract does have subsidies. One prime example although not major is 2.6 in the contract which provides that the State will pay for the fill and storage tank mount ups. "It's about \$9 million."

(Quote - Charles O. Honig, Chairman of the Board, ALPETCO; Chairman of the Board, Alaska Interstate Company.)

"But at the time it is ultimately paid for, it will be paid for at the value of the oil at that time, so if oil is \$20 a barrel then, it will be paid for at the rate of \$20 per barrel."

(Quote - Willard M. Hanzlik, Vice President, ALPETCO; Vice President, Alaska Interstate Company.)

Subsidies Cont.

Page 2

4. "With respect to the line pack, I suppose that could be viewed as a subsidy. So I really think it's more of an investment of \$9 million dollars."

(Quote - Charles O. Honig, Chairman of the Board, ALPETCO; Chairman of the Board, Alaska Interstate Company.)

"Or you could look at it that way, or as a subsidy for 27 years?"

(Representative Bill Miles, Chairman, House Royalty Oil and Gas Committee.)

"Yes, I suppose you can look at it either way."

(Quote - Charles O. Honig, Chairman of the Board, ALPETCO; Chairman of the Board, Alaska Interstate Company.)

5. "All I'm saying is that at that point the State of Alaska may be faced with commitments they feel obliged to undertake, which go beyond that of the contract, simply because this is one of your major investment projects in Alaska. And, one way or another, you are not going to allow it to founder for the lack of cash flow."

(Milton Lipton of Walter Levy and Associates at hearing of Special Committee on Royalty Oil and Gas, March 15, 1978.)