

SCOMM

#16:2

INTERIM REPORT

AND

written

TESTIMONY SUBMITTED TO JOINT GAS PIPELINE COMMITTEE

impact
^

PUBLIC HEARINGS

FEBRUARY 17 - 20, 1976

TABLE OF CONTENTS

<u>ITEM NO.</u>		<u>PAGE</u>
I.	Interim Report of the Joint Gas Pipeline Impact Committee.....	1
II.	Agenda - Gas Hearings (February 17,18,19).....	5
III.	Natural Gas Fact Sheet.....	7
IV.	Baker & Botts Report, Rush Moody.....	8
V.	Letter - Herbert Lehfeldt.....	22
VI.	Letter - R.L. Huffman.....	23
VII.	Letter - Dale Teel, Alaska Pipeline Co. (February 16).....	24
VIII.	Letter - Dale Teel, Alaska Pipeline Co. (February 9).....	29
IX.	Cumulative Reserves Graph.....	31
X.	Use of Natural Gas in Alaska, George Silides, P.E.	32
XI.	Testimony - Bob Hartig, OMAR.....	43
XII.	Letter - K.R. Keep, B.P. Alaska, Inc. (February 17).....	48
XIII.	Report - J. Gore, B.P. North America, Inc.	53
XIV.	Sadlerochit Sand Reservoir Oil Data.....	64
XV.	Report on Methanol/Methyl Fuel, Franklin Fleeks.....	65
XVI.	Letter - Tanzer Economics Assocs. (February 13).....	75
XVII.	Total Value of Income from Twenty Years Production.....	79
XVIII.	Methyl-Fuel Report, Wentworth Brothers.....	80
XIX.	Stanford Research Institute Report.....	84
XX.	Letter - Fairbanks Industrial Development Corp. (Feb. 5).....	110
XXI.	Testimony - Thomas Stahr, Anchorage Municipal Light & Power....	113
XXII.	Testimony - John Bennett, El Paso.....	114
XXIII.	Testimony - Howard Slack, Atlantic Richfield Company.....	122
XXIV.	Report - Federal Power Commission/ARCO.....	136
XXV.	Testimony - W.Ray Booth, Exxon Co. U.S.A.	163
XXVI.	Exhibit A, Exxon.....	175
XXVII.	Exhibit B, Exxon.....	196
XXVIII.	Testimony - Sharron Lobaugh, Alaska Conservation Society.....	202

INTERIM REPORT
OF THE
JOINT GAS PIPELINE IMPACT COMMITTEE

This Committee, through public hearings and staff investigation, has become convinced that immediate action by the State of Alaska is essential if the citizens of this State are to receive maximum benefit from the State's natural gas resource.

The Committee will issue a full and complete report on its findings and recommendations at a later date, but is impelled to submit this interim report to the Legislature and the people of the State of Alaska because of the urgency of the present situation.

The Committee finds and concludes the following:

1. A federal decision authorizing the transportation of North Slope natural gas across Canada would be inimical to the interests of the State of Alaska. The State's resource would be drained, its people denied access to a premium fuel and raw material, its work force deprived of employment opportunities, and productive economic growth would be thwarted.
2. A federal decision authorizing the transportation of North Slope natural gas across the State of Alaska to an open port will serve the best interests of the State.
3. The level of benefits, and burdens reasonably to be expected by the State as a consequence of any decision on a North Slope gas transportation system are of such magnitude that the routing decision must be regarded as critical to the future of the State. Action to secure a Trans-Alaska routing must be pursued as expeditiously as possible; no reasonable step should be left untaken.
4. The position of the state as owner of a one-eighth royalty in natural

gas and natural gas liquids produced from State-owned lands on the North Slope creates an immediate opportunity for effective State action which can assist in securing a Trans-Alaska transportation system.

5. Affirmative, aggressive action by the Governor, the Commissioner of Natural Resources, the State Royalty Board, and the Legislature with respect to the State's royalty gas is imperative.
6. Effective use of the State's royalty gas, to serve the best interests of the State, requires:
 - a. The State must elect to take its royalty share of natural gas and natural gas liquids in kind.
 - b. The State must commit a portion of its royalty gas to purchasers who will assist in securing approval of a Trans-Alaska transportation system, and who will thereafter utilize such a Trans-Alaska system.
7. Present levels of natural gas demand in Alaska permit a commitment of a portion of the State's royalty gas to purchasers outside the State; while every effort must be made to retain a substantial part of Alaska's gas for present and future in-state needs, it is in the overall best interests of the State to offer for sale outside the State, a substantial portion of the State's royalty gas to purchasers who can, and will, assist in securing authorization of a Trans-Alaska transportation system.
8. Those persons and firms interested in the construction and operation of a Trans-Alaska transportation system can materially alleviate State unemployment problems, and the State should, in striking a bargain for the commitment of State resources to a Trans-Alaska

- system, secure appropriate commitments for the hire and training of Alaska residents in the construction and operation of such a system.
9. Finally, the risk that non-action by the State, or delayed action by the State, will cause the selection of a Trans-Canadian routing, and the risk that the State will lose substantial benefit of its natural gas resource are so great, it is the sense of this Committee that State action must not be delayed.

BY REASON OF THE FOREGOING, IT IS THE RECOMMENDATION OF THIS COMMITTEE THAT:

1. The commissioner of Natural Resources and the State Royalty Board should undertake immediate negotiations with interested out-of-state purchasers to reach definitive sales and/or exchange agreements covering disposition of substantial portions of the State's royalty gas on the best obtainable terms.
2. The Commissioner of Natural Resources and the State Royalty Board should undertake immediate negotiations with natural gas transporters involved in the proposal for a Trans-Alaska system to reach definitive transportation agreements covering the State's royalty gas sold for out-of-state use, and the State's withdrawal of the unsold portion of its royalty gas from the system for in-state use; appropriate commitments should be obtained with respect to hire and training of Alaska residents.
3. The arrangements and agreements so negotiated should be presented to the Legislature for ratification prior to the end of the Second Session of the Ninth Legislature to avoid, if possible, a special session.
4. The Legislature should hold itself ready for immediate consideration

of and prompt action on, the recommendations of the Commissioner and Board.

5. Such arrangements, contracts, and agreements as are negotiated by the Commissioner and Board and approved by the Legislature should be incorporated into the pending applications for a Trans-Alaska transportation system, presented to the Federal Power Commission by the appropriate transporter-applicant, and approval thereof obtained in the pending Federal Power Commission proceedings.
6. The Legislature should adopt SCR 66 and further seek the active cooperation of all owners of North Slope gas in support of the Trans-Alaska pipeline route.



Alaska State Legislature

Senate

JUNEAU, ALASKA

A G E N D A

GAS PIPELINE IMPACT COMMITTEE

PUBLIC HEARINGS

FEBRUARY 17, 18, & 19 - Supreme Courtroom A, 1-5 PM

FEBRUARY 17

- 1:00 PM NBC Whitepaper "Natural Gas"
- 1:45 PM Rush Moody Jr.
- 3:00 PM George Sellides - Uses of Natural Gas in Alaska
- 3:30 PM Anchorage Natural Gas, Dale Teel
- 4:00 PM OMAR
- 4:30 PM BP Alaska, Joe Josephson

FEBRUARY 18

- 1:00 PM Legislative Committee on Taxation and Revenue
- 1:30 PM Wentworth Brothers, J.J. Schons
- 2:30 PM Fairbanks Industrial Corporation,
Associated General Contractors, Conrad Frank
- 3:00 PM National Electrical Contractors Association, Julius Kornfiend
- 3:30 PM Federal Labor Council of Fairbanks, Dave Rasley
- 4:00 PM Anchorage Municipal Light and Power, Tom Stahr
- 4:30 PM State of Alaska, Patrick Dobey

AGENDA
Page -2-

FEBRUARY 19

- 1:00 PM State of Alaska, Guy Martin, William Fackler, Easy Gilbreth
2:00 PM El Paso
3:00 PM Tenneco
3:30 PM ARCO
4:00 PM Exxon
4:30 PM Collier Chemical Corporation

~~6,000~~ ~~4,000,000~~
24,000,000,000,000

NATURAL GAS FACT SHEET

4-5 billion barrels of oil

SADELROCHIT RESERVOIR

Estimated reserves= 26 to 32 Trillion Cubic Feet (TCF)
 Estimated daily flow from pipeline= 2.5 Billion Cubic Feet* (BCF)
 Estimated yearly flow = .9 Trillion Cubic Feet

Alaska's royalty share= 3.25--4 TCF
 Daily royalty share = 312 Million Cubic Feet (MMCF)
 Yearly royalty share = 114 BCF

*Department of Interior study.
 More proven reserves are expected to be proven in the North Slope area.

ALASKAN USE

Almost all the natural gas used in Alaska is in the Cook Inlet area.

 Anchorage Natural Gas uses about 30 BCF per year.
 That is equal to 12 days production from Prudhoe Bay.
 On a cold day in Anchorage, about 120 MMCF is used.
 Anchorage Natural Gas has firm commitments for 10--15 years of gas from Cook Inlet.

 Phillips Petroleum uses about 61 BCF per year, most of which is liquified and shipped to Japan.

 Collier Chemical Corporation uses about 21 BCF per year in their Ammonia/Urea plant. They are now doubling their operation.

 One thousand cubic feet of gas (1 MCF) is equal to about 1 Million BTU. North Slope gas is particularly "rich" at about 1.1 MMBTU.

Six MCF of gas is roughly equal to one barrel of oil.

Consumers are willing to pay a premium for gas. It is a clean energy source.

On strictly energy equivalent, \$2.00 per MCF gas = \$12 barrel oil.
 Considering the advantages of using gas, \$2.00 gas = \$9 barrel oil.

 United States gas production has declined from a peak of about 62 BCF per day in 1973 to 55 BCF/day in 1975.

BAKER & BOTTS

1701 PENNSYLVANIA AVE., N. W.
WASHINGTON, D. C. 20006

TELEPHONE (202) 337-4000

ONE SHELL PLAZA
HOUSTON, TEXAS 77002
TELEPHONE (713) 229-1234
CABLE ROTERLOVE • TELEX 76-2779

ASSOCIATED OFFICES

PASEO DE LA REPUBLICA 19
MEXICO, D. F. MEXICO

21 AVENUE GEORGE • 2^E ETAGE
PARIS 9, FRANCE

January 14, 1976

Senator John Rader, Chairman
Joint Gas Pipeline Impact Committee
The Legislature of the State of Alaska
Juneau, Alaska 99801

Dear Senator Rader:

Your Committee has asked me to address certain issues relative to the transportation of Alaska natural gas, assuming for the purpose of my analysis that there will be gas available for sale from the North Slope. 1/

I propose to set forth in this letter the conclusions that I have reached as a result of my research and my knowledge of the Federal Power Commission, together with certain alternatives which the State might wish to consider. To this letter I will append the legal analysis which leads to the conclusions expressed herein.

1/ You are aware of the possibility that natural gas production for sale may have a detrimental effect on the recovery of oil. Studies conducted by the Department of the Interior and by H.K. Van Poolen and Associates raise questions in this regard which are now being examined by the Committee. This issue is, I agree, of critical importance to State consideration of natural gas transportation issues, inasmuch as the State may find it necessary, for reasons of conservation, to limit natural gas production or require reinjection of associated natural gas for maintenance of reservoir pressure. Such conservation actions are, in my opinion, legally permissible if necessary to prevent waste, see pp. 85-94 of attached analysis, but might result in an indefinite postponement of a natural gas transportation system.

AGO 545830

From the outset, I need to make clear my recognition, that State policy relative to natural gas will develop, as it should, through processes of government, and that these policy decisions will involve consideration of far more than questions of law and Federal policy. What I offer can be only a part of the whole which the State will consider as the State moves forward to a sound and productive policy of resource management. 2/

As a substantive starting point in my report to you, it is my judgment that the State should, from the standpoint of legal consequences, decide as quickly as possible the ultimate goals of State natural gas policy. If the State has a strong concern for a retention of a portion of Alaska gas for future Alaska needs, affirmative and aggressive State action will be necessary. Non-action by the State with respect to disposition and transportation of North Slope natural gas threatens permanent loss of the gas resources insofar as Alaska consumers are concerned; non-action creates a risk that natural gas produced in Alaska will not be available to fulfill future Alaska residential or industrial needs.

Let us assume that the El Paso, Trans-Alaska transportation route is authorized. Non-action by the State will result, sooner or later, in producer sales of eight-eighths of the natural gas stream in interstate commerce, either to an interstate pipeline, to distributors in the lower 48 states, or to direct users in the lower 48 states; and non-action by the state will result in the construction and operation of an interstate transportation system designed for, and financed on, the expectation of the flow of eight-eighths of the deliverable natural gas from the North Slope. If the State permits, by non-action, these developments, then certain legal consequences may be expected.

2/ I would ask it to be understood that my opinions do not reflect considerations outside my area of knowledge and training; I have no basis, for example, for advice on environmental or economic factors; nor can I gauge the will of the citizens of Alaska concerning economic growth and industrial development; nor can I estimate how strong will be the demand for revenue because of programs which the State may determine are necessary.

The issues which I address are, therefore, approached only from the relatively narrow standpoint of law and Federal regulation. I do not presume to prescribe what is "right" or "good" for the State. These determinations are peculiarly within the province of this Legislature, which will, I am sure, look to a much broader range of considerations, information, and analysis than are within my capabilities.

1. If producers market Alaska natural gas in interstate commerce, paying the State a one-eighth royalty in cash, the Federal Power Commission can assert jurisdiction over eight-eighths of Alaska production, and thereby attempt to prevent any later efforts by the producers, or by the State, to withdraw the State's one-eighth royalty share for an in-kind taking by the State for use in the State. (pp. 64-73) 3

2. In the event of such a sale by producers to an interstate pipeline, and in the event of FPC denial of a request to withdraw State royalty gas, the only means for securing gas service in Alaska would be through a future demand by Alaska municipalities or distributors for service by the pipeline; such a request may be treated by the FPC, and lower 48 pipeline or distributor customers, as a request for new service which cannot lawfully be authorized. If the pipeline, at the time of the demand, is unable to render adequate service to its non-Alaska customers, or if grant of the Alaska demand would require to enlargement of pipeline transportation facilities, the Commission may be required, by law, to refuse demands for Alaska service -- even for residential and public service needs.

3. If Alaska can successfully claim -- contrary to the hypothesis in Paragraph 2 -- status as an existing customer, pipeline natural gas supplies would be shared by Alaska and non-Alaska customers on the basis of FPC curtailment priorities and allocation orders.

4. In the event of direct sale by producers to end users in the lower 48 states, or sale to distribution companies in the lower 48 states, there is no clear legal mechanism available to the State of Alaska to secure any portion of the natural gas produced in Alaska for future Alaska needs as they may develop.

Non-action by the State, in my judgment, creates serious risk that Alaska natural gas will not be available for future Alaska needs, even if the El Paso transportation proposal prevails. It is not just the

3/ Page references here and later in this letter are to the attached legal analysis.

potential industrial gas demand (which may or may not be a matter of State concern, dependent on the will of the citizenry with respect to industrial development) that is at risk. The needs of Fairbanks, and other communities, for residential service and service to schools, hospitals, and the like is also threatened.

The risk can be lessened by appropriate state action, as hereinafter discussed, if a trans-Alaska routing is authorized. If a trans-Canada routing is selected, whereby North Slope natural gas leaves Alaska north of the Arctic Circle, the State has no means of protecting its future gas needs. The routing question is, therefore, critical to the State -- at least in the context of future availability of Alaska gas for future Alaska needs. 4/

I am of the firm opinion that neither of the present proposals for transportation of North Slope natural gas offers a substantial guarantee that Alaska natural gas needs will be met. If either the El Paso or the Arctic Gas proposal is approved as presently submitted, the State could well find itself unable to draw upon its own gas resources to meet the future needs of the State.

The problems here are inherent in the nature of the applications and the Natural Gas Act: if the Arctic gas proposal prevails, there is no physical means to move gas from North Slope areas to the State's population centers; the Arctic gas routing will simply preclude gas movement within the State since the gas will leave the State north of the Arctic Circle. If, on the other hand, the El Paso proposal prevails on the basis of present filings with the FPC, the full natural gas stream will begin movement in interstate commerce, and even though it may be physically possible to withdraw gas where and when needed in Alaska, it may be legally impermissible to do so.

4/ Whatever the transportation route, natural gas production and transportation may reasonably be expected to contribute significant revenues and economic activity to the State. Accordingly, even if the transportation system which is Federally authorized does not lend itself to serving state natural gas needs, benefits to the State still might result from natural gas production, and transportation. A decision in this regard involves a balancing of economic, environmental, and political considerations which are beyond the scope of the requested analysis, and outside the scope of my knowledge and experience.

The State's present danger stems from the fact that certificates may issue, and interstate service may commence, without formal recognition of the State's needs. Interstate service unconditioned to Alaska's rights, creates grave problems concerning later attempts by the State to withdraw gas from the system -- problems which arise under Granite City Steel Co., v. FPC, 320 F2d 711 (C. A. D. C.. 1963) which suggests that gas customers in Alaska may not be added as pipeline customers if the pipeline is, at the time service to new customers is sought, then unable to meet the needs of existing customers; under Sec. 7(b) of the Natural Gas Act as interpreted by the Commission, which suggests that a partial diversion of the interstate natural gas stream will not be permitted without prior Commission authorization; and under Louisiana Public Service Commission v. FPC, 359 F2 524 (C. A. 5, 1966) cert. den'd. 385 U.S. 833, which holds that commingling of non-jurisdictional natural gas with jurisdictional natural gas results in a single gas stream which is wholly jurisdictional.

It does not follow, however, that Alaska is powerless to influence the movement of North Slope gas in a manner more nearly suited to the State's future gas needs than the proposals now pending. To the contrary, I believe there are reasonable courses of action which the State can pursue.

The State may exercise the option set forth in its oil and gas leases to take royalty gas in kind, and market this production separately from working interest gas; the State need not seek FPC authorization for royalty sales, and should limit the term thereof to the extent possible.

I believe that it would be most unwise, under present circumstances, to permit the producing companies which hold leases on State lands to market the State's royalty share of gas production. If marketing occurs, with the gas moving in interstate commerce, the problems summarized above -- and particularly the Sec. 7(b) abandonment problem -- stand as very real threats to later withdrawal of State royalty gas from the marketing arrangements made by the producers. Most simply put, if 8/8ths of the gas stream is committed to interstate commerce by delivery under an unconditional producer certificate of public convenience and necessity, withdrawal of the royalty 1/8th at a later date may require

FPC approval -- which may, or may not, be forthcoming.
This is the lesson of FPC Docket N. C171-879, Superior Oil Company, Letter Order issued June 13, 1975. (pp 64-73).

This particular problem can be mitigated if the State exercises its option, prior to the delivery of any gas, to take its royalty share in kind, with appropriate notice to producer, purchaser, and FPC that the producer is without authority to market the State's natural gas.

The State should, therefore, negotiate for separate sale of its royalty gas on the best terms available, giving due consideration to a relatively short-term sale. The State should take the position that it is not subject to the Natural Gas Act, nor to the jurisdiction of the FPC, and that the State is therefore free to make sales for resale in interstate commerce (or in any other market), without certificate authority, and without restriction as to rates or terms of service. This position, though clouded by the Court decision in FPC v. Corp. Comm. of Oklahoma, 362 F. Supp. 522 (W.D. Okla., 1973) aff'd 415 U.S. 961 (1974) is, I believe, legally sound and legally sustainable.

State marketing of its royalty gas is not a complete answer to the basic problem. That gas must be transported, and the only available means of transport will be through the facilities of an interstate pipeline. The FPC can, therefore, exercise indirect control of royalty gas through its certification powers under Section 7 of the Natural Gas Act, even to the extent of denying the right of transportation if it is opposed to the end-use to which the gas will be put, or the price paid for the gas. See FPC v. Transcontinental Gas Pipeline Corp., 365 U.S. 1 (1961), and pp.3-9 of the attached analysis. Thus, it will still be necessary for the State to involve itself in transportation negotiations and see that FPC approval of transportation arrangements is obtained, even if the State markets its own gas by sale at the wellhead or sale downstream. The protection which the State must have is advance FPC approval of State withdrawal of its gas from interstate commerce, but this approval should be sought and obtained by the transporter in connection with its certificate applications and related tariff findings.

In suggesting these actions, I hold to the view that the State's power to call upon the gas resource when needed in the future can, in reasonable probability, be exercised if the State's rights and obligations are fully spelled out, fully presented to the FPC, and accepted by the FPC as an integral part of the transportation system which is certified by the FPC.

While all problems relating to future in-State use of State-owned gas may not be wholly solved by advance agreement, and advance FPC clearance, of specific production, transportation, and sales arrangements, it is my judgment that the problems are reduced to the levels of acceptable risk-taking if the FPC, prior to construction and operation of a transportation system, expressly conditions all necessary certificates of public convenience and necessity and pipeline tariffs to permit and approve such arrangements as are negotiated by the State with respect to its royalty gas.

The State may consider the enactment of legislation to hold State owned resources within the State unless such are surplus to the needs of the state.

Discussed in some detail in the appended legal analysis is a recent Texas statute which is designed to secure for the benefit of the State the resources which are publicly owned. The statute is prospective in operation, and simply requires that all State-issued oil and gas leases shall contain appropriate provisions to prohibit sale of natural gas produced from State-owned lands outside the State unless it is found that such gas is surplus to the needs of the State. (pp79-85).

While the State clearly may not "embargo" natural gas through exercise of its regulatory powers, (pp43-45 it may be argued that the State's powers incident to ownership of public lands are different from, and greater than, mere regulatory powers. Cannot the State decide to withhold its lands from development? if so, (and about this I can see little argument), does not this right include the lesser right to permit development only upon terms acceptable to the State as a property owner? (pp.15-17).

I do not offer an unqualified opinion that such legislation would withstand court challenge; I acknowledge that a challenge would probably be forthcoming, and that the legislation might fall as an undue burden on interstate commerce. Nonetheless, there is some chance of upholding protective legislation, and enactment could serve as a clear Legislative expression of Alaska's determination to retain a fair share of Alaska's resources. (pp79-85).

The State may consider various means of encouraging conversion of natural gas to methanol, or encouraging extraction of all natural gas liquids, prior to movement of natural gas in interstate commerce.

If North Slope gas is converted to methanol before becoming committed to interstate commerce, the conversion facilities, the methanol itself, and the transportation of methanol would not be subject to FPC control. Since the natural gas would be produced and "consumed" (i.e., converted to something other than natural gas) within the State, the natural gas would never become subject to FPC jurisdiction.

Similarly, if ethane, propane, butane, and other liquids are removed from the natural gas stream prior to transportation or sale in interstate commerce, the extraction facilities, the liquids themselves, and the transportation of the liquids should not be subject to FPC control.

It is beyond the scope of my knowledge to explore the economic feasibility of these alternatives; nor can I judge whether the oil pipeline now under construction can, from an engineering standpoint, serve as a conduit for methanol or other liquids. I believe, however, that the State should be aware that a natural gas stream has enormous potential value other than its obvious value as a heat source. It would be imprudent not to explore all potential uses of the gas stream; particularly where conversion within the State, or liquids extraction within the State, diminishes the range of FPC controls, and where, as here, the use of liquids for generation of heat represents a waste of valuable raw material.

Encouragement of conversion or extraction may be given through legitimate State tax incentives or through dedication, on favorable terms, of State-owned gas to a conversion or extraction project. The most effective means of encouragement should be determined at the time full exploration is made of economic and engineering feasibility.

Legislative action may be considered with respect to extraction operations, but probably may not be considered with respect to a conversion project. The latter situation would almost surely require an impermissible degree of interference with interstate commerce, since any statute directing the flow of natural gas to a con-

version plant would, in actual operation, preclude movement of gas in interstate commerce. Such a restriction would not, in my judgment, withstand Court challenge.

Legislative direction that liquids extraction occur prior to movement of the residue gas in interstate commerce may, on the other hand, be a valid exercise of State regulatory powers to prevent waste. This issue is discussed in some detail in the attached legal analysis (24-100), and I conclude that mandatory extraction, if based on appropriate finding that extraction is necessary to prevent waste of a natural resource, and if properly applied to preclude the possibility of an unconstitutional confiscation, has a reasonable basis and can, therefore, be defended.

In addition to the foregoing alternatives relating to possible State action to retain a portion of the State's gas resources for State use, other, and different, alternatives exist.

What Actions Can the State Pursue to Achieve Benefit from the State's Gas Resources?

Until this point, we have focused on natural gas transportation issues; I suggest that there are other matters which deserve consideration as the State of Alaska moves toward resolution of its basic energy policies. These other matters are not strictly within the request made of me for legal analysis, and indeed some require far more exhaustive consideration before a firm recommendation can be made; I touch upon each briefly because they are germane to the general issues under discussion, and because some, or all, may emerge as part of an overall State strategy of resource management.

1. State leasing policies should be re-examined.

(a) The State is presently leasing on the basis of a one-eighth royalty. Other producing states, notably Texas and Louisiana, now demand, and receive, a one-fifth or one sixth royalty. Alaska should re-assess its bargaining position, its revenue needs, and whether the greater degree of control which in-kind royalty permits, justify leasing in terms other than those presently employed.

(b) Consideration should be given to the possibility that the leasing of State lands, or the withholding of state lands from leasing, is a valid instrument of State policy which can be used to assist in holding State resources for State needs; for example, can

leasing schedules be tied to changes in intrastate supply and demand? Can development be held until the State needs the resource? Here again revenue considerations and State desires regarding the optimum level of drilling and production activity must be weighed, but I suggest that one of Alaska's greatest strengths lies in its ownership of oil and gas bearing lands; thought should be given to the best use of that strength.

2. State taxing policies should be re-examined.

(a) The State presently provides for a production tax on natural gas of 4% of the gross value at the well; other producing states impose a much higher tax--for example, Texas exacts a severance tax of 7-1/2% of the market value of the gas when produced, and Louisiana imposes a basic severance tax of 7 cents/Mcf on natural gas. In considering whether revision of Alaska production taxes is appropriate, thought should be given to the Louisiana form: Louisiana's revenue levels are not controlled by the FPC, while Texas' are, at least to the extent that Texas gas is sold interstate. A further defect in the Texas structure lies in its requirement, in the final analysis, that Texas consumers bear a higher tax than out-of-state users; since the State tax is tied to value, intrastate sales at higher rates than interstate sales produce a higher tax bill for the intrastate producer than for the interstate producer.

(b) Alaska can consider the enactment of a franchise tax on interstate pipelines. Colonial Pipeline Company v. Traigle, 421 U.S. 100, decided April 28, 1975, upheld a Louisiana statute that imposed a franchise tax on a pipeline company that was admittedly engaged exclusively in interstate commerce.

In 1969, a Louisiana Court held that the commerce clause of the Federal Constitution was violated by a state tax "payable for the

privelege of carrying on or doing business... in this state." The Louisiana legislature then amended the offending provision by providing that the tax was levied upon "(t)he qualification to carry on or do business in this state in a corporate form". The Supreme Court of Louisiana upheld the tax as constitutional levy for priveleges enjoyed by corporations in the state carrying on business, interstate or local, in the corporate form. 289 So. 2d 93 (1974). The U.S. Supreme Court affirmed. The Court cited Memphis Natural Gas Company v. Stone, 335 U.S. 80 (1948), a case that sustained a similar franchise tax imposed by Mississippi on a foreign pipeline corporation exclusively engaged in interstate business. The Court quoted Justice Reed's opinion in the 1948 case: "This is a tax on activities for which the state, not the United States, gives protection and the state is entitled to compensation when its tax cannot be said to be an unreasonable burden or a toll on the interstate business". The "activities for which the state gives protection" included "protection of... maintaining, keeping in repair, and otherwise manning the facilities of the system," the Court said.

Conclusion

As must be evident, it is my view that from the standpoint of legal consequence, the State should pursue an affirmative, aggressive course of enlightened self-interest if the present and future natural gas needs of the State are to be met. The State must decide what it wants, and then set out to achieve its goals.

My judgment is that the State may reasonably expect success in its negotiations. Consider the pressure points available to the State as bargaining levers:

1. Equity favors the State; it seeks nothing more than a share of the resources which it owns. Further, the State of Alaska alone bears a substantial environmental cost as North Slope resources are developed and transported; since this burden exists, an off-setting benefit should be made available to the people of Alaska.
2. The State has as-yet unused regulatory powers which can materially affect the flow of oil and gas.
3. The State has as-yet unused powers of ownership which can materially affect the flow of oil and gas.
4. The State has as-yet unused powers of taxation which can affect the price of oil and gas.
5. The State probably can retain some control of its royalty gas if the State takes effective action; by non-action the State stands to lose control of its royalty gas. The State's position on its royalty gas is of critical significance because it is doubtful that any North Slope transportation system can go forward without commitment of royalty gas to the system, either as part of system supply or as the subject of a continuing transportation agreement. The transportation system needs the royalty gas volumes to support claims of economic viability.

These factors lead me to believe that the State can bargain effectively.

I believe negotiations with both transportation groups are in order. The Arctic Gas proposal has encountered significant opposition, and the FPC staff has only recently concluded that the Arctic Gas group should consider an alternative routing to bring its line down the Alyeska corridor to Fairbanks, and then south eastward. This routing offers an opportunity for physical movement of North Slope gas to, or near, population centers through an Arctic Gas line, a possibility which did not exist so long as Arctic Gas proposed to move eastward out of the State while still within the Arctic Circle.

El Paso should obviously also be approached in definitive negotiations. It has historically supported the principal that a portion of the Alaska gas should be made available for Alaska usage and the El Paso proposal can serve State needs with fewer major revisions than Arctic Gas.

It is, therefore, appropriate for the State to open negotiations with both transportation proponents. It is time to ask, and obtain, positive answers to one basic question: How can Alaska retain the benefit of its natural gas resource under your proposal?

What must be made clear is that the Alaska Legislature and the State Administration, have affirmative duties to ensure, to the fullest possible extent, that the needs of Alaska are served. Others may, and should, consider private interests. But it must be unmistakably clear that Alaska will judge its present and future position on leasing, regulation, taxation, and royalty gas disposition with due regard to Alaska's present and future needs.

It seems to me that if Alaska can derive no benefit from natural gas produced within its borders in the sense of sharing in the use of the resource, then clearly Alaska can protect its citizen's rights only by looking to natural gas as a source of revenue. Every legitimate means of using gas to raise revenue should be explored. If, on the other hand, Alaska is permitted to share in the benefit of a secure and reliable source of natural gas for use as a non-polluting heat source and as a raw material feedstock, then Alaska need place less emphasis on direct revenue and more emphasis on cooperative development.

If men of good will make an intelligent effort at accommodation and understanding, there is no reason why the mutual problems of producer, transporter, and consumer cannot be solved in a manner which balances fairly their respective interests, and which also serves the interests of national and state government as well.

Respectfully submitted,

Rush Moody, Jr.

Rush Moody, Jr.

RM/ap



CITY OF VALDEZ

P. O. BOX 506
PHONE: (907) 835-4313

February 10, 1976

ZIP CODE: 99686

Senator John Rader, Chairman
Gas Pipeline Impact Committee
Pouch V
Juneau, Alaska 99801

Subject: Gas Pipeline Impact Committee Meeting, February 17,18, 19, 1976

Dear Senator Rader:

This is in reply to your letter of February 2, 1976 regarding possible consumption of natural gas in the city of Valdez.

If natural gas becomes available to the city of Valdez, a whole new era would be opened up. The natural gas would be utilized to heat homes, businesses, schools and hospitals, power electrical generation turbines, and for processing raw materials, minerals and other as yet unknown industries. The use of natural gas would replace the use of heating fuel for heating purposes, thus allowing the heating fuel to be utilized in other more economical ways.

While I have no idea as to the quantity of natural gas which would be consumed by a city of 10,000 to 15,000 people, I am certain it is considerable.

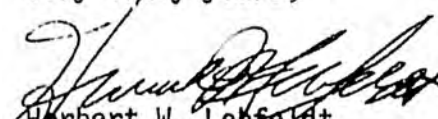
With the El Paso natural gas pipeline passing through the city of Valdez, it would be very inexpensive to construct a short service line into the city proper. The savings to the consumer would be fantastic just in transportation costs alone.

As soon as we become aware that the El Paso gas pipeline is to be built, the city administration of Valdez will immediately undertake the necessary steps to assure an adequate distribution system for the city.

The availability of natural gas to the citizens of this state is a vital necessity if the state is ever to become other than a consuming state. A low cost energy source is necessary if Alaska is ever going to be able to compete with other states in the production of consumer goods.

I urge you to exert every effort to assure that state royalty gas be retained for use within the state of Alaska.

Very truly yours,


Herbert W. Leffeldt
City Manager

AGO 545844

HWL:ss



GOLDEN VALLEY ELECTRIC ASSOCIATION INC. Box 1249, Fairbanks, Alaska 99707, Phone 907-452-115

February 13, 1976

Senator John Rader, Chairman
Joint Gas Pipeline Impact Committee
Alaska State Legislature
Juneau, AK 99801

Dear Senator Rader

I recently read the Moody report and wholeheartedly concur with its recommendations.

There is a substantial potential market for natural gas available in Interior Alaska. GVEA will have 140,000 KW of base load type gas turbine capacity in operation by November 1977. These units, at nominal base load capacity would require approximately 25,000 cu. ft/day. Eight other reserve peaking units could be adapted to burn gas quite easily and would be if the economic analysis proved favorable. Our system plans to add an additional 100,000 KW of generation by 1980-81; therefore, by 1981 GVEA alone would be capable of using in the neighborhood of 50,000 cu. ft/day of natural gas. Other area steam/electric plants in combination would require about 30,000 cu. ft/day.

Further, I feel certain that Alyeska would consider burning natural gas at their pump stations 5 through 12 now scheduled to burn #2 distillate. These stations in combination phase 3 operation would use approximately 70,000 cu. ft/day.

Arrangements might be made to have them back off and go on liquid fuel as other industrial gas requirements and needs within the State developed.

It appears that this is one way that the State might initially utilize this valuable resource and more important, better guarantee its continued availability within the State of Alaska.

Best wishes.

Very truly yours

R. L. Huffman
General Manager

RLH:dee

AGO 545845

**ALASKA PIPELINE COMPANY**P. O. BOX 6288
ANCHORAGE, ALASKA 995023000 SPENARD ROAD
PHONE (907) 277-5551

February 16, 1976

Senator John Rader, Chairman
Joint Gas Pipeline Impact Committee
The Legislature of the State of Alaska
Juneau, AK 99801

Dear Senator Rader:

At your invitation we have rescheduled our travel in order to be present at this hearing, together with our consultant, Mr. Charles E. Smith. Charlie was the Alaska manager for Union Oil Company of California from 1959 to 1962, and later was their vice president for natural gas and gas liquids. He is now president of Transworld Gas Systems Inc., of Whittier, California. He has broad and thorough knowledge of the natural gas industry and its problems and prospects, and has assisted in preparing our position today.

We believe that it is essential and even imperative that the State should resolve not to let the Prudhoe Bay royalty gas become committed to or sold in interstate commerce and thus become subject to federal jurisdiction. Our review of the "Legal Analyses of Issues Relating to Natural Gas Transmission" as submitted by Rush Moody, Jr., strengthens this belief.

Based on our present sales and historical growth rate, we may have less than 10 years' supply remaining in our present contract for gas from the Kenai Gas Field. We are doing whatever we can to supplement these supplies: from Cook Inlet Royalty Gas; by negotiations for additional gas from existing uncommitted reserves in the Cook Inlet area; and by our own exploration program in the Susitna Valley. However, there is competition for all such gas reserves, from Japan and

ALASKA PIPELINE COMPANY

ANCHORAGE, ALASKA

Senator John Rader, Chairman
February 16, 1976
Page Two

west coast cities, and it is apparent to us that existing Cook Inlet area gas sources will not be sufficient to supply all the existing demand for this gas. In fact, we can show that there is a projected deficit of about four (4) trillion cubic feet to the year 2000. This conclusion can be seen from the report (SRI Project ECC-4304) which Stanford Research Institute prepared in December 1975 for Pacific Alaska LNG Company. This deficit is approximately the same as the quantity of proven Prudhoe Bay royalty gas. In order to adequately protect the consumer, we do not believe it would be prudent for us, nor would it be in the public interest for the State, to rely on any but proven reserves as the future supply for use within Alaska. We do believe the State should view the Prudhoe Bay royalty as the best proven gas reserve for Alaskan use in future years, regardless of which route is selected for delivering this gas to market.

If the El Paso project is finally approved, which we favor, the alternatives open to the State are more straightforward. State gas can be removed from the pipeline prior to delivery to the LNG plant, and a pipeline connection can be made to the existing gas distribution system in Anchorage. In addition new distribution systems could be installed in any city within economic range of the line. Gas which is surplus to the needs of these distribution systems can be stored in underground reservoirs for future deliveries and peaking service, or converted to methanol fuel for distribution throughout Alaska, particularly as an alternative

ALASKA PIPELINE COMPANY

ANCHORAGE, ALASKA

Senator John Rader, Chairman
February 16, 1976
Page Three

fuel for power generation. In our opinion such a plan would exempt the gas from the jurisdiction of the Federal Power Commission.

In the event the Canadian routing were to be chosen for Prudhoe Bay gas, there are several possible alternatives to be considered for the treatment and transportation of the royalty gas:

- (1) A small gas line might be laid to bring the gas to the vicinity of Fairbanks. After satisfying Fairbanks' needs, the remaining gas could be converted to methanol fuel or LNG for further delivery by appropriate means. Methanol fuel has equal or superior qualities as a fuel, and is also in demand as a petrochemical feedstock. Methanol fuel can be utilized as a liquid fuel replacing oil, with minimal equipment change out, but with combustion characteristics equivalent to natural gas. It would be an ideal peaking fuel for the gas turbines which supply power in Anchorage and Fairbanks. Thus even if the 7/8 of Prudhoe Bay gas is taken through Canada, the royalty could be used as fuel by many Alaskan communities and any excess could be sold in the world market. Methanol fuel could be transported by rail to Seward or Whittier for further delivery throughout Alaska. LNG might be exchanged with Pacific Alaska LNG Company for natural gas reserves in place in the Cook Inlet area.
- (2) The Prudhoe Bay royalty gas could be converted to LNG or methanol fuel at wellhead and delivered by Boeing 747 cargo aircraft. Trans-world Gas Systems has made studies in cooperation with Boeing which indicate that air movement of LNG is technically feasible for transportation from remote areas. Such a method adapts itself to small deliveries of gas into areas not yet being served. Further, LNG would be valuable as peaking fuel in the Anchorage area and it could provide base load fuel after the Cook Inlet reserves are depleted or otherwise committed.

ALASKA PIPELINE COMPANY

ANCHORAGE, ALASKA

Senator John Rader, Chairman
February 16, 1976
Page Four

The cost of detailed evaluation and engineering of these alternatives cannot be justified unless or until it is known that the Canadian route will be chosen, and in such event there should be adequate time for the State to provide for handling of royalty gas by the time actual gas deliveries begin. However, as a precautionary measure we believe the State should retain the option to keep the royalty gas in place whether prior to completing its delivery facilities or during any "downtime" of these facilities after deliveries have started.

Regardless of the gas line routing decision, Prudhoe Bay royalty gas is a vital resource for Alaska, and control of its use should be reserved to the State rather than federal authorities. We do not believe that the State should allow even temporary deliveries into interstate commerce because of the danger in relying on existing regulatory and judicial precedents. Only by retaining the gas in place or by taking it as it is produced can the State maximize its opportunity to retain control. We urge the legislature to act now, before any commitment can be made or even presumed by federal authorities or by the applicant companies.

If adequate gas supplies should become available in the Cook Inlet area in the future and the Prudhoe Bay royalty thus becomes surplus, the State could at such time release it into interstate commerce.

ALASKA PIPELINE COMPANY

ANCHORAGE, ALASKA

Senator John Rader, Chairman
February 16, 1976
Page Five

The foregoing is the only direct testimony we have at present. We would request that response to any questions be extended to include our consultant, Mr. Charles Smith of Transworld Gas Systems and Mr. Harold Schmidt, who is our senior vice president, and Mr. Bill Hickman, who is our management analyst.

Very truly yours,



Dale Teel
President

DT:jdh



ALASKA PIPELINE COMPANY

P. O. BOX 6288
ANCHORAGE, ALASKA 99502

3000 SPENARD ROAD
PHONE (907) 277-5551

February 9, 1976

Senator John Rader, Chairman
Joint Gas Pipeline Impact Committee
The Legislature of the State of Alaska
Juneau, Alaska 99801

Dear John:

In 1975 our sales were about 30 billion cubic feet (BCF), to military and civilian power plants and to all other uses, residential and commercial. At the end of 1975 we had 450 BCF remaining under contract. Recovery of waste heat and other reductions of demand for gas by the power plants can be projected, and we are not obligated to the military after 1980. However, it may be prudent for us to anticipate that our annual sales will increase by 1 BCF or more each year for the foreseeable future. Thus we should be working to obtain additional reserves at every opportunity.

We have not been negotiating for Prudhoe Bay royalty gas thus far, because royalty gas is now available in the Cook Inlet area and because there may be about as much other uncommitted gas in the Cook Inlet area as there is of royalty gas at Prudhoe Bay. The distance (investment) and the daily volume required for using Prudhoe Bay royalty gas have made it comparatively impractical for us to consider thus far.

We have begun exploring for gas in the Susitna Valley in the hope that reserves for our requirements could be found and thereby avoid the full impact of competition by Los Angeles, Portland, or Tokyo for gas from the Cook Inlet area. However, we need gas (not just "hope") and if Prudhoe Bay royalty gas will be available within 5 to 10 years, we believe we should begin considering it as an alternative or supplementary supply. As I read the material you sent me, it seems to be essential that the Prudhoe Bay royalty gas should not be commingled with producer gas regardless of the route selected, in order for the State to retain control of its gas. This would mean that a separate pipeline would have to be built for this royalty gas.

If the State were willing to do the financing of such a pipeline, and compressors as necessary, it may be possible for us to arrange to take part or all of the Prudhoe Bay royalty gas. I believe that a 20 inch (?)

AGO 545851

ALASKA PIPELINE COMPANY

ANCHORAGE, ALASKA

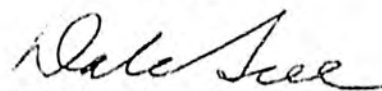
Senator John Rader, Chairman
February 9, 1976
Page #2

pipeline, refrigerated to avoid permafrost problems, could be built along the oil pipeline right of way to the Fairbanks area and then along the new highway to the Anchorage area. It could serve the requirements of Chugach when their "Beluga" supply becomes inadequate, as well as our requirements particularly for the municipal and military power plants. It might also serve some of the requirements of present or future petrochemical industries. I am not sure what daily rate of royalty gas is being considered, but I assume it to be of the order of 100 to 200 million cubic feet per day, which compares to our present peak capacity of 160 million and our present average daily sales of about 75 million.

The seasonal aspect of our demand for gas may be the primary problem with our taking Prudhoe Bay royalty gas, but it may be possible to solve that problem by off-season industrial applications or other means. At any rate, we believe there may be sufficient prospect for Alaskan use of this gas that it should be fully explored.

We are not prepared to testify on February 17-20, and will be out of the state on those days. However, we believe our position should be considered as your committee studies this subject.

Very truly yours,



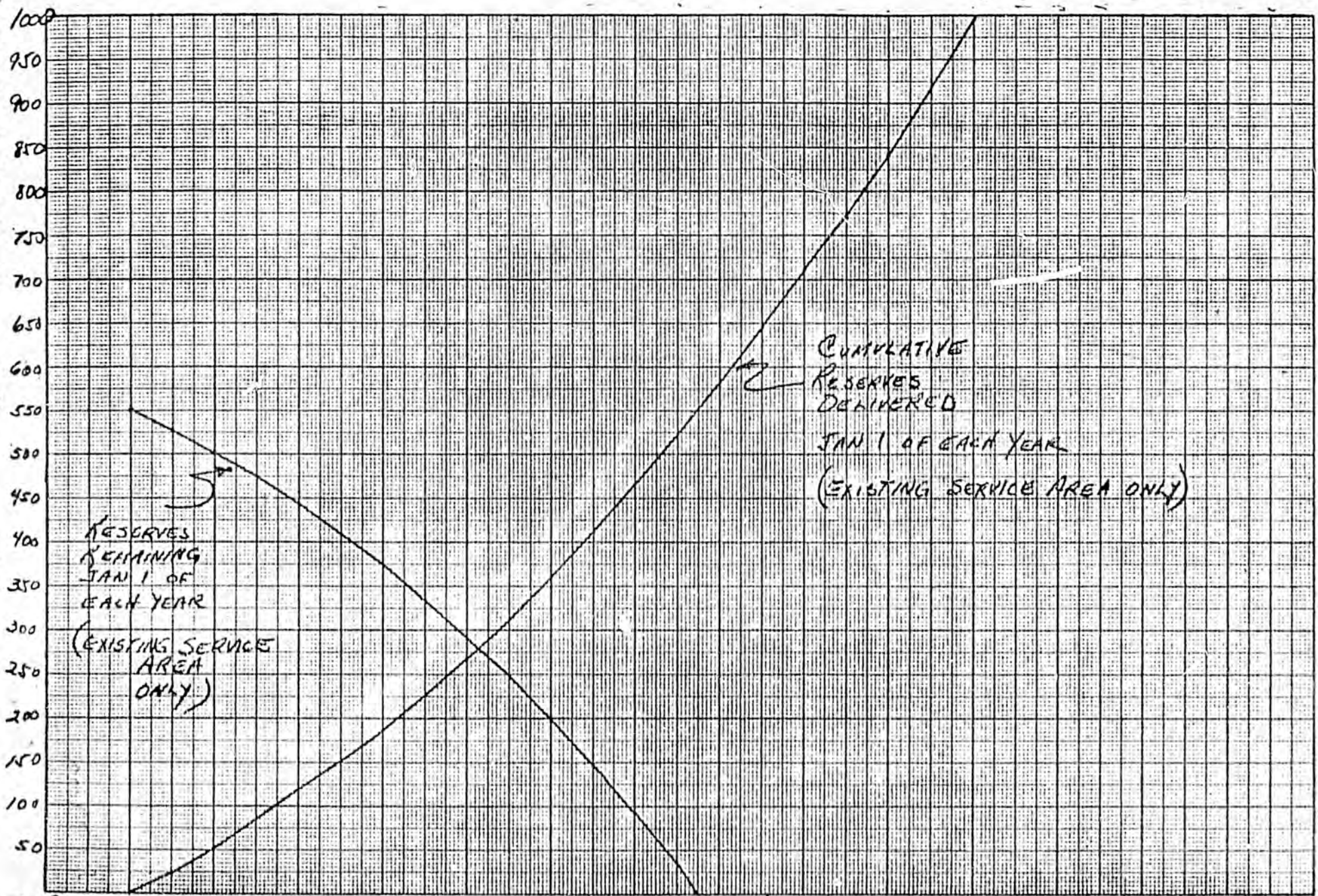
Dale Teel
President

DT:dh

BCRF BILLIONS OF CUBIC FEET

RESERVES

RESERVES REMAINING JAN 1 OF EACH YEAR



RESERVES REMAINING JAN 1 OF EACH YEAR (EXISTING SERVICE AREA ONLY) 1976 3 4 5 6 7 8 9 80 1 2 3 4 5 6 7 8 9 90 1 2 3 4 5 6 7 8 9 2000

USE OF NATURAL GAS IN ALASKA

BY

GEORGE C. SILIDES, P. E.

TO THE

SPECIAL LEGISLATIVE COMMITTEE ON

GAS PIPELINE IMPACT

FEBRUARY 17, 1976

I N T R O D U C T I O N

For the record, my name is George Silides. I am a Registered Professional Engineer in private practice, a former State Senator, and a member of the Eighth Legislature's Interim Natural Gas Pipeline Committee

Thank you Senator Rader, and members of the Ninth Legislature's Special Committee on Gas Pipeline Impact, for your invitation to appear before you and express my thoughts on the complex issues confronting you.

The Committee of which I was a member made three recommendations to the Legislature.

1. That a Special Legislative Committee be established in order to continue studying the alternative proposals of gas pipeline construction and routings, and to keep abreast of the actions of the Federal Power Commission and the Congress.

2. Obtain legal expertise in the area of Federal Power Commission regulation in order to protect Alaska's interests.

The creation of this Committee before which I appear today, and the retention of Mr. Rush Moody, formerly with the F.P.C., bears witness that the first two recommendations were accepted.

3. The third recommendation was that the State take such action as appears necessary so as to make it's position crystal clear. I am proceeding under the assumption that this Committee intends to move in that direction. To this date no clearly stated intent as to the use of our royalty gas or oil has been announced, nor has the Commissioner of Natural Resources invited specific, bona-fide, binding proposals from interested persons for the purchase and use of our royalty gas or oil. There is a partial legislative remedy for this as I shall suggest later.

Senator Rader, who chairs this Committee, invited me to speak on the uses of Natural Gas. Most of my comments will deal, primarily, with this aspect, but I would be remiss in not exploring with you some of the other considerations that relate and govern our ability to secure the use of the gas.

Many of my comments appear similar to those of Mr. Rush Moody. I make no apologies for this since I, and others, have been making these comments to the Legislature since 1972. It is encouraging to be joined in them by someone of Mr. Moody's reputation, experience, and a Washington, D.C. address, who gives us a much clearer insight than before as to what we might expect from the Federal Power Commission.

A M O U N T O F G A S

Prudhoe Bay reportedly contains 26 trillion cubic feet of recoverable cap and solution gas. Each barrel of oil produced will bring up about 750 cubic feet of solution gas. Therefore, 9.6 billion barrels of oil production may be expected to result in the concurrent production of 7.2 trillion cubic feet of solution gas. In terms of daily production 1.2 million barrels of oil results in 900 million cubic feet of solution gas and 2.0 million barrels per day results in 1.5 billion cubic feet of solution gas daily. This, I stress, is exclusive of any allowable cap gas production.

At 12 1/2% royalty interest, Alaska's share of solution gas amounts to approximately 185 million cubic feet of solution gas daily.

When cap gas recovery is allowed for full pipeline throughput, Alaska's royalty share will rise to about 310 million cubic feet daily under the El Paso proposal, and 435 million cubic feet daily under the Arctic Gas scheme. The question immediately arises as to whether or not a pipeline through Canada is detrimental to Alaska's internal economies by depleting our royalty share at a rate faster than we can consume or convert to the myriad of products capable of being produced from Natural Gas. Add to this the certainty that the price of Natural Gas at the market place will continue to rise in relation to the cost of production; should cause us to consider net income just as important as production of the oil reservoir in determining the allowable rate of production.

AGO 545857

ALLOWABLE RATE OF PRODUCTION

This is not to suggest that we should curtail solution and cap gas production below that which is necessary to comply with sound reservoir engineering. Nor do I subscribe to the simplistic, out-of-context, interpretation from a recent report to support the theory that we would lose 4 1/2 per cent of recoverable oil reserves unless all gas production was withheld to the year 2000 or so. Mr. C. K. Gilbraith and Mr. Pat Dobey of the Division of Oil and Gas are the ones to question on that account.

I am assuming that for about the first two years of oil production we will allow removal of about one half the solution gas and none of cap gas until the true nature of the reservoir and its flow pressures can be accurately determined by the State's Engineers. I mention these figures as significant because in point blank questioning, officials of El Paso claimed that they would be willing to proceed with construction even at this early-on reduced flow, while the larger diameter-different system of the Canadian line apparently cannot afford such curtailment. In other words, we tend to further lose control unless an Alaska route is used.

USES OF NATURAL GAS

We come now to the various uses of Natural Gas. Let me say at the outset that the least efficient use one can make of gas is to burn it simply for heat or to generate power. Product manufacture is much more beneficial. Through such latter use we not only provide high quality employment but we actually preserve the resource by conversion to a usable product.

It is at this point that I feel compelled to digress into discussion of another route which my associates and I consider of greater benefit to Alaska for reasons that will become apparent.

Thus far you have had two proposals - one through Canada and one through Alaska to Gravina Point. That latter route touches only one urban area - Fairbanks.

Let me also suggest an alternative route to Cook Inlet - specifically the Beluga area. By so doing, the following benefits accrue:

1. The resource is made accessible to the majority of the people of the State, not just 15%.
2. One of the telling criticisms levelled against the El Paso scheme by Arctic Gas is the almost 8% of the gas to be consumed in the liquification process. At Beluga, coal can be used to power the liquification pumps, thus conserving a valuable resource and materially

assisting the creation of a coal mining industry.

3. Methanol manufacture from our royalty gas can be used for the export of coal in slurry form, capable of being transported by tankers. Heretofore, water was used to transport crushed coal in pipelines. Upon arrival at the boiler, about 90-95% of the water content had to be removed. Using a methanol carrier, the slurry can be fired directly into the using boilers.

This, of course, is burning up the resource, not the most efficient use. But, at least, it has assisted in the formation of jobs and taxable income.

Methanol is a liquid chemical commodity of many uses. One important use is the manufacture of formaldehyde, from which are made synthetic adhesives for use in plywood, particle boards and in compressed wood - a superior substitute for scarce hardwoods. It also leads into a long chain of melamine plastics which can easily be manufactured in Alaska for export.

Other salient characteristics of products capable of large scale manufacture of products in Alaska are:

Amonia, urea and nitrates, needed in increasing quantities to sustain the world food supply. Alaska should become a major exporter of fertilizer. These products can be traded for imports which we need.

Nor should the agrarian potential of Alaska be ignored. Cattle ranchers on Kodiak Island and Aleutian Islands have been inhibited by the high cost of feed. The Tanana Valley is producing grain at more than twice the national average per acre. The key to successful cattle and swine raising in Alaska is abundant, cheap fertilizer. Gas is the raw material.

A particularly pure iron can be smelted continuously in the electric furnace, using gas or synthesis gas in place of coke. The tetaniferous iron ores of Klukwan and Snettisham can be smelted by this process in a clean manner.

Going quickly through a partial list of possible uses in Alaska for very large amounts of gas we find the following:

- Synthesis Gas
- Amonia
- Urea
- Nitric Acid
- Methanol
- Formaldehyde
- Lime
- Pelletized Ore and Iron
- Cement
- Acetylene
- Vinyl Chloride and Polyvinyl Chloride
- Nitrates
- Fertilizers
- Plastics
- Adhesives
- Residue Board and Compressed Wood
- Polypropylene, Polyethylene
- Styrofoam
- LNG

Also of importance is the availability of bottled gas to the smaller towns and villages which now suffer both high prices and fuel shortage problems. Obviously, these smaller communities cannot afford piped distribution systems.

We can see then, that gas derivatives such as ethane and propane can provide a substantial, clean petrochemical industry in Alaska. Non-availability of feedstocks rather than cost retards petrochemical capacity. Investment is moving toward the oil and gas producing areas where feedstock availability can be assured. Examples are the Province of Alberta and British Columbia. Last year a 1.5 billion dollar ethane plant was announced in B.C.

C O N T I N G E N C Y P L A N

The question arises: "Can we have these things in the face of adverse ruling by the F.P.C., either in routing through Canada or attempted interference in our internal affairs." The answer is, "Yes, if we have a contingency plan."

First: Take the gas in hand. Make no commitment of sale to either pipeline, but retain control from the well head to the market place. Declare this intent by final passage of SB 174 on oil and gas. That Bill was introduced by the Senate Resources Committee at my request in 1974. It passed the Senate 18-2 and now resides in the House Resources Committee. If the Administration cannot make up its mind on this matter the Legislature can do it for them.

Do not, as has been suggested, amend the provisions of the statute giving legislative overview of the decision of the Oil and Gas Advisory Board. This Bill was co-sponsored in 1974 by Senator Silides, Senator Butrovich, Senator Poland and Senator Croft. It has proven the cornerstone of public scrutiny by the Legislature.

Second: In either routing, and especially if the line goes through Canada, negotiate a trade for our share of the Methane in exchange for Gas Liquids. This trade should be on a BTU equivalent.

Methane constitutes about 68 1/2 per cent of the gas produced at Prudhoe. The availability of Methane within the State is not as important as the availability of gas liquids, relatively speaking. It is the Methane that the mid-West cities are seeking to introduce into their distributor systems. Alaskan cities, with the exception of Anchorage and Fairbanks, do not warrant such distributor systems.

Ethane, Propane and Butane are more important to the State.

- A. Bottled gas for rural use is needed to enhance the quality of life throughout the State.
 - B. The gas liquids are the main feedstocks for petrochemicals.
 - C. The gas liquids appear not to be subject to F.P.C. regulations.
 - D. The volume of gas liquids thus obtained could make a small diameter, high pressure pipeline possible from Prudhoe Bay to Tidewater.
- It most certainly bears study by the Committee.

C O N C L U S I O N

I could continue this complex discussion at even greater length, but I may have already exceeded my brief. My main purpose was first to indicate the value of the resource, and secondly, to suggest that avenues other than the very obvious remain open, and that they should be explored with a firm, positive action.



The ORGANIZATION for the MANAGEMENT of ALASKA'S RESOURCES, INC.

TESTIMONY PRESENTED BEFORE THE GAS LINE IMPACT COMMITTEE

FEBRUARY 17, 1976, JUNEAU, ALASKA

MY NAME IS BOB HARTIG, I SERVE AS ONE OF THE 49 FOUNDERS AND A MEMBER OF THE EXECUTIVE COMMITTEE FOR THE OMAR GROUP. WHILE OUR ORGANIZATION SEEKS TO PROMOTE THE WISE MANAGEMENT OF ALL ALASKA'S RESOURCES, FOR THE PAST 10 MONTHS, OMAR HAS BEEN DIRECTING ALL ITS EFFORTS TO ONE PROJECT--THE CONSTRUCTION OF A TRANS-ALASKAN, ALL AMERICAN NATURAL GAS PIPELINE RATHER THAN THE PROPOSED TRANS-CANADIAN LINE.

OMAR WELCOMES THE OPPORTUNITY TO SPEAK TO YOU AGAIN TODAY, AND COMMENDS YOU FOR YOUR CONTINUING INTEREST. WE ALSO WISH TO COMMEND THE COMMITTEE'S ACTION IN COMMISSIONING RUSH MOODY, JR. TO RESEARCH AND REPORT ON SOME OF THE MATTERS CONCERNING THE STATE'S RIGHT AND ABILITY TO CONTROL ITS NATURAL RESOURCES.

I DO NOT WISH TO RESPOND TO THE TECHNICAL QUESTIONS WHICH WERE POSED BY THIS COMMITTEE IN ITS CALL OF THIS HEARING BECAUSE OMAR IS NOT AN ENGINEERING FIRM. INSTEAD, WE ARE A GROUP OF CONCERNED CITIZENS AND, IT IS IN THE AREA OF PUBLIC POLICY THAT WE FUNCTION.

MOST IMPORTANT OF THE THREE POINTS WE WISH TO MAKE TODAY IS THAT WE ARE DETERMINED TO SEE THE GAS LINE BUILT THROUGH ALASKA. OUR REASONS ARE BOTH ECONOMIC AND ENVIRONMENTAL. IT MAKES SENSE TO USE THE CONTINUED DEVELOPMENT OF ALASKA'S RESOURCES TO KEEP UNEMPLOYMENT RELATIVELY LOW. IT MAKES SENSE TO KEEP OUR RELATIVELY PROSPEROUS ECONOMY AT THE CURRENT LEVEL. IT MAKES SENSE TO USE THE EXISTING ROADS, CONSTRUCTION CAMPS, LANDING STRIPS AND COMMUNICATIONS

FACILITIES AS MUCH AS POSSIBLE FOR A GAS LINE ONCE THE ALYESKA LINE CONSTRUCTION IS COMPLETED IN ORDER TO REDUCE ENVIRONMENTAL DAMAGE AND REDUCE LOADING COSTS.

IN ADDITION TO BEING VITALLY AFFECTED BY THE COSTS OF THE TRANSPORTATION SYSTEM FOR THE NATURAL GAS, ALASKANS ALSO DESERVE THE OPPORTUNITY TO USE THE ROYALTY SHARE OF THE GAS - 12 $\frac{1}{2}$ % - TO MAXIMIZE ECONOMIC BENEFITS TO THE ENTIRE STATE.

THEREFORE WE RECOMMEND THAT THE MEMBERS OF THIS COMMITTEE CONSIDER TAKING THE FOLLOWING ACTIONS:

1. REQUEST THAT THE ADMINISTRATION NOTIFY ALL HOLDERS OF THE PRUDHOE BAY OIL AND GAS LEASES THAT THE STATE ELECTS TO TAKE ITS ROYALTY GAS IN KIND.

2. TO INSURE CONSTRUCTION OF THE TRANS-ALASKA PIPELINE, CONSIDERATION SHOULD BE GIVEN TO THE PRESENT SALE OF THE ROYALTY GAS TO THE FIRM WHICH WILL BUILD SUCH A LINE. SUCH A COMMITMENT OF ROYALTY GAS TO A TRANS-ALASKA PIPELINE WILL SUBSTANTIALLY HELP BRING THAT LINE INTO BEING.

3. WHILE IT IS RECOGNIZED THAT MOST GAS SALES CONTRACTS ARE NORMALLY LONG TERM CONTRACTS, AN EFFORT SHOULD BE MADE TO OBTAIN A RELATIVELY SHORT TERM SALE. PROVISIONS SHOULD ALSO BE MADE IN THE ROYALTY GAS SALES CONTRACT TO WITHDRAW CERTAIN PERCENTAGES OF THE GAS THROUGHPUT TO PROVIDE FOR NEEDS OF COMMUNITIES ALONG THE PIPELINE ROUTE, INCLUDING THE FAIRBANKS AREA. WHILE THESE EXACT NEEDS MAY NOT BE DETERMINABLE, IT IS SUBMITTED THAT PROVISIONS WHICH WOULD PERMIT INCREASING PERCENTAGE WITHDRAWALS OVER THE PERIOD OF THE SALES CONTRACT WOULD MEET THE INCREASED DOMESTIC AND INDUSTRIAL DEVELOPMENT NEEDS AS THEY BECOME IDENTIFIABLE.

THE RECOMMENDATION TO SELL THE STATE'S ROYALTY GAS IS BASED ON THE RECOGNITION OF THE FOLLOWING:

- 1. ALASKA HAS NO IDENTIFIABLE USE FOR THE GAS.
- 2. AMOUNTS OF FLOW ARE STILL UNDECIDED WITH INITIAL FLOWS BEING DETERMINED BY THE ALASKA OIL AND GAS CONSERVATION COMMITTEE ON PROJECTIONS. THESE FLOWS WILL LATER BE ADJUSTED BASED ON EXPERIENCE OF PRODUCTION.
- 3. ONLY AFTER THE PRODUCTION SCHEDULE IS ESTABLISHED CAN A FIRM DETERMINATION BE MADE OF HOW TO BEST MEET THE NEEDS OF OUR COMMUNITIES, AND POSSIBLE PETROCHEMICAL DEVELOPMENT.
- 4. PETROCHEMICAL DEVELOPMENT NORMALLY REQUIRES LEAD TIMES OF BETWEEN 5 AND 10 YEARS.
- 5. FUTURE DISCOVERIES WILL BE AVAILABLE TO MEET FUTURE NEEDS.

WE FEEL THIS PROGRAM RECOGNIZES THE NECESSITY OF HAVING THE STATE'S ROYALTY GAS AVAILABLE FOR USE WITHIN THE STATE AND THE IMPORTANCE OF UTILIZING THE AVAILABILITY OF THE STATE'S ROYALTY GAS AS A WEAPON IN GETTING THE PIPELINE BUILT THROUGH ALASKA.

AS TO THE SPECIFIC QUESTIONS POSED BY YOUR COMMITTEE IN YOUR LETTER OF JANUARY 30, 1976:

(1) (a) WE ARE IN AGREEMENT WITH MR. MOODY'S LEGAL ANALYSIS. PRELIMINARY RESEARCH CONDUCTED BY OMAR PERSONNEL TOGETHER WITH INFORMATION GAINED IN MEETINGS WITH OUR CONGRESSIONAL STAFFS AND PERSONNEL WHO POSSESS AN EXPERTISE IN FPC MATTERS, HAS ALREADY CONVINCED US OF THE NEED TO ESTABLISH A NATURAL GAS POLICY FOR THE STATE AND THE IMPORTANCE OF AND THE ACCURACY CONTAINED IN MR. MOODY'S LEGAL ANALYSIS.

(b) MOST OF MY STATEMENT HAS BEEN DIRECTED TO ANSWERING THIS. HOWEVER, WE WOULD URGE THAT STATE LEGISLATION ALTER TAXATION AND LEASING STATUTES TO PROVIDE INCENTIVES TO THOSE PRODUCERS WHO UTILIZE THESE RESOURCES

WITHIN THE STATE.

(2) RESERVOIR RECOVERY IS BEYOND OUR PROVINCE. HOWEVER WE WOULD EMPHASIZE THE QUALIFICATIONS PLACED ON THE STUDY BY THE CONTRACTOR AND THE STATE. THAT IS, THAT "RESERVOIR PERFORMANCE PREDICTIONS ON A FIELD WITHOUT PRODUCTION HISTORY ARE APPROXIMATE AT BEST". AND IN ADDITION, WE WISH TO CALL ATTENTION TO THE FACT THAT ARCTIC GAS HAD RECOVERY PROJECTIONS SIMILAR TO THE STATE, YET ACCORDING TO A NEWS REPORT FROM THE OTTAWA JOURNAL, THE CONSORTIUM STILL INTENDS TO BUILD A PIPELINE SYSTEM LARGER THAN NEEDED, IN EXPECTATION OF TRANSPORTING FUTURE GAS FINDS THROUGH THAT SAME LINE. THIS MEANS THE INITIAL TRANSPORTATION COST WOULD BE HIGHER THAN NECESSARY, AND THE RESULTANT RETURN TO THE STATE OF ALASKA LOWER THAN IT SHOULD BE.

(3) REGARDING PROSPECTIVE PURCHASERS FOR THE ROYALTY GAS, AND USES WITHIN THE STATE, WE FEEL CONFIDENT THAT ONCE A GIVEN QUANTITY OF GAS AND DATE OF AVAILABILITY IS DETERMINED, THERE WILL BE NO LACK OF PURCHASERS FOR PETROCHEMICAL USE. BUT ALL OF THAT IS MOOT IF WE DO NOT DEAL WITH THE GAS AS A WEAPON IN GETTING THE GAS LINE BUILT THROUGH OUR STATE.

IN SUMMARY:

(1) ONLY WITH A TRANS-ALASKAN NATURAL GAS PIPELINE WILL THE STATE BE ASSURED OF THE OPPORTUNITY TO RETAIN ITS ROYALTY SHARE FOR FUTURE DOMESTIC AND INDUSTRIAL USES.

(2) IN ORDER TO ENSURE THE APPROVAL AND CONSTRUCTION OF A TRANS-ALASKAN PIPELINE THE DISPOSITION OF THE STATE'S ROYALTY GAS SHOULD BE USED AS A WEAPON. IN THAT REGARD, AND, RECOGNIZING THAT THERE IS PROBABLY NOT A PRESENT IDENTIFIABLE NEED FOR THE GAS, THE STATE SHOULD : (1) NOTIFY ITS OIL AND GAS LESSEES OF ITS PRESENT ELECTION TO TAKE ITS ROYALTY SHARE IN

KIND (2) ARRANGE FOR SHORT TERM SALES OF THE ROYALTY GAS IF POSSIBLE OR IN THE ALTERNATIVE, LONG TERM SALES WITH PROVISIONS TO ACQUIRE INCREASE PERCENTAGES ON A FIXED SCHEDULE.

IN ADDITION:

(3) THE LEGISLATURE SHOULD CONSIDER LEGISLATION WHICH WOULD ALTER FUTURE LEASES FOR OIL AND GAS TO PROVIDE INCENTIVES FOR UTILIZING THESE RESOURCES WITHIN THE STATE.

BP Alaska Inc. 100 Pine Street, San Francisco, California 94111. Telephone (415) 445-9400



February 17, 1976

Senator John Rader
Chairman, Joint Gas Pipeline Impact
Committee
The Legislature Of The State Of Alaska
Juneau, Alaska 99801

Dear Senator Rader:

We appreciate having an opportunity to submit our comments on your letter of January 30, 1976, soliciting testimony on the Rush Moody Report, the State's Reservoir Analysis and Royalty Gas Options. We will also respond herein to your letter of January 15, 1976, asking five questions regarding the recently published Department of Natural Resources Study on Sadlerochit Reservoir Conservation.

At the outset, there are a few things that should be said about the position of BP Alaska in these matters. By means of its 1969 agreement with Standard Oil Company (Sohio) BP Alaska conveyed its working interests in the oil and gas leases in the Prudhoe Bay area to Sohio reserving to BP Alaska a seventy-five percent net profits royalty interest from production from the Prudhoe Bay properties attributable to production in excess of a certain level. The effect of this agreement is to make Sohio the working interest owner of all the gas under the Sohio/BP leases in Prudhoe Bay. The same agreement made BP Alaska the operator of the Sohio interests in Prudhoe Bay.

The BP Alaska net profits royalty interest does not come into play until production of oil reaches levels in excess of approximately 1,200,000 barrels per day. It will be recalled that this is the level of production which the Trans Alaska Oil Pipeline will be capable of handling under current authorization.

Senator John Rader

February 17, 1976

Page Two

Since the BP Alaska net profits royalty interest in gas is triggered by certain criteria of sustained oil production of specified volume and at specified times, it will be seen that the BP gas interest is of small magnitude in comparison with the interests of the principal gas working owners in the Prudhoe Bay Field which are ARCO, EXXON and SOHIO.

BP Alaska has entered into an agreement with Northern Natural Gas Company giving that company the option to purchase the as yet undefined volumes of gas that may be attributed to BP Alaska through BP Alaska's net profits interest agreement up to a maximum volume of three trillion cubic feet. It should be noted that the Northern Natural Gas agreement covers not only gas from Prudhoe Bay but also any other gas which is attributable to BP Alaska and which may be produced from other North Slope oil and gas leases owned by Sohio and BP.

BP has further agreed with Columbia Gas Transmission Corporation to make available to that company any BP gas which is not required to satisfy its undertaking with Northern Natural Gas.

BP Alaska has not entered into any agreements which concern the basis or method of transport of the gas which the above two companies have the option to purchase or in respect to any other gas that may be available to our company on the North Slope. BP Alaska has no intention of participating in the construction of a gas line nor of assisting in the financing of such a venture. BP Alaska is not aligned with the proponents of either of the two principal schemes for transportation of Prudhoe Bay gas. Our role is simply that of a producer of gas.

The Moody opinion represents a very substantial exercise in legal scholarship involving a number of complex legal issues. As the author concedes, it also raises issues which involve rather longer term implications than the immediate question of the State's disposition of royalty gas and the alignment of the gas pipeline.

Senator John Rader

February 17, 1976

Page Three

We can not responsibly endorse or reject an effort of this magnitude without comparable research and analysis. We understand the State's concern with its ability to control the disposition of its royalty gas in the light of Federal law and regulation. We believe the Moody Report is correct in its conclusion that the State should decide as quickly as possible the ultimate goals of the State's natural gas policy. If the State determines that it is in its best interest to attempt to retain a portion of Alaska's gas for future Alaskan needs, we agree with Mr. Moody's recommendation that positive action must be taken before the gas has been committed to interstate commerce. Such participation could include, as Mr. Moody suggests, active involvement by the State in transportation negotiations with the Federal Power Commission.

With respect to the possible changes in the State's leasing and taxing policies, discussed by Mr. Moody, the discussion centered as much on questions of policy as on legal issues. In view of the complexity of the policy and legal issues which might be presented by novel taxation proposals and suggested changes in the State's leasing laws and regulations, we propose to defer comment until the committees of the legislature meet to consider specific proposals incorporating such changes.

We now turn to your letter of January 15, 1976, which poses questions arising out of the State's recent study on the Sadlerochit Reservoir. For ease of reference we set out below the questions and our answers.

1. What effect does the recent study, "Prediction of Reservoir Fluid Recovery Sadlerochit Formation Prudhoe Bay Field", have on marketing plans for Prudhoe Bay gas?

The State study evaluated several possible reservoir management schemes and indicated the relative effect of each hypothetical case. The results are not inconsistent with our anticipation that a practical reservoir management scheme can be implemented that will allow gas offtake from the field at rates of the order of 2 bscf/d sales.

Senator John Rader

February 17, 1976

Page Four

2. How does this study differ from industry and federal studies?

Published studies have predicted various production characteristics, consistent with the available detail and reliability of the data applied. It is to be expected that slightly differing results will be found in these circumstances, but generally the same relative effects of reservoir management schemes are to be found.

3. How accurate can a model be without production history?

Model studies incorporate many uncertainties with or without any production history. They are certainly more reliable when production history is available for calibrating the various input parameters. They can be considered to be reliable as to general performance and are specifically valuable in assessing relative effects due to varying reservoir production schemes. Good reservoir management planning recognizes and allows for these uncertainties.

4. Will some production history be necessary before an accurate model is established that will prove feasibility of a gas pipeline for marketing of Sadlerochit gas?

We believe it is possible to plan now for a reasonable level of gas offtake from the field, recognizing that the actual circumstance that results during production may need some modification to the reservoir management, particularly with regard to pressure maintenance, to continue to effectively produce the field.

5. How critical are the results of this study in obtaining FPC certification and financing for the gas pipeline project?

Senator John Rader

February 17, 1976

Page Five

5. The above remarks indicate that we believe it is feasible, under a satisfactory reservoir management scheme, to plan for sustained gas sales. As a potential producer, it is not our principal expertise to comment on the gas marketing or financing questions. These could be more authoritatively answered by the gas pipeline/marketing companies.

In conclusion, we do not believe that the recently published State of Alaska Department of Natural Resources Study nor the lack of production history should adversely affect the F.P.C. decision on the certification of a pipeline.

BP Alaska did not participate in the F.P.C. proceedings and has not been asked to respond to the interrogatories set out in the F.P.C. letter dated December 12, 1975. We have, however, testified at the hearings of your committee held on December 10, 1975, in Anchorage and at that time responded to some of the same questions included in the F.P.C. interrogatories.

It may be useful for you to be aware of answers we shall be providing to questions posed by the Senate Interior and Insular Affairs Committee and the Senate Commerce Committee under cover of a letter dated January 27, 1976, from Senators Warren G. Magnuson and Henry M. Jackson. A copy of the above letter and the referenced questions are enclosed for your convenient reference together with a draft of BP Alaska's response to those questions. The BP response is in the form of an internal memorandum dated February 12, 1976, to J. Gore of BP Alaska's Washington, D.C. office from D. B. Walker who is Vice President, Production Planning for BP Alaska.

If the Committee should desire further information on these or other matters during our new deliberations we will make every effort to respond.

Sincerely,



K. R. Keep
Vice President and General Manager

Enclosure

AGO 545874

United States Senate

WASHINGTON, D.C. 20510

January 27, 1976

Mr. John Gore
Manager, Government Affairs
B. P. North America, Inc.
1730 M Street, N.W.
Washington, D.C. 20036

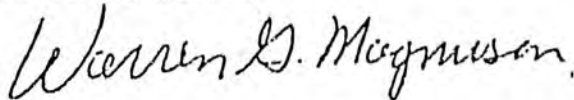
Dear Mr. Gore:

The Senate Interior and Insular Affairs Committee and the Senate Commerce Committee are examining the extent of Arctic natural gas reserves and alternative transportation systems for delivery of this gas to markets in the lower 48 states. The Committees are also examining the institutional, resource and other factors which may constrain or significantly influence the cost of this natural gas and the timing and mode of its delivery into the existing distribution system.

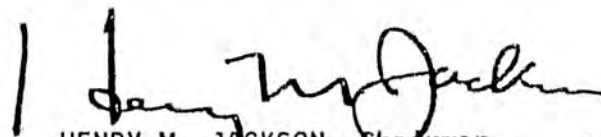
To facilitate our respective Committees' consideration of this matter and to develop the factual background relevant to major policy decisions respecting the development of Alaskan natural gas, our Committees request that you respond to the issues raised in the attached questionnaire by Parts I.A.; I.B.(1), (2), (3) and (6); II.A.(3), (a) and (b); and II.B. (2), (a), (b), (c) and (d). We would appreciate delivery of five copies of your response to these questions to the Interior and Commerce Committees no later than February 11, 1976.

For further information, please contact Henry Lippek at 224-9351 or Thomas Platt at 224-0611.

Sincerely yours,



WARREN G. MAGNUSON, Chairman
Committee on Commerce



HENRY M. JACKSON, Chairman
Committee on Interior and
Insular Affairs

94th Congress }
2d Session }

COMMITTEE PRINT

ISSUES CONCERNING
THE TRANSPORTATION OF
ALASKAN NATURAL GAS

QUESTIONNAIRE

PREPARED FOR THE

COMMITTEES ON
INTERIOR AND INSULAR AFFAIRS

AND

COMMERCE
UNITED STATES SENATE



JANUARY 1976

U.S. GOVERNMENT PRINTING OFFICE

65-042

WASHINGTON : 1976

AGO 545876

COMMITTEE ON INTERIOR AND INSULAR AFFAIRS

HENRY M. JACKSON, Washington, Chairman

FRANK CHURCH, Idaho	PAUL J. FANNIN, Arizona
LEE METCALF, Montana	CLIFFORD P. HANSEN, Wyoming
J. BENNETT JOHNSTON, Louisiana	MARK O. HATFIELD, Oregon
JAMES ABOUREZK, South Dakota	JAMES A. McCLURE, Idaho
FLOYD K. HASKELL, Colorado	DEWEY F. BARTLETT, Oklahoma
JOHN GLENN, Ohio	
RICHARD STONE, Florida	
DALE BUMPERS, Arkansas	

GRENVILLE GARRISON, Special Counsel and Staff Director
 DANIEL A. DREYFUS, Deputy Staff Director for Legislation
 WILLIAM J. VAN NESS, Chief Counsel
 D. MICHAEL HARVEY, Deputy Chief Counsel
 HARRISON LOESCH, Minority Counsel

COMMITTEE ON COMMERCE

WARREN G. MAGNUSON, Washington, Chairman

JOHN O. PASTORE, Rhode Island	JAMES B. PEARSON, Kansas
YANCE HARTKE, Indiana	ROBERT P. GRIFFIN, Michigan
PHILIP A. HART, Michigan	HOWARD H. BAKER, Jr., Tennessee
HOWARD W. CANNON, Nevada	TED STEVENS, Alaska
RUSSELL B. LONG, Louisiana	J. GLENN BEALL, Jr., Maryland
FRANK E. MOSS, Utah	LOWELL P. WEICKER, Jr., Connecticut
ERNEST F. HOLLINGS, South Carolina	JAMES L. BUCKLEY, New York
DANIEL K. INOUE, Hawaii	
JOHN V. TUNNEY, California	
ADLAI E. STEVENSON, Illinois	
WENDELL H. FORD, Kentucky	
JOHN A. DURKIN, New Hampshire	

MICHAEL PERTSCHUK, Chief Counsel
 S. LYNN SOTCLIFFE, General Counsel
 MALCOLM M. B. STERRETT, Minority Counsel

(II)

MEMORANDUM OF THE CHAIRMAN

In February 1976, the Senate Committee on Interior and Insular Affairs and the Senate Committee on Commerce will conduct joint oversight hearings on Arctic natural gas reserves and alternative transportation systems for delivery of this gas to markets in the lower 48 states. The Committees will examine the institutional, resource and other factors which may constrain or significantly influence the cost, timing and mode of delivery of this natural gas into existing distribution systems.

To facilitate our respective Committee's consideration of this matter and to develop a factual background on the major policy decisions respecting Alaska gas, interested persons are invited to respond to all or any of the attached questions by February 11, 1976.

Materials submitted will be included in the hearing record on this matter.

HENRY M. JACKSON,
 Chairman, Committee on Interior and Insular Affairs.
 WARREN G. MAGNUSON,
 Chairman, Committee on Commerce.

(III)

I. ASSESSMENT OF NATURAL GAS SUPPLIES

A. NATURAL GAS SUPPLIES

- ✓(1) What are the current estimates of proven reserves in:
- the Sadlerochit formation of the Prudhoe Bay field,
 - other formations in the Prudhoe Bay field,
 - reserves elsewhere in Arctic or Interior Alaska, or on the Arctic OCS, and
 - the Mackenzie Delta and adjacent Canadian onshore and offshore areas.
- ✓(2) What additional reserves can reasonably be expected to be discovered and produced from each of these areas by 1985?
- ✓(3) What is the range of uncertainty and/or dispute in each of the estimates in questions 1 and 2 above:
- resulting from geological or engineering uncertainty,
 - depending on leasing or resource development policies, or
 - resulting from uncertainty about other factors (economic incentives, industry response, logistical problems, etc.)?
- ✓(4) What are the potential natural gas resources in each of the areas identified in question (1) and the likelihood of their producibility in volumes which could influence the viability or relative merits of alternative systems for delivery of Prudhoe Bay natural gas?
- ✓(5) Consider specifically what leasing or development policy regarding the Alaska outer continental shelf, Naval Petroleum Reserve No. 4, the Arctic Wildlife Range, state lands and lands controlled by Alaska Native corporations might be necessary to make viable various alternative transportation systems? Consider also the possibility of major discoveries in Lower Cook Inlet, the Gulf of Alaska, or other areas of Alaska, and their implications for the viability or merits of alternative transport systems?

B. DELIVERABILITY AND COST

- ✓(1) What levels of natural gas production could each of the areas considered in subpart A above reasonably be expected to support in each year 1980 through 1985, if transportation were available, given due allowance for the time necessary for field development?

(1)

II. DEMAND FOR ALASKAN NATURAL GAS

A. ANTICIPATED SHORTAGES

In the absence of the Alaskan gas, what are the anticipated natural gas shortages in the lower 48 states by region in the 1980-85 period?

(1) Which pipelines are expected to be in deepest curtailment of priority users in that period? What is the range of uncertainty associated with these estimates?

(2) What is the anticipated intrastate demand for natural gas in Alaska during the 1980-85 period?

(a) How much of the Prudhoe Bay gas is planned to be consumed in Alaska?

(b) To what extent do these projections of Alaskan consumption assume natural gas use for boiler fuel and other uses for which oil or coal could be substituted?

(c) How much do these estimates vary with different assumptions concerning natural gas and oil prices?

(3) Which pipelines or distributors have options to purchase Alaskan natural gas at this time?

(a) Would the same pipelines and distributors obtain Alaskan natural gas regardless of whether the Arctic Gas or the El Paso project are approved?

(b) What are the terms and conditions of these options to purchase?

(c) If Prudhoe Bay gas were to be sold to the pipeline systems in greatest need on the basis of the best current projections pursuant to the FPC's current curtailment policy, which pipelines would receive the gas and what quantity would be sold to each?

(d) On what terms would non-transportation system owners have access to the Alaskan gas transportation system?

(4) The State of Alaska has not yet committed its royalty share of the Prudhoe Bay gas to sale or options. Will the State's decision regarding disposition of its royalty gas (a) between interstate and intrastate purchasers, or (b) among interstate purchasers, significantly influence the viability or the FPC's evaluation of alternative transportation systems?

B. PRICE

(1) Is the demand for Alaskan natural gas sensitive to natural gas prices and to the price of alternative fuels in the lower 48 states?

(2) What is the range of uncertainty or dispute over each of these estimates? Consider particularly the relationship between crude oil recovery and natural gas production from the Prudhoe Bay field.

57 (3) The Van Poellen study for the State of Alaska implies that the potential tradeoff between gas and oil production from the Sadlerochit formation will not be known until

(a) tests have been made of the ability to inject water into the reservoir and a source of water has been assured, and

(b) the operation of the aquifer underlying the reservoir has been observed during oil production.

Is this inference correct? If not, can the optimum rate of gas production presently be calculated? If so, what is it? If the inference is correct, when are the earliest and latest dates that enough information might be available to make a prudent decision on the rate of gas production and the system to transport such natural gas?

(4) (a) What is the statutory mandate and policy of the oil and gas conservation authority in Alaska with respect to optimizing the joint production of oil and gas?

(b) To what extent is there a requirement or authority for the agency or the State to consider economic or development factors (as opposed to physical conservation alone) in regulating field production levels?

(5) (a) Could the rates of production at Prudhoe Bay now contemplated by the applicants in Docket CP-75-96 before the Federal Power Commission be appreciably reduced by actions of the State of Alaska?

(b) When will the Alaskan conservation agency decide on the allowable rate of natural gas and oil production?

(c) Can its initial decision be later modified?

(d) Is there a conflict between the FPC's certificating authority and the State's conservation authority? If so, which authority would prevail?

(6) What is the anticipated cost (not necessarily equal to price) of Prudhoe Bay natural gas at the wellhead? Please supply the assumptions and detailed back-up for such estimates. Specifically:

(a) Are these calculations incremental costs, assuming that all joint costs of lease acquisition and field development are borne by oil production, or do they assume an allocation of such joint costs to gas production; and

(b) Does the cost estimate include the value of oil production forgone, if any?

✓(2) When do the producers and purchasers intend to enter into firm long-term contracts for the sale of the Prudhoe Bay natural gas?

- ✓(a) What is the reason for the delay to date?
 ✓(b) What price will the producers receive in the absence of FPC price controls?
 ✓(c) What will be the duration of the sales price?
 ✓(d) What are the other likely major terms of such contracts?

(3) For the two transportation systems proposed by the applicants and the modifications recommended by the FPC environmental staff, what are the anticipated:

- (a) capital costs (in 1975 dollars);
 (b) the initial total transportation tariff per Mcf delivered to points on the West Coast, in the Midwest and in the East; and
 (c) the total transportation tariff per Mcf delivered to such destinations 15 years after initial delivery?

(4) Are current estimates realistic in light of the large cost overruns that recently have characterized major construction projects like the TransAlaska oil pipeline, the Washington Metro or nuclear generating plants? To what extent do the current cost estimates take into account the likelihood of materials shortages, failure to perform by certain contractors, defects or late delivery of equipment, labor disputes, unusually severe weather, regulatory delays, etc.? If the experience of the Alaskan oil pipeline and all these factors are taken into consideration, what is the magnitude of total system costs (in both current dollars and 1975 constant dollars) that conceivably could be expected?

(5) To what extent does transportation at each system's design capacity depend upon additional discoveries of new reserves? What is the range of anticipated total capital and operating costs per Mcf at various levels of throughput?

6. (a) What is the size of the market for Alaskan gas in the lower 48 states if its average lower 48 city gate price (in constant 1975 dollars) is \$2.00 per Mcf? \$2.50 per Mcf? \$3.00 per Mcf? \$4.00 per Mcf? \$5.00 per Mcf? What is the assumed oil price in these estimates?

(b) At each average price what portion of the total gas over the course of a year would be consumed by priority users, (residential and commercial) and at what price; and what portion would have to be sold for boiler fuel or as interruptible supply, and at what price?

(7) What would be the impact on demand for Alaskan gas if its price at the city gate were substantially higher than the equivalent average price of oil? At what price per Mcf would pipelines no longer be willing to purchase Alaskan gas? What is the probability and under what circumstances, taking into account production costs, all tariffs

and taxes, that the price of Alaskan gas would exceed the amount purchasers are willing to pay for an equivalent volume of base load supply?

Please provide the estimates requested in questions (6) and (7) on the alternative assumptions that Alaska natural gas is required to be priced (1) incrementally or (2) on a "rolled in" basis.

C. COST OF DELAY

(1) What revisions must be made in project costs for each year of delay (up to five years) in the commencement of construction?

(2) What is the best estimate of the total cost to consumers for each year of delay beyond 1980 in terms of the price of alternative fuels or impact on the economy of a gas shortage?

III. STATUS OF REGULATORY APPROVALS

A. AGENCIES INVOLVED

List all of the Federal and state agencies which must issue permits or approvals as a prerequisite to the construction or operation of an Alaskan gas transmission system.

(1) State the estimated timetable for the applicants to obtain such approvals in the absence of expediting legislation.

(2) Is it possible or reasonable for the FPC to grant a certificate for any gas transportation system before the deliverability issues identified in subpart I, B are resolved?

(3) State any approvals required after the FPC issues a certificate of public convenience and necessity. Can the necessity of any such approvals delay or even prohibit construction of the system?

(4) Identify the possibilities for slippage and delay in the timetable for the FPC and other agency approvals?

B. FEDERAL-STATE RELATIONS

(1) Are Federal and state approval processes coordinated?

(2) Is there a potential for conflict between state land-use, coastal zone management, construction, conservation, safety and other regulatory or taxation activities and Federal requirements and permits?

(3) What is the mechanism, or what mechanism should be established, for encouraging early state input and resolving differences between Federal and state policies?

by

C. JUDICIAL REVIEW

(1) Which Federal or state agency decisions regarding the transportation of Alaskan gas are the likely subjects of judicial review? What is a reasonable estimate of the time required to complete such judicial review of agency decisions? Could construction commence while such judicial review was underway?

(2) In the absence of any legislation, what is the expected date on which construction could commence? Be completed?

D. ALTERNATIVES

Please provide estimates of the costs, environmental impacts, construction lead times and other relevant facts concerning:

(1) An alternative pipeline route from the North Slope to Fairbanks and then paralleling the Alcan Highway;

(2) Conversion of natural gas to methanol and shipment by the trans-Alaska oil pipeline or tanker or submarine; and

(3) Other possible alternatives.

E. SAFETY

What are the design and operation techniques to assure safe and continuous operation of Alaskan natural gas transportation systems?

1. What is the relationship between the Federal Power Commission and the Department of Transportation with respect to safety standards during gas pipeline construction and operation?

2. What are the probable and worst case estimates of injury and damage of natural gas pipeline accidents?

3. Which State and/or Federal agencies have jurisdiction over LNG terminal sites with respect to safety, distance from population centers, and ship traffic control?

4. What plans or procedures have the responsible agencies or the applicant devised to prevent or deal with LNG tanker collisions or other LNG handling accidents? What is the best available technology to minimize the risk of an LNG accident and to deal with serious LNG accidents?

5. What are the probable and worst case estimates of injury and damage that could result from an LNG tanker or terminal accident? What are the owners' liabilities for such an accident? Are existing liability laws adequate to provide compensation for all damages resulting from a probable and worst case accident?

F. CANADIAN PROCEDURE

(1) What is the status of Canadian proceedings regarding the Arctic Gas and Maple Leaf projects? What is the anticipated schedule for final approvals by the National Energy Board and the Cabinet? What approvals are required by Provincial Governments? Are there other opportunities for delay of a Canadian decision, such as settlement of Canadian native claims? What is the best estimate of when the Canadian Government will reveal whether a trans-Canada route to transport Alaskan gas is acceptable to Canada?

(2) To what extent does the Canadian decision in fact await or depend upon a decision by the United States?

(3) What diplomatic channels or other mechanisms are available to assure coordination of the U.S. and Canadian approval processes? How would differences be resolved if incompatible trans-Canada routes are approved in the U.S. and Canada?

G. TREATY STATUS

(1) What is the anticipated initialling date for the U.S.-Canadian pipeline treaty?

(2) What are the terms of the draft treaty?

(3) Would the treaty limit or restrain the taxation or regulatory authority of state or Provincial governments?

(4) What other issues remain to be resolved in a specific protocol dealing with an Alaska-Canada transmission system?

IV. FINANCING

A. PRIVATE CAPABILITY

(1) Do private capital markets have the capability to provide the necessary funds for the construction of an Alaskan gas transportation system? Can the equity capital for this project be attracted solely on the basis of regulated revenues from natural gas consumers? What is the anticipated interest rate at which needed long-term debt capital can be raised?

(2) Assume the project encountered substantial cost overruns. Could it still be financed privately? What are the outer limits of the amount of capital that could be privately raised?

B. SUBSIDIES

(1) To what extent are either of the applicants intending to seek Federal subsidies, loan guarantees or other forms of financial assistance to offset costs or provide cost overrun protection?

(2) Can either project be constructed and operated without any such Federal assistance?

(3) If Federal assistance to protect against cost overruns is required, what incentives can be incorporated to give the successful applicant incentives to minimize costs?

(4) If a project requiring LNG transportation is certified:

- How many vessels would be needed?
- Where would such vessels be constructed?
- What is the amount of subsidies or loan guarantees likely to be requested?

C. TARIFFS

(1) Is it anticipated that Alaskan gas will be sold pursuant to an all-events full cost of service tariff whereby rates are automatically adjusted to reflect any costs incurred and are paid by purchasers whether natural gas is delivered or not?

(2) What is the anticipated risk that gas deliveries will be interrupted over the life of a project?

(3) Is the private financing of the Alaskan gas transportation system contingent upon state and Federal approval of such an all-events tariff?

(4) Are there precedents for an all-events tariff in other situations?

(5) What is the likelihood that state public utility commissions would approve natural gas purchases conditioned upon such tariffs?

(6) Can purchasers obtain insurance from private markets to insulate them against financial difficulties if gas deliveries are interrupted?

(7) If the risk of interruption is significant, would it be prudent to limit the percentage of Alaskan gas entering any pipeline or distribution company?

V. LEGISLATION

(1) What legislation, if any, is required to facilitate the construction of an Alaskan natural gas transportation system?

(2) What subjects should such legislation address? Consider and comment on such matters as:

- an expedited schedule for FPC action;
- a narrowing of judicial review in time and scope;
- establishment of a Congressional review process;
- congressional selection of one or more routes by directing all involved federal agencies to expeditiously grant all required permits and licenses;
- establishment of wellhead price ceilings and tariffs for Alaskan gas;
- establishment of a consolidated administrative process for the siting of LNG facilities;
- basis for and extent of an LNG vessel owner's liability for damages in the event of accident;
- provision for financial assistance to assure project construction;
- providing for allocation of Alaskan gas to pipeline systems in greatest need;
- resolution of environmental issues associated with the transportation of Alaskan gas; and
- other matters.

○

February 12, 1976

TO: J. Gore - Washington, D.C.

FROM: D. B. Walker - San Francisco, CA

Response to questions regarding "Issues Concerning the Transportation of Natural Gas":

I.A.1. (a) The current estimate of proven reserves of gas in the Prudhoe Bay pool, consisting of the closely related Sadlerochit, Sag River and Shublik Formation, is 24 trillion cubic feet.

(b) No other hydrocarbon-bearing formations in the Prudhoe Bay field are, at this time, considered to contain proven reserves of gas.

(c) & (d) BP Alaska does not have sufficient data to establish whether proven reserves of gas exist elsewhere in Arctic or interior Alaska or on the Arctic OCS or in the Mackenzie Delta and adjacent Canadian onshore and offshore areas.

I.A.2. BP Alaska does not have sufficient data available to make any reasonable prediction of the volume of additional gas reserves that may be discovered and produced from these areas by 1985.

I.A.3. (a) Geological and engineering data would suggest that the uncertainty in the reserves estimate given in I.A.1. (a), above, is approximately $\pm 15\%$.

(b) & (c) As we are unable to make any reasonable prediction of the volume of gas reserves in areas other than in the proven acreage of Prudhoe Bay, the estimates are not sensitive to factors listed in this question. There can be no doubt that leasing and other policies that give real incentives for active exploration and development work will increase the prospects of additional gas reserves being discovered and proven.

I.A.4. We have made no estimate of the potential gas reserves of the areas listed that could be considered to be reliable,

AGO 545883

nor have we evaluated the effect these might have on transportation systems for Prudhoe Bay gas.

I.A.5. BP Alaska is not directly involved in any gas pipeline ventures and therefore is not best qualified to respond to this question. Any leasing and development policies that give incentives for active exploration and production should lead to a situation where more data will exist to evaluate the possible alternative transportation systems.

I.B.1. When a gas pipeline is constructed and available to transport gas from the Prudhoe Bay field, sometime after the commencement of oil production, the field should be able to produce sales volumes of about 2 to 2.5 billion cubic feet of gas per day. These rates should be sustained by the operation of the field under an overall reservoir management scheme with pressure maintenance by water injection being applied and continued as necessary.

I.B.2. Until further information is available from both reservoir data and production history, there will remain some uncertainty as to the reservoir management necessary to sustain the offtake rates quoted. However, BP Alaska considers that offtakes within the range given can be sustained with appropriate development drilling and facilities installation, and with pressure maintenance as necessary so that there will be no significant loss of ultimate oil recovery.

I.B.3. BP Alaska has not yet received the full Van Poolen report and therefore is unable to comment on the implications in that study. Experience from production history and tests will enable the operators in the field to more precisely design a management scheme that will enable the field to be efficiently produced to sustain the planned offtake rates. We do not consider that any trade off between gas and oil production is implied by recognizing that this additional data will enable the operators to refine or revise their development plans.

I.B.6. It is not currently possible to estimate reliably what the ultimate cost of the facilities to be installed for gas production will be, nor, without any experience, what the exact operating costs might be until gas production commences. Both the unique nature of the location and the current trend

J. Gore

- 3 -

February 12, 1976

of escalating costs make any reliable estimations difficult. Further such direct costs should not be viewed in isolation from the overall costs of exploration for the discovery of this gas and the taxes that will be applied.

II.A.3. BP Alaska has entered into an agreement with Northern Natural Gas Company, which gives them the option to purchase the as yet undefined volumes of gas that may be attributed to BP Alaska through the BP Alaska/Sohio net profits interest agreements, up to a maximum volume of 3 trillion cubic feet. BP Alaska has not entered into any agreement which concerns the basis or method of transport of the gas which Northern Natural has the option to purchase, or any other gas that may be available to our company on the North Slope.

BP Alaska also has made similar commitment to Columbia Gas Transmission Corporation with respect to any Prudhoe Bay gas not required to satisfy its undertaking with Northern Natural Gas.

II.B.2. (a) As indicated previously, BP Alaska has granted to Northern Natural Gas an option to purchase up to 3 trillion cubic feet of gas attributed to its net profits interest in Prudhoe Bay leases, held by Sohio, and some of BP Alaska's other leases on Alaska's North Slope. The amount of Prudhoe Bay gas owned by BP Alaska is related by contract to the time and volume of sustained oil production from Prudhoe Bay, and also is related to the level of oil produced at specific times. The total amount of Prudhoe production also is dependent upon unitization and production methods, all of which makes it impracticable, if not impossible, for Northern to exercise its option until the Prudhoe field goes on production.

(b), (c) & (d) Northern's option provides for good faith negotiations of the price and other terms at the time gas is available for purchase.

BP Alaska also has made similar commitment to Columbia Gas Transmission Corporation with respect to any Prudhoe Bay gas not required to satisfy its undertaking with Northern Natural Gas.

PRUDHOE BAY FIELDSADLEROCHIT SAND RESERVOIR OIL DATA

---JOHN HUBER

ANALYSIS OF STOCK TANK OIL SAMPLES

H ₂ S-% wt.	NIL
SULPHUR % WT	0.95
POUR POINT	27.5°F.
KINEMATIC VISCOSITY (CENTISTOKES)	
	50°F. 53
	70°F. 26
	100°F. 12.6
GRAVITY API	27.9
VANADIUM ppm	13.5
NICKEL ppm	7
WAX % WT	6.3
MELT PT WAX°F	135
% DISTILLED 150°C.	9.5
" 200°C.	17.5
" 300°C.	38.0

SEPARATOR GAS DATA

	<u>PRESSURE</u> (psia)	<u>TEMP.</u>	<u>GOR.</u>	<u>GAS SP. GR.</u>	<u>S.T.O. GRAVITY</u>
1st	615	130	620	0.785	
2nd	100	120	130	0.950	
3rd	15	115	<u>37.7</u>	1.33	0.8864
			787.7		(28.13°API)

SEPARATOR GAS MOL %

	<u>1st</u>	<u>2nd</u>	<u>3rd</u>
CO ₂	15.27	18.75	12.91
N ₂	0.75	0.23	0.03
C ₁	73.94	55.66	24.03
C ₂ - C ₉	10.04	25.36	63.03

NOTE HIGH CO₂ CONTENTRESERVOIR TEMPERATURE - 200°F.

AGO 545886

REPORT ON METHANOL/METHYL FUEL

Prepared for: Senator John Huber

By: Franklin D. Fleeks

Introduction

Along with the discovery of the Prudhoe Bay oil field came the discovery of a vast pool of gas located at the same field. In order to exploit and remove this resource various schemes have been brought forth. The focus has been on removal by a gas pipeline. The Legislature formed the Joint Gas Pipeline Impact Committee to make a thorough study to help formulate and implement necessary policy decisions.

While gathering its data, questions have arisen dealing with (1) competing gas line proposals, (2) how to handle the state's royalty gas, and (3) problems with federal regulatory agencies. In a thought-provoking report, the consultant to the Committee -- Rush Moody, Jr., succinctly outlined the federal problem. If natural gas is sold in interstate commerce, regulation will be done by the Federal Power Commission. Whether or not the state's royalty gas is initially taken "in kind" it is more than probable that when a later request is made, the state could not withdraw its royalty share without FPC approval.¹

Considering the current regulated price of gas and the degree of possible federal interference with Alaska's policy regarding its natural gas resource, several alternatives have been looked at. Senator Huber, a member of the Joint Committee, has pursued an alternative based on conversion of the gas to methanol/methyl fuel.

We use methanol here for convenience. The proper term should be methyl fuel, a liquid consisting principally of methanol, produced catalytically from synthesis gas, a mixture of hydrogen and carbon monoxide.

What is Methanol/Methyl Fuel
and Its Uses

Methanol/Methyl Fuel or methyl alcohol, CH_3OH , is a colorless, neutral liquid at ambient temperature with a mild odor.² In its earliest form, it was called "wood alcohol." It is a clean burning stable fuel which can be converted from natural gas and coal. It can be shipped in conventional tankers and stored in conventional tanks.

The versatility of methanol is clearly shown in the uses that can be made of it. Some of its more important uses currently and in the future are:

- (1) Directly as a liquid boiler fuel;
- (2) Turbine fuel;
- (3) In automotive fleets;
- (4) Petrochemical feedstock;
- (5) Development of Alaskan coal resources.^{3,4}

Chemical Feedstock

As Exhibit 1 shows, methanol/methyl fuel can be converted into a number of chemicals having commercial value. The methanol/methyl fuel produced from Alaskan gas and coal resources can create an array of downstream petrochemical industries. With the decrease of hydrocarbon feedstocks based on natural gas in the lower 48 there is a market for methanol/methyl fuel produced from Alaskan coal and gas.

Gasoline Additives

Methanol/methyl fuel can be used as a gasoline additive or as a substitute for gasoline.

As an additive, methanol/methyl fuel will decrease current gasoline consumption on a barrel for barrel basis. According to available information, there is no fall off in fuel efficiency up to approximately ten percent blend levels.⁵ Methanol/methyl fuel, however, has about half the heating value per gallon when compared to gasoline. Comparison of some of the properties of methanol/methyl fuel and gasoline are shown in Exhibit 2.⁶ A bill, introduced in the California Legislature in 1975, would require the addition of methanol to gasoline sold in the state.

Methanol/methyl fuel can effectively reduce the level of pollutants caused by automotive emissions.⁷ From a study carried out by the Lawrence Livermore Laboratory in 1974 the following is given:

" . . . The health effects on man as a consequence of emissions from methanol as compared to gasoline fired automobiles can be summarized as follows: (1) reduction in adverse health effects of photochemical smog as a consequence of reduced photoactivity, (2) elimination of the possibility of lead toxicity to children and other sensitive individuals, because no lead is needed to boost the octane number (3) aromatic emissions from automobiles will be drastically reduced, reducing the carcinogens released to the atmosphere, and (4) reduce exposure to sulfuric acid mist. . ." ⁸

One of the crucial elements in the gas pipeline/methanol energy debate is what is the net effective energy. If methanol is added in at ten percent blend it will increase the efficiency of energy used in the automobile.

-. . . (The) maximum BTU's available from the estimated Prudhoe Bay maximum gas production is 2.36 trillion BTU/degrees. That same gas, transformed into methanol at the wellhead would yield at least 514,000 bbl of methanol. Transported to the lower 48 states at no BTU shrinkage . . . it would displace 514,000 bbl of gasoline in a ten percent blend. Gasoline has a BTU content of 514 million BTU per bbl so the net gain in effective energy in the transportation part of the lower 48 market would be 2.7 trillion BTU/day. This is more than the natural gas delivered BTU's of heating value. . . ." 9

Industrial or Electrical Utility Fuel

The use of methanol/methyl fuel as a liquid boiler and liquid turbine fuel is currently feasible. Tests have been carried out by the electrical utility industry which show that turbines perform more efficiently on methanol/methyl fuel. Although twice as many gallons of methanol/methyl fuel must be burned to provide the same number of BTU's as oil, turbines burning methanol/methyl fuel generate up to six percent more power per million BTU's.¹⁰

Transportation of Methanol/Methyl Fuel

The transmission of methanol/methyl fuel to a shipping point for transport to potential markets can be done in a variety of ways. After conversion at Prudhoe Bay, it can be shipped on a batch basis through the Alyeska pipeline, a common carrier.¹¹ The enabling legislation for the Alyeska Pipeline project (PL 93-153) allows for transportation of synthetic or gaseous fuels through the Alyeska Pipeline.¹² Also a pipeline could be built entirely for methanol/methyl fuel and other synthetic or gaseous fuels.

Once the methanol/methyl fuel reaches tidewater it can be shipped in conventional tankers. Unlike liquified natural gas (LNG) methanol/methyl

- 5 -

fuel does not need special tanker ships to carry it or special storage facilities. Present proposals call for the transportation of natural gas by pipeline to Gravina Point where it will be liquified for shipment via tankers (to be built) to its demand markets.¹³ Use of conventional tankers in transporting methanol/methyl fuel can cut into the lead time needed to get the product from the gas field to market.

Methanol/Methyl Fuel Concept Effect on Alaska

One immediate effect would be to remove the gas from FPC jurisdiction. In Mr. Moody's letter of January 14, 1976, he concluded:

" . . . if North Slope gas is converted to methanol before becoming committed to interstate commerce, the conversion facilities, the methanol itself, and the transportation of methanol would not be subject to FPC control. Since the natural gas would be produced and "consumed" (i.e., converted to something other than natural gas) within the state, the natural gas would never become subject to FPC jurisdiction. . ." 14

For Alaska, one of the most promising concepts that methanol/methyl fuel opens up is the possibility of using the state's coal resources. By taking the state's royalty gas in kind and transporting the gas to the vicinity of the major Alaskan coal fields, especially those near tidewater, a new industry can be developed.

The coal and gas mixture increases the conversion to methanol/methyl fuel by approximately ten percent. The building of the methanol/methyl fuel plants will provide an infrastructure that will be in place once the natural gas resource is depleted. That infrastructure will be available to further develop the state's coal resources. The building

of the methanol/methyl fuel plants will provide needed energy for the state, increase employment, and provide the industrial infrastructure needed to develop one of the state's most abundant resources, coal.

Conclusion

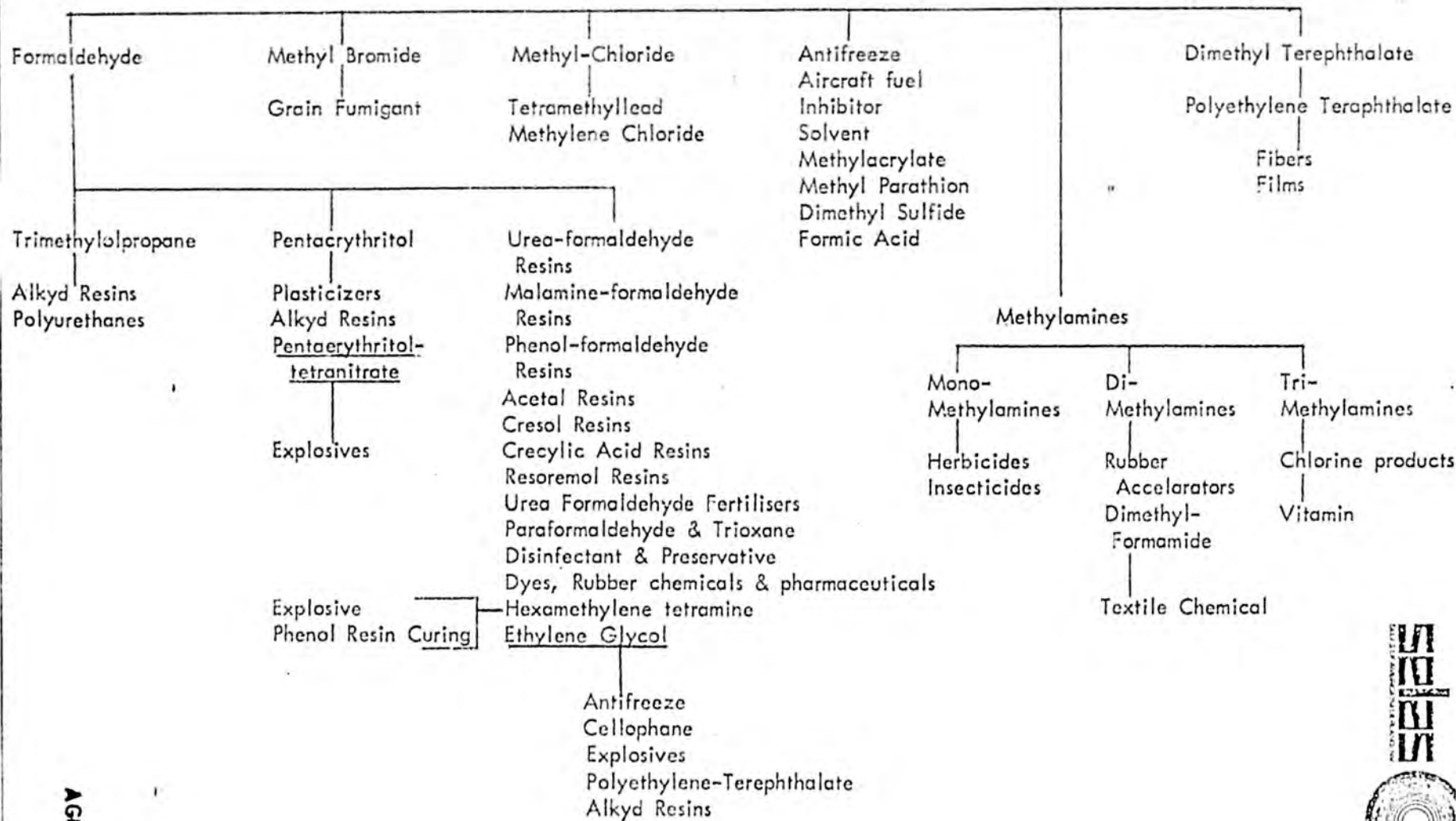
From review of the literature and studies, most of the data presented is in a prospective form. Even though prospective, the production of methanol/methyl fuel using Alaskan gas is feasible and should be pursued as a viable alternative. The methanol/methyl fuel concept will negate federal regulation, provide a substitute to help alleviate the nation's energy problems and protect the environment by reducing pollutants. The market for industrial chemical uses is not yet defined. However, the net quantities of methanol/methyl fuel produced from Alaskan natural gas can be absorbed by the electrical utility and automotive markets. Continued study should be made of the methanol/methyl fuel concepts.

FOOTNOTES

1. Rush Moody, Jr., Legal Analysis of Issues Relating to Natural Gas Transportation, 64 (1976).
2. Lecture, Methanol -- Feedstock for the Chemical Industry and Fuel of the Future, Tiemann and Raghuraman, Selas of American, April, 1973.
3. Alaskan Methanol Concept -- A Pre-Feasibility Study, Institute for Energy Analysis, Oak Ridge Associated Universities, IEA Research Memorandum, 75-5, Nov., 1975.
4. The Clean Synthetic Fuel That's Already Here, E. Faltermeyer, Fortune Magazine, Sept., 1975, 147.
5. Alaskan Methanol Concept, supra.
6. Methanol -- The "New Fuel" from Coal, Mills and Harney, Chemtech, January, 1974, 26.
7. Arctic Energy A New Perspective, Westinghouse Oceanic Division, January, 1976, 42.
8. Paper, Environmental Aspects of Methanol as Vehicular Fuel: Health and Environmental Effects, Beverly J. Berger, Lawrence Livermore Laboratory, Sept., 1974, 4-5.
9. Arctic Energy, A New Perspective, supra, 50.
10. Faltermeyer, supra, 150.
11. Alaska Methanol Concept, supra, 66.
12. Arctic Energy, A New Perspective, supra, 10.
13. Trans-Alaska Gas Pipeline Project, State of Alaska, Department of Labor, December, 1975, 2.
14. Moody, Jr., Cover letter, supra, 8.

Figure 1

METHANOL



SELAS OF AMERICA (NEDERLAND) N.V.

AGO 545895



EXHIBIT 2

COMPARISON OF METHANOL AND GASOLINE

	<u>Methanol</u>	<u>Gasoline</u>
Formula	CH_3OH	$\text{C}_4\text{H}_{10}\text{C}_{12}\text{H}_{26}$
Boiling point, F	148	100-400
Freezing point, F	-144	-100
Latent heat of vaporization at bp BTU/lb	502	116
Liquid density 16/gal.	6.6	6.2
Heat of combustion (liquid-fuel-liquid H_2O) BTU/lb.	9,776	20,260
BTU/gal.	64,500	124,800

Source: Mills and Harney, Methanol -- The "New" Fuel from Coal;
Chemtech, January 1974, 27.

TANZER ECONOMIC ASSOCIATES, INC.

ECONOMIC CONSULTANTS

302 WEST 86TH STREET

NEW YORK, N. Y. 10024

(212) 421-1950

CABLE "TANZECON" NEW YORK

February 13, 1976

Senator John Huber
 Chairman,
 Special Committee on Taxation and Revenue
 Alaska State Legislature
 Pouch V
 Juneau, Alaska 99811

Dear John:

Thank you for sending me a copy of the Rush Moody report on "Legal Analysis of Issues Relating to Natural Gas Transportation." I did indeed find it quite interesting and informative. While I am not competent to comment on the legal issues analyzed, I am happy to respond to your request for comments or recommendations on the report, as it may touch on economic questions. This letter represents my initial reaction to some of these matters:

1. As I understand the Moody report, a key legal conclusion is that the State should take royalty gas in kind rather than in value; otherwise, it may lose control in the future of this royalty gas because it will come under FPC regulation, and thus it would be possible that none of Alaska's natural gas would be available for consumption within the State.

2. From an economic point of view, I think the State would also be wise to take royalty gas (and maybe royalty oil also) in kind, so as not to lose the future option on having the royalty gas. This is particularly true because the real value of the royalty gas to the State may be much higher than its market value, for the following reasons.

3. First, at present the price of FPC regulated natural gas moving in interstate commerce is about one-fourth its real market value, as measured by prices on intra-state sales (50¢ versus \$2.00 per MCF). While natural gas prices may be deregulated in a few years, there is no present certainty on this.

4. More important, in the long run I think it is generally agreed that the use of natural gas for its heat content as a fuel is a waste of a valuable resource, since its greatest value would be as a petrochemical feedstock. This suggests among other

AGC 545897

things that over the long run natural gas prices will rise as it increasingly is reserved for its more valuable use.

5. But, because of the high profit rates the oil companies use in their DCF calculations (as discussed at length in my report), their decisions will tend to be made on short run profit considerations, which may not be best for the State. By way of hypothetical illustration, I constructed a case to show where it might be better for the State to have the gas stay in the ground until it became more valuable, while for the companies it would be more profitable to produce quickly. The hypothetical assumptions were that natural gas would sell at \$2 per MCF in the 1980s, \$6 per MCF in the 1990s, and \$18 per MCF thereafter. Assuming a time value of money, or discount rate, for the companies of 20% per year and for the State of 10% per year, it turns out that if a gas field has a 20 year life, the companies would be best off producing all the gas in the 1981-2000 period, while the State would be better off with the gas produced in the 1991-2010 period. (See attached table.)

6. The problem of the State having a lower discount factor, and hence a longer time horizon, than the companies is of course a general one which may lead to conflicts of interest in many oil and gas areas. Thus, for example, it may be better for the State if all oil and gas were produced at a slower rate than the companies would like, and it is possible that this could be handled under conservation regulations. Specifically, however, with regard to its royalty gas, if the State decides it would be better off with gas production at a slower rate than the companies want, perhaps a way could be worked out to require the companies to leave the royalty gas in the ground until the State requests it, either for its own use or for resale. Alternatively, the State could perhaps exchange the royalty gas with companies for "future gas" to be delivered by them when desired by the State.

7. Another factor favoring taking of royalty gas in kind is that market prices of gas may not reflect the full economic cost to the State of not having the gas. In the short run, a lack of gas could mean costly shutdowns of industry and great consumer inconvenience. In the long run, the absence of an assured supply of gas might hinder the whole economic development of the State. Thus, the question of royalty gas cannot be divorced from questions of planning long-run economic development. But, at least keeping the option to take gas in kind does not foreclose future industrial development opportunities.

8. Also, I think taking royalty gas in kind would have the advantage that it will help the State learn more about the oil and gas business, from practical experience. With oil companies fully integrated from the raw material through petrochemicals, and with the allocation of costs between oil and gas production,

and between raw material production and other functions, often being arbitrary, it is important for the State to have a good grasp of the practical economics of the gas business as well as the oil business. This is vital for the State even if it is to simply maximize its benefits as a tax collector.

9. Finally, I certainly agree with the Moody Report's general recommendations that State leasing policies and taxation on natural gas should be reconsidered. In my opinion both of these questions call for detailed study of possible alternatives. Here I would only observe that tax rates in Texas and Louisiana, where the oil companies have widespread political support from small producers, would not normally be an adequate yardstick as to what rates of taxation could be imposed.

I hope these general comments will be of use to you. My thanks also for your kind words about my report.

Yours sincerely,

Michael Tanzer

Dr. Michael Tanzer,
President

ALASKAN NATURAL GAS PRODUCTION:
HYPOTHETICAL EXAMPLE ILLUSTRATING
POSSIBLE CONFLICT OF INTEREST
BETWEEN THE STATE AND THE COMPANIES
OVER TIMING OF PRODUCTION

Assumptions:

- (1) Prices of natural gas (\$ per MCF): 1981-90, \$2; 1991-2000, \$6; 2001-2020, \$18.
- (2) Ignore in all cases investment and operating costs (Alternative interpretation: Prices are net of costs).
- (3) Potential production = 1 MCF per year for 20 years.
- (4) Discount factors for computing present value in 1980 of future income from gas: companies, 20% per year; State, 10% per year.

TOTAL VALUE OF INCOME FROM
20 YEARS OF GAS PRODUCTION (\$):

	1981-2000	1991-2010	2001-2020
A. Gross Value (undiscounted)			
(a) First 10 years	20	60	180
(b) Next 10 years	60	180	180
(c) Total 20 years	80	240	360
B. 1980 Present Value, Discounted at 20% per year (company rate)			
(a) First 10 years	8.39	4.06	1.96
(b) Next 10 years	4.06	1.96	.32
(c) Total 20 years	12.45**	6.02	2.28
C. 1980 Present Value, Discounted at 10% per year (State rate)			
(a) First 10 years	12.29	14.22	16.43
(b) Next 10 years	14.22	16.43	6.32
(c) Total 20 years	27.51	30.65**	22.75

** = Most profitable production period

METHYL-FUEL

Wentworth Brothers, Inc.

Cincinnati, Ohio

At the onset, I would like to very briefly outline the METHYL-FUEL concept.

At the present time, the total installed world's methanol production (chemical grade) is about 25,000 short tons, (a short ton contains about 7.2 API barrels, or just over 300 gallons). This capacity consists of about 5,000 tons in Japan with the balance about equally split between the U.S. and the balance of the world.

In the U.S., our personnel have designed about 30-35% of the installed capacity, including the current worlds largest chemical grade plant (2,500 TPD) down in Beaumont, Texas.

In part stemming from the later plant, and recognizing the large volumes of associated gas being flared in remote locations, the METHYL-FUEL concept was brought forth as a means to bring this energy to market in a stable liquid form. Events in 1973, the Middle East war, temporarily brought a halt to this endeavor in many parts of the world.

This then prompted a renewed look at producing METHYL-FUEL from our nations coal reserves.

When considering coal as feedstock, one is forced to consider the environmental unacceptable coals, the low quality coals or the marginal coals in remote locations. Good, high quality coal should be used as is.

A brief while back, it was brought to our attention that significant quantities of coal existed in Alaska. Very preliminary studies indicated that these coals can be quite economically converted to METHYL-FUEL and transported as a liquid to distant markets. Through this work, the melding of possibilities came forth wherein the production of METHYL-FUEL from the State's coal and/or from the State's coal and gas, appears to offer a very attractive situation. Examples:

1. The synthesis gas from coal for METHYL-FUEL production is deficient in hydrogen. Synthesis gas from natural gas is deficient in carbon. This brings forth the prospect of a optimized combination coal and gas fed plant with thus a considerable increase in conversion efficiency.

2. Many of the Alaskan coals appear to be the type that would lend themselves to simple coal beneficiation. This brought forth the concept wherein, for example, two tons of coal would be mined, one ton would be upgraded to a dehydrated, low sulfur, high BTU coal, the other ton (or the reject from the beneficiation) would serve as METHYL-FUEL feedstock. The METHYL-FUEL would then be utilized as the slurring media for the beneficiated coal. This not only results in further increases in conversion efficiency, but permits very economical transport of the beneficiated coal and a most appropriate use of gas and coal in the State.

3. It is understood that the gas with Alaskan crude contains a rather large amount of carbon dioxide (CO_2). For METHYL-FUEL production, this presence of CO_2 is a benefit in that it does not have to be removed to permit METHYL-FUEL production, but rather augments it and becomes of the product -- METHYL-FUEL.

4. It is understood that the Alaskan associated gas contains a fair amount of LPG (Propane and Butane) and natural gas liquids (iso pentane and heavier). Our firm has a proprietary process wherein the butane and heavier liquids can be handled very economically with METHYL-FUEL with no loss in conversion efficiency for these stocks. This concept can thus result in the elimination of the waste in at least one, perhaps two, or even three of the other energy systems that will result. The capital and operating cost

savings that are possible here can be quite outstanding. Also, it is this point that makes comparison of METHYL-FUEL handling with other gas handling alternatives about like comparing "apples with oranges" -- with the apples in this case being much more valuable than the oranges because of the inherent case in handling METHYL-FUEL.

5. Last, but not least, is the further processing on the Alaskan scene of the byproducts from a METHYL-FUEL complex with the value added benefits to Alaska. The ones that immediately suggest themselves are ammonia, urea, the ammonium nitrates and the many -- many derivatives possible from the chemical grade alcohols. In summary, it is believed that METHYL-FUEL should be given serious consideration in Alaska. The benefits resulting are many, and far reaching; i.e.:

A.) METHYL-FUEL from coal will in effect revive an old industry and initiate a new vibrant Alaskan industry.

B.) METHYL-FUEL from coal and gas will start and establish an infrastructure which, when the gas reserves are depleted the quantities of coal remaining will permit an on-going clean energy supply situation into the next century.

C.) The existence of a METHYL-FUEL facility will permit consideration of a vast downstream petro-chemical complex for products which in their own right may not otherwise be economically viable.



STANFORD RESEARCH INSTITUTE
Menlo Park, California 94025 U.S.A.

LNG, METHANOL, FISCHER-TROPSCH SYNTHESIS:
METHODS OF UTILIZING REMOTE NATURAL GAS

SRI has recently completed a \$300,000 technoeconomic study on this subject. This in-depth study is sponsored by 40 companies from 16 countries.

At the present time, trillions of cubic feet of natural gas are being burned uselessly in flares in remote oil fields in the Middle East, Africa, South America, Indonesia, and elsewhere. Remote natural gas fields have not been developed because of lack of markets.

The economical utilization of remote gas would be attractive to both the exporting and importing countries. Schemes previously considered uneconomical for transporting and utilizing this gas are now being seriously proposed. The two most commonly suggested means of utilizing remote natural gas are liquefaction of the gas to LNG or conversion to methanol and transportation of the liquid product to the market. Several LNG projects are in operation or planned for utilizing natural gas from Algeria, Libya, Brunei, Indonesia, Nigeria, and Alaska. Proposed fuel methanol-from-gas projects have been announced for Middle East gas.

Less attention, however, has been given to other methods of utilizing remote gas. These methods include:

- Fischer-Tropsch liquid fuels
- Long distance natural gas pipelines
- Petrochemical manufacture.

This study includes technical and economic evaluations of all of these options for various distances between producing and consuming regions.

The cost of this study is US\$8,000.

AGO 545906



STANFORD RESEARCH INSTITUTE
MENLO PARK, CALIFORNIA 94025
(415) 326-6200

November 6, 1975

Senator John Huber
Pouch V
Juneau, Alaska 99811

Dear Senator Huber:

As I promised at our meeting here last month, I am sending you the Table of Contents of our recently issued report, "LNG, Methanol, Fischer-Tropsch Synthesis: Methods of Utilizing Remote Natural Gas."

If you have any questions, please contact me.

Sincerely,

A. James Moll, Director
Energy Technology Department

AJM/jlb

Enclosure

cc: Anchorage, Alaska

AGO 545907



CLIENT PRIVATE
STANFORD RESEARCH INSTITUTE
Menlo Park, California 94025 U.S.A.

John F. Green

October 1975

LNG, METHANOL, FISCHER-TROPSCH SYNTHESIS: Methods of Utilizing Remote Natural Gas

By: C. F. CLARK
S. J. DAVENPORT
R. E. FULLEN
S. M. KOHAN
N. KORENS
K. E. LUNDE
E. P. MEKO

K. A. MILLER
A. J. MOLL
M. A. MOORE
W. J. SCHUMACHER
C. A. TREXEL
K. K. USHIBA
J. G. WITWER

Prepared for:

FORTY INTERNATIONAL ORGANIZATIONS

SRI Project ECC-3777

CLIENT PRIVATE

AGO 545908

ACKNOWLEDGMENTS

Stanford Research Institute (SRI) expresses its appreciation to the project sponsors listed below for their support.

Air Products and Chemicals, Inc.
 Arabian Oil Co.
 British Gas Corp.
 Chemico Cryogenics Systems Co.
 Chinese Petroleum Corp.
 Compagnie Francaise de Raffinage
 Dome Petroleum Ltd.
 Dresser Industries, Inc.
 Dutch State Mines
 Earl & Wright
 El Paso Natural Gas Co.

 ELF-ERAP
 Empresa Nacional del Gas S.A.
 Getty Oil Co.

 The Harshaw Chemical Co.
 The Kansai Electric Power Co.
 The M. W. Kellogg Co.
 Linde AG (Germany)
 Mitsui Shipbuilding and Engineering Co.
 Mobil Research and Development Corp.

 National Iranian Oil Co.
 N. V. Nederlandse Gasunie
 Niigata Engineering Co.
 Nissho-Iwai American Corp.
 PanCanadian Petroleum Ltd.
 Petrola International S.A.
 The Pipeline Authority
 J. F. Pritchard & Co.
 Sener
 Shell International Research Maatschappij N. V.
 Snam Progetti
 Sonatrach
 South African Coal, Oil & Gas Corp.
 Standard Oil Co. of California

 Standard Oil Co., Indiana

Superior Oil Co.
Texaco, Inc.
Union Carbide Corp.
Union Rheinische Braunkohlen Kraftstoff AG
Yacimientos Petroliferos Fiscales Bolivianos

SRI also acknowledges the assistance of the following organizations that provided technical and economic information for this project.

Air Products and Chemicals, Inc.
J. C. Carter Co.
Chemico Process Plants Co.
Chicago Bridge and Iron Co.
Davy Powergas, Inc.
El Paso LNG Co.
El Paso Natural Gas Co.
FMC Corp.
General Electric Co.
Girdler Chemical, Inc.
Imperial Chemical Industries, Ltd.
Ingersoll-Rand Co.
Katalco Co.
The M. W. Kellogg Co.
Linde AG
Mitsui Shipbuilding and Engineering Co., Ltd.
Pacific Gas and Electric Co.
Pacific Lighting Co.
Phillips Petroleum Co.
J. F. Pritchard and Co.
Selas Corporation of America
Shell Oil Co.
The South African Coal, Oil and Gas Corporation (SASOL)
Sumitomo Metal Industries, Ltd.
Union Carbide Corp.
Vulcan-Cincinnati, Inc.

CONTENTS

ACKNOWLEDGMENTS	iii
LIST OF ILLUSTRATIONS	xi
LIST OF TABLES	xvii
ABBREVIATIONS AND CONVERSION FACTORS	xxv
I INTRODUCTION	1
II SUMMARY AND CONCLUSIONS	5
International Trade in Natural Gas	5
Liquefied Natural Gas, Methanol, and Fischer-	
Tropsch Liquids	5
Petrochemicals in the Producing Country	8
Gas Pipelines	9
III WORLDWIDE SUPPLY-DEMAND FOR NATURAL GAS	11
Introduction	11
Summary	12
Demand	17
World Demand	18
United States	19
Western Europe	22
Japan	24
Communist Countries	25
Rest of the World	27
Supply	28
Middle East	32
Africa	33
South America	34
USSR	35
Far East	36
Reserves	37

IV ECONOMIC AND DESIGN BASES.	41
Introduction	41
Design Bases	41
Location.	41
Ambient Conditions.	42
Gas Composition, Temperature, and Pressure.	42
Plant Capacities.	42
Storage Facilities.	43
Plant Operating Factors	44
Capital Investment Bases	44
Location Factors.	44
Utilities	46
General Facilities.	47
Plant Facilities Investment	47
Town Facilities	48
Land.	48
Royalties	48
Working Capital	48
Organization and Start-Up Expenses.	48
Total Capital Investment.	49
Annual Operating Costs	49
Materials and Supply Costs.	49
Labor	49
Purchased Utilities	50
Fixed Costs	50
Total Annual Operating Costs.	51
Financial Parameters	51
Capital Source.	51
Interest.	51
Debt Retirement Schedule.	51
Depreciation.	51
Project Life.	52
Income Taxes.	52
Profitability Calculations	52
Construction and Cash Flow Schedule	52
Discounted Cash Flow Method of Analysis	53
U.S. Regulated Utility Method of Analysis	57
References	60
V LIQUEFIED NATURAL GAS.	61
Introduction	61
Summary.	66

V	LIQUEFIED NATURAL GAS (Continued)	
-	LNG Liquefaction	73
	Background.	73
	Process Description--Lean Gas Case.	79
	Economic Analysis--Lean Gas Case.	97
	Process Description--Rich Gas Case.	114
	Economic Analysis--Rich Gas Case.	118
	LNG Receiving Terminals.	126
	Background.	126
	Process Description	129
	Economic Analysis	137
	Uses of LNG Cold	149
	Concept of Cold Use	149
	Existing Facilities that Utilize LNG Cold	154
	Specific Applications of LNG Cold	155
	Integrated Coldplex	158
	References	162
VI	METHANOL	167
	Introduction	167
	Summary.	168
	Production of Methanol	174
	Background.	174
	Process Description--Lean Gas Case.	179
	Economic Analysis--Lean Gas Case.	190
	Process Description--Rich Gas Case.	199
	Economic Analysis--Rich Gas Case.	203
	Methanol Receiving Terminals	207
	Conversion of Methanol to Substitute Natural Gas	210
	Process Description	210
	Economic Analysis	211
	Utilization of Methanol.	217
	Introduction.	217
	Methanol's Physical and Chemical Properties	218
	Methanol as an Alternative Automotive Fuel.	221
	Methanol's Future as an Automotive Fuel	227
	References	228
VII	FISCHER-TROPSCH LIQUIDS.	231
	Introduction	231
	Summary.	231
	Production of Fischer-Tropsch Liquids.	235
	Background.	235
	Process Description--Lean Gas Case.	242

VII FISCHER-TROPSCH LIQUIDS (Continued)

Operating Requirements	253
Economic Analysis--Lean Gas Case.	253
Process Description--Rich Gas Case.	259
Economic Analysis--Rich Gas Case.	262
Fischer-Tropsch Products.	262
Fischer-Tropsch Receiving Terminals and Transportation . .	272
References	275

VIII OCEAN SHIPPING	277
Introduction	277
Summary.	277
Background	282
LNG Shipping.	282
Methanol Shipping	285
Fischer-Tropsch Fuel Oil Shipping	285
Design and Economic Bases.	286
Size of Vessels	286
Shipping Distances.	286
Country of Construction	286
Flag.	287
Fleet Size Requirements	287
Cost Elements	288
Salvage	292
Financing Terms	292
Tax Structure	293
Methodology Used in Calculating Ocean Shipping Costs.	293
LNG Tankers.	293
Shipping Characteristics of LNG	293
Containment Systems	294
Free Standing Versus Membrane	294
Commercial Tank Designs	297
LNG Vessel Operating Characteristics.	301
Tanker Design Used in Economic Analyses	305
Construction Costs.	306
Nonvariable Annual Operating Costs.	306
Capital and Operating Costs Used in the Economic Analyses	308
Alternative Cases	313
Methanol Tankers	321
Shipping Characteristics of Methanol.	321
Methanol Tanker Operating Characteristics	322
Tanker Design Used in the Economic Analyses	323

VIII OCEAN SHIPPING (Continued)

	Construction Costs	323
	Nonvariable Annual Operating Costs	324
	Capital and Operating Costs Used in the Economic Analyses	324
	Alternative Cases	328
	Fischer-Tropsch Fuel Oil Tankers	332
	Shipping Characteristics of Fischer-Tropsch Fuel Oils	332
	Fischer-Tropsch Fuel Oil Tanker Operating Characteristics	332
	Tanker Design Used in the Economic Analyses	332
	Construction and Nonvariable Annual Operating Costs	332
	Capital and Operating Costs Used in the Economic Analyses	332
	Alternative Cases	334
	Future Developments	336
	Other Ocean Shipping Costs	337
	References	339
IX	PETROCHEMICALS IN THE PRODUCING COUNTRY	341
	Introduction	341
	Summary	342
	Ethylene and Derivatives	343
	Supply and Demand	343
	Economic Analysis	347
	Ammonia	356
	Supply and Demand	356
	Process Description	358
	Economic Analysis	362
	Fischer-Tropsch Chemical By-Product and Hydrogen	367
	References	373
X	GAS PIPELINES	375
	Introduction	375
	Summary	375
	Background	375
	Technological Considerations	376
	Pipe Laying Techniques	378
	Arctic Construction	379
	Arctic Grade Pipe	380

X GAS PIPELINES (Continued)

Iran to West Germany Pipeline.	381
Design Description.	381
Capital Costs	384
Operating Costs and Delivered Gas Price	386
Pipeline Versus LNG.	388
Appendix A--ALASKAN GAS PIPELINE PROPOSALS	393

ILLUSTRATIONS

II-1	Comparison of Delivered Costs of Methanol and Liquefied Natural Gas as a Function of Shipping Distance.	7
II-2	Comparison of Delivered Costs of Methanol and Fischer-Tropsch Liquids as a Function of Shipping Distance.	7
III-1	Imports into Markets for Remote Natural Gas	16
III-2	Comparison of Natural Gas Export Potential and Import Requirements	17
III-3	U.S. Natural Gas Consumption and Production	21
III-4	Western Europe Natural Gas Consumption and Production.	23
III-5	Japan Natural Gas Consumption and Production.	25
III-6	Eastern Europe Natural Gas Consumption and Production.	27
III-7	Middle East Natural Gas Consumption and Potential Production.	33
III-8	Africa Natural Gas Consumption and Potential Production.	34
III-9	South America Natural Gas Consumption and Potential Production.	35
III-10	USSR Natural Gas Consumption and Potential Production.	36
III-11	Far East Natural Gas Consumption and Potential Production.	37
V-1	Projected Liquefaction Capacity for International LNG Export/Import Projects.	67
V-2	Price of Regasified LNG as a Function of Shipping Distance and Tanker Size.	70
V-3	Cooling Duty Curves for Liquefaction Cycles	75

V-4	Cascade Cycle	76
V-5	Mixed Refrigerant Cycle	77
V-6	PRICO Mixed Refrigerant Cycle Process	78
V-7	LNG Plant Purification, Section 100--Amine Purification.	83
V-8	LNG Plant Purification, Section 100--Molecular Sieve Dehydration	84
V-9	LNG Plant Refrigerant Makeup, Section 200	87
V-10	LNG Plant Liquefaction, Section 300	89
V-11	Combined-Cycle Compressor Drivers, Section 300.	92
V-12	LNG Plant Storage and Loading, Section 400.	95
V-13	Sensitivity of LNG Price to Tanker and Plant Size	107
V-14	Revenue Required for LNG as a Function of Financial Parameters--1,000 MM scfd Plant, 80,000 Cubic Meter Tankers	108
V-15	Revenue Required for LNG as a Function of Financial Parameters--1,000 MM scfd Plant, 125,000 Cubic Meter Tankers	109
V-16	Revenue Required for LNG as a Function of Financial Parameters--1,000 MM scfd Plant, 165,000 Cubic Meter Tankers	110
V-17	Revenue Required for LNG as a Function of Financial Parameters--500 MM scfd Plant, 80,000 Cubic Meter Tankers	111
V-18	Revenue Required for LNG as a Function of Financial Parameters--500 MM scfd Plant, 125,000 Cubic Meter Tankers	112
V-19	Revenue Required for LNG as a Function of Financial Parameters--500 MM scfd Plant, 165,000 Cubic Meter Tankers	113
V-20	LNG Plant LPG Separation, Section 200--Rich Gas Case.	119
V-21	LNG Plant Sulfur Recovery, Section 500--Claus Plant, Rich Gas Case.	121
V-22	Ethane Price to Ethylene Plant.	125
V-23	Submerged Combustion LNG Vaporizer.	128

V-24	Direct-Fired Convective Heat Exchanger.	129
V-25	Intermediate Fluid LNG Vaporizer.	130
V-26	LNG Terminal--Schematic Flow Diagram.	131
V-27	Effect of Tanker Size on Incremental Revenue Requirements for an LNG Terminal.	148
V-28	Incremental Revenue Required as a Function of Financial Parameters for a 450 MM scfd LNG Terminal-- 125,000 Cubic Meter Tankers	150
V-29	Incremental Revenue Required as a Function of Financial Parameters for a 450 MM scfd LNG Terminal-- 165,000 Cubic Meter Tankers	151
V-30	Incremental Revenue Required as a Function of Financial Parameters for a 900 MM scfd LNG Terminal-- 125,000 Cubic Meter Tankers	152
V-31	Incremental Revenue Required as a Function of Financial Parameters for a 900 MM scfd LNG Terminal-- 165,000 Cubic Meter Tankers	153
V-32	Integrated Coldplex for a 26.8 Million Normal Cubic Meter Per Day LNG Receiving Terminal.	160
VI-1	Cost of Methanol and SNG from Methanol as a Function of Shipping Distance and Tanker size	172
VI-2	Methanol from Natural Gas	185
VI-3	Conceptual Methanol Reactor	188
VI-4	Effect of Methanol Plant Capacity on Estimated Required Capital Investment	194
VI-5	Effect of Feed Cost on Revenue Required from Sale of Methanol	197
VI-6	Effect of Economic Variables on Revenue Required from Sale of Methanol	198
VI-7	Effect of Rich Feed Gas on Revenue Required from Sale of Methanol	206
VI-8	Fuel Efficiency and Emissions Using Methanol- Gasoline Blends	225
VII-1	Cost of Fischer-Tropsch Fuels as a Function of Shipping Distance and Tanker Size	235

VII-2	Process Flow Diagram of a Fischer-Tropsch Plant-- Lean Gas Case	245
VII-3	Schematic of the Kellogg Reactor Section.	251
VII-4	Effect of Natural Gas Feed Cost on Revenue Required from Sale of Fischer-Tropsch Products--Lean Gas Case. . .	260
VII-5	Revenue Required as a Function of Financial Parameters for Fischer-Tropsch Fuel--Lean Gas Case. . .	261
VII-6	Effect of Natural Gas Price on Revenue Required from Sale of Fischer-Tropsch Products--Rich Gas Case. . .	267
VII-7	Typical Distillation Curves for Fischer-Tropsch Oils. . .	269
VIII-1	Ocean Shipping Costs by Ship Type, Size, and Distance.	279
VIII-2	Capital Investment by Ship Type, Size, and Distance.	280
VIII-3	Capital Investment Per Million Btu Delivered Annually by Ship Type, Size, and Distance	281
VIII-4	Kvaerner-Moss Tank Design	298
VIII-5	Conch Free-Standing Tank Design	300
VIII-6	Gaz Transport Membrane Tank Design.	302
VIII-7	Technigaz Membrane Tank Design.	303
VIII-8	LNG Tanker Transportation Costs for Selected Trading Distances	314
VIII-9	Revenue Required as a Function of Financial Parameters for a 125,000 nm ³ LNG Tanker Fleet at 6,000 Nautical Miles.	315
VIII-10	Structure of a Typical Tax Leverage Lease	319
VIII-11	Methanol Transportation Costs for Selected Trading Distances	329
VIII-12	Revenue Required as a Function of Financial Parameters for a 300,000 dwt Methanol Tanker Fleet at 6,000 Nautical Miles	330
VIII-13	Fischer-Tropsch Transportation Costs for Selected Trading Distances	334
VIII-14	Revenue Required as a Function of Financial Parameters for a 300,000 dwt Fischer-Tropsch Tanker Fleet at 6,000 Nautical Miles.	335

IX-1	Effect of Relative Construction Costs and Financing Basis on Permissible Ethane Cost--Polyethylene Production.	353
IX-2	Effect of Relative Construction Costs and Financing Basis on Permissible Ethane Cost--Ethylene Production.	354
IX-3	World Nitrogen Production Capacity.	357
IX-4	Block Flow Diagram of the Methanol/Ammonia Complex. . .	360
IX-5	Block Flow Diagram of an Ammonia Plant Based on Methanol Plant Purge Gas.	361
IX-6	Effect of Gas Price on Ammonia Sales Price.	367
IX-7	Revenue Required as a Function of Financial Parameters for Ammonia from Natural Gas	368
IX-8	Revenue Required as a Function of Financial Parameters for Ammonia from Methanol Plant Purge Gas. .	369
X-1	Route Map--Iran to West Germany Natural Gas Pipeline. .	383
X-2	Required Prices of Gas Delivered by Pipeline or as Liquefied Natural Gas	391

TABLES

II-1	Summary Economics for LNG, Methanol, and Fischer-Tropsch Liquids from Natural Gas.	6
III-1	Total World Demand for Natural Gas, 1970-2000	13
III-2	Total World Gas Production, 1970-2000	14
III-3	World Trade in Natural Gas.	15
III-4	Historical and Projected Demand for Primary Energy in the World, 1950-2000	18
III-5	Historical and Projected Demand for Primary Energy in the United States, 1950-2000	19
III-6	Historical and Projected Demand for Primary Energy in Western Europe, 1950-2000.	22
III-7	Historical and Projected Demand for Primary Energy in Japan, 1950-2000	24
III-8	Historical and Projected Demand for Primary Energy in the Communist Countries, 1950-2000	26
III-9	Historical and Projected Demand for Primary Energy in the Rest of the World, 1950-2000	28
III-10	Natural Gas Production in 1972.	29
III-11	Natural Gas Supply Data	38
III-12	Proven Natural Gas Reserves and Potentially Recoverable Natural Gas Resources of the World.	39
IV-1	Gas Compositions and Delivery Conditions.	43
IV-2	Example of Capital Investment for DCF Calculations.	54
IV-3	Example of Annual Operating Costs for DCF Calculations.	54
IV-4	Example of DCF Rate Calculation	55
IV-5	Example Investment for U.S. Regulated Utility Calculations.	57
IV-6	Example of U.S. Regulated Utility Rate of Return Calculation	59

V-1	International Liquefied Natural Gas Projects.	62
V-2	Liquefied Natural Gas Baseload Receiving Terminals. . .	64
V-3	Summary of Liquefied Natural Gas Project Costs.	69
V-4	Summary of Capital Investments for an LNG Project . . .	71
V-5	Material and Fuel Balance for a 1,000 MM scfd LNG Plant--Lean Gas Case.	81
V-6	Major Operating Requirements for an LNG Plant-- Lean Gas Case	97
V-7	Estimated Capital Investment for LNG from Lean Natural Gas--1,000 MM scfd Plant.	98
V-8	Estimated Capital Investment for LNG from Lean Natural Gas--500 MM scfd Plant.	99
V-9	Estimated Annual Operating Costs and Revenue Required for LNG from Lean Natural Gas-- 1,000 MM scfd Plant, 80,000 Cubic Meter Tankers	101
V-10	Estimated Annual Operating Costs and Revenue Required for LNG from Lean Natural Gas-- 1,000 MM scfd Plant, 125,000 Cubic Meter Tankers. . . .	102
V-11	Estimated Annual Operating Costs and Revenue Required for LNG from Lean Natural Gas-- 1,000 MM scfd Plant, 165,000 Cubic Meter Tankers. . . .	103
V-12	Estimated Annual Operating Costs and Revenue Required for LNG from Lean Natural Gas-- 500 MM scfd Plant, 80,000 Cubic Meter Tankers	104
V-13	Estimated Annual Operating Costs and Revenue Required for LNG from Lean Natural Gas-- 500 MM scfd Plant, 125,000 Cubic Meter Tankers.	105
V-14	Estimated Annual Operating Costs and Revenue Required for LNG from Lean Natural Gas-- 500 MM scfd Plant, 165,000 Cubic Meter Tankers.	106
V-15	LNG/LPG Plant Material and Fuel Balance-- Rich Gas Case	115
V-16	Major Operating Requirements of an LNG/LPG Plant-- Rich Gas Case	118
V-17	Estimated Capital Investment for LNG from Rich Natural Gas	123

V-18	Estimated Annual Operating Costs and Revenue Required for LNG from Rich Natural Gas.	124
V-19	Major Operating Requirements of LNG Receiving Terminal.	136
V-20	Estimated Capital Investment for an LNG Terminal-- 900 MM scfd Sendout Capacity.	138
V-21	Estimated Capital Investment for an LNG Terminal-- 450 MM scfd Sendout Capacity.	139
V-22	Estimated Annual Operating Costs for an LNG Terminal--450 MM scfd Capacity, 80,000 Cubic Meter Tankers	141
V-23	Estimated Annual Operating Costs for an LNG Terminal--450 MM scfd Capacity, 125,000 Cubic Meter Tankers	142
V-24	Estimated Annual Operating Costs for an LNG Terminal--450 MM scfd Capacity, 165,000 Cubic Meter Tankers	143
V-25	Estimated Annual Operating Costs for an LNG Terminal--900 MM scfd Capacity, 80,000 Cubic Meter Tankers	144
V-26	Estimated Annual Operating Costs for an LNG Terminal--900 MM scfd Capacity, 125,000 Cubic Meter Tankers	145
V-27	Estimated Annual Operating Costs for an LNG Terminal--900 MM scfd Capacity, 165,000 Cubic Meter Tankers	146
V-28	Effect of Plant Size on LNG Terminal Economics	147
V-29	Effect of Tanker Size on LNG Terminal Economics	147
V-30	Characteristics of LNG Cold Users	156
V-31	Savings Through Use of LNG Cold	157
V-32	Operating Characteristics of Units in a 26.8 Million nm ³ per day Coldplex.	161
VI-1	Summary of Total Capital Investment for a Methanol from Natural Gas Project.	170
VI-2	Summary of Methanol Project Costs	171
VI-3	Methanol Plant Material and Fuel Balance-- Lean Feed Gas	181

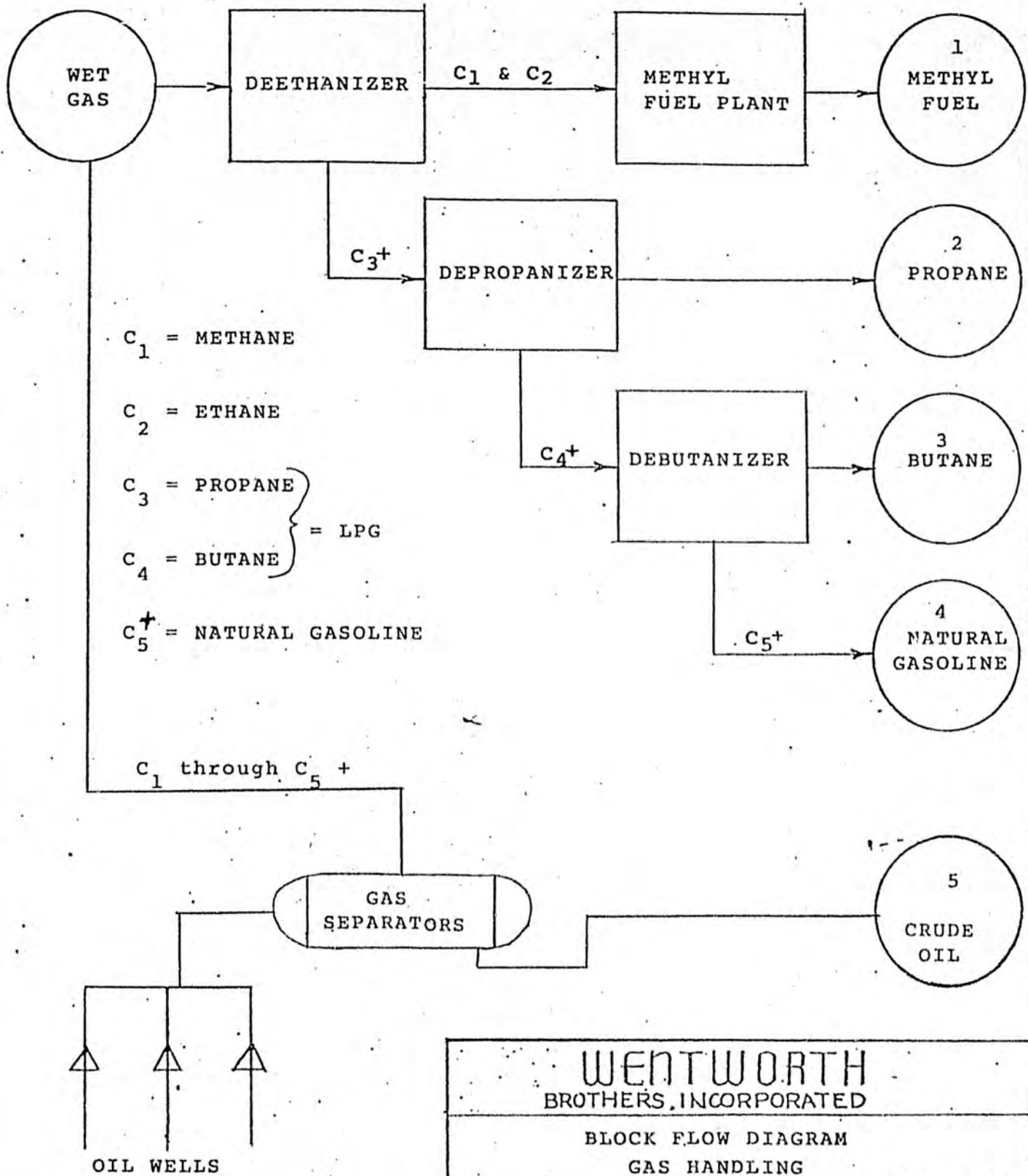
VI-4	Methanol from Natural Gas	187
VI-5	Methanol Plant Utilities and Labor Requirements	190
VI-6	Estimated Capital Investment for Methanol from Lean Natural Gas.	191
VI-7	Estimated Annual Operating Costs and Revenue Required for Methanol from Lean Natural Gas	196
VI-8	Methanol Plant Material and Fuel Balance-- Rich Feed Gas	201
VI-9	Methanol Plant Utilities and Labor Requirements-- Rich Feed Gas	203
VI-10	Estimated Capital Investment for Methanol from Rich Natural Gas.	204
VI-11	Estimated Annual Operating Costs and Revenue Required for Methanol from Rich Natural Gas	205
VI-12	Estimated Capital Investment and Operating Costs for a Methanol Receiving Terminal	209
VI-13	Conversion of Methanol to Substitute Natural Gas.	213
VI-14	Major Operating Requirements for Conversion of Methanol to Substitute Natural Gas.	215
VI-15	Estimated Capital Investment for Conversion of Methanol to SNG	215
VI-16	Estimated Annual Operating Costs and Revenue Required for Converting Methanol to SNG	216
VI-17	Comparison of Properties of Methanol, Gasoline, and Distillate Fuels.	219
VI-18	Toxicity of Methanol and Hydrocarbon Fuels.	220
VI-19	Automobile Efficiency and Emissions under Lean Operating Conditions--Comparison of Methanol and Gasoline Fuels.	226
VII-1	Summary of Fischer-Tropsch Project Costs.	233
VII-2	Summary of Total Capital Investment for Fischer- Tropsch Plant Based on Natural Gas Feedstock.	234
VII-3	Fischer-Tropsch Process Development	237
VII-4	Commercial Fischer-Tropsch Plants	238

VII-5	Fischer-Tropsch Plant Material and Energy Stream Flows--Lean Feed Gas.	247
VII-6	Fischer-Tropsch Operating Requirements.	254
VII-7	Estimated Capital Investment for a Fischer-Tropsch Plant Based on Natural Gas Feedstock--Lean Gas Case . .	256
VII-8	Fischer-Tropsch Storage Requirements.	257
VII-9	Estimated Annual Operating Costs and Revenue Required for a Fischer-Tropsch Plant, Based on Natural Gas Feedstock--Lean Gas Case.	258
VII-10	Fischer-Tropsch Plant Material and Energy Flows-- Rich Feed Gas	263
VII-11	Estimated Capital Investment for a Fischer-Tropsch Plant Based on Natural Gas Feedstock--Rich Gas Case . .	265
VII-12	Estimated Annual Operating Costs and Revenue Required for a Fischer-Tropsch Plant Based on Natural Gas Feedstock--Rich Gas Case.	266
VII-13	Typical Properties of Fischer-Tropsch Oils.	268
VII-14	Typical Carbon Number Distribution of Fischer- Tropsch Oils.	270
VII-15	Typical Nonacid Chemical Yield Distribution of Fischer-Tropsch Products.	271
VII-16	Typical Yield Distribution of Organic Acids from Fischer-Tropsch Products	271
VII-17	Fischer-Tropsch Shipping Costs.	273
VII-18	Estimated Capital Investment and Operating Costs for a Fischer-Tropsch Receiving Terminal.	274
VIII-1	LNG Shipping Distances.	287
VIII-2	Learning Curve Effects for Multiple Ship Construction.	289
VIII-3	Estimated Annual Overhead and Miscellaneous Costs for LNG Carriers.	292
VIII-4	Estimated Annual Overhead and Miscellaneous Costs for Methanol and Fischer-Tropsch Fuel Oil Carriers. . .	292
VIII-5	Principal Characteristics of Spherical, Free- Standing Tank LNG Carriers.	307

VIII-6	Spherical, Free-Standing Tank Design LNG Carriers-- Construction Costs per Vessel	308
VIII-7	Spherical, Free-Standing Tank Design LNG Carriers-- Nonvariable Annual Operating Costs per Vessel	309
VIII-8	Capital and Operating Costs for LNG Tanker Fleets	311
VIII-9	Principal Characteristics of Methanol and Fischer- Tropsch Fuel Oil Tanker Vessels	324
VIII-10	Methanol and Fischer Tropsch Fuel Oil Tankers-- Construction Costs per Vessel	325
VIII-11	Methanol or Fischer-Tropsch Fuel Oil Tankers-- Estimated Nonvariable Annual Operating Costs.	326
VIII-12	Capital and Operating Costs for Methanol Tanker Fleets	327
VIII-13	Capital and Operating Costs for Fischer-Tropsch Fuel Oil Tanker Fleets.	333
VIII-14	Ocean Transportation Costs for Other Commodities Used in Economic Analyses	338
IX-1	New Petrochemical Plants Under Construction, Planned, or Proposed.	344
IX-2	Planned Polyethylene Projects	345
IX-3	Future Ethylene Capacity Requirements	345
IX-4	Estimated Capital Investment for Ethylene and Polyethylene Production	348
IX-5	Ethane Value for Low-Density Polyethylene Production.	351
IX-6	Ethylene and Polyethylene Production Costs.	351
IX-7	Ethane Value for Ethylene Production.	352
IX-8	World Fertilizer Supply/Demand for Nitrogen	358
IX-9	Capital Investment for an Ammonia Plant	363
IX-10	Estimated Annual Operating Costs for Ammonia from Methanol Plant Purge Gas	365
IX-11	Estimated Annual Operating Costs for Ammonia from Natural Gas.	366
IX-12	Production of Nonacid Chemicals from a Fischer- Tropsch Plant	370

X-1	Major Large Diameter Pipeline Projects for Natural Gas and Crude Oil	377
X-2	Capital Investment Iran-to-West Germany Gas Pipeline. .	384
X-3	Annual Operating Costs and Revenue Requirements Iran-to-West Germany Pipeline	387
X-4	Sensitivity Analysis of the Iran-to-West Germany Pipeline.	389
X-5	Required Delivered Gas Prices--Iran to Western Europe.	390
A-1	Summary of Alaskan Pipeline Transportation Alternatives.	396

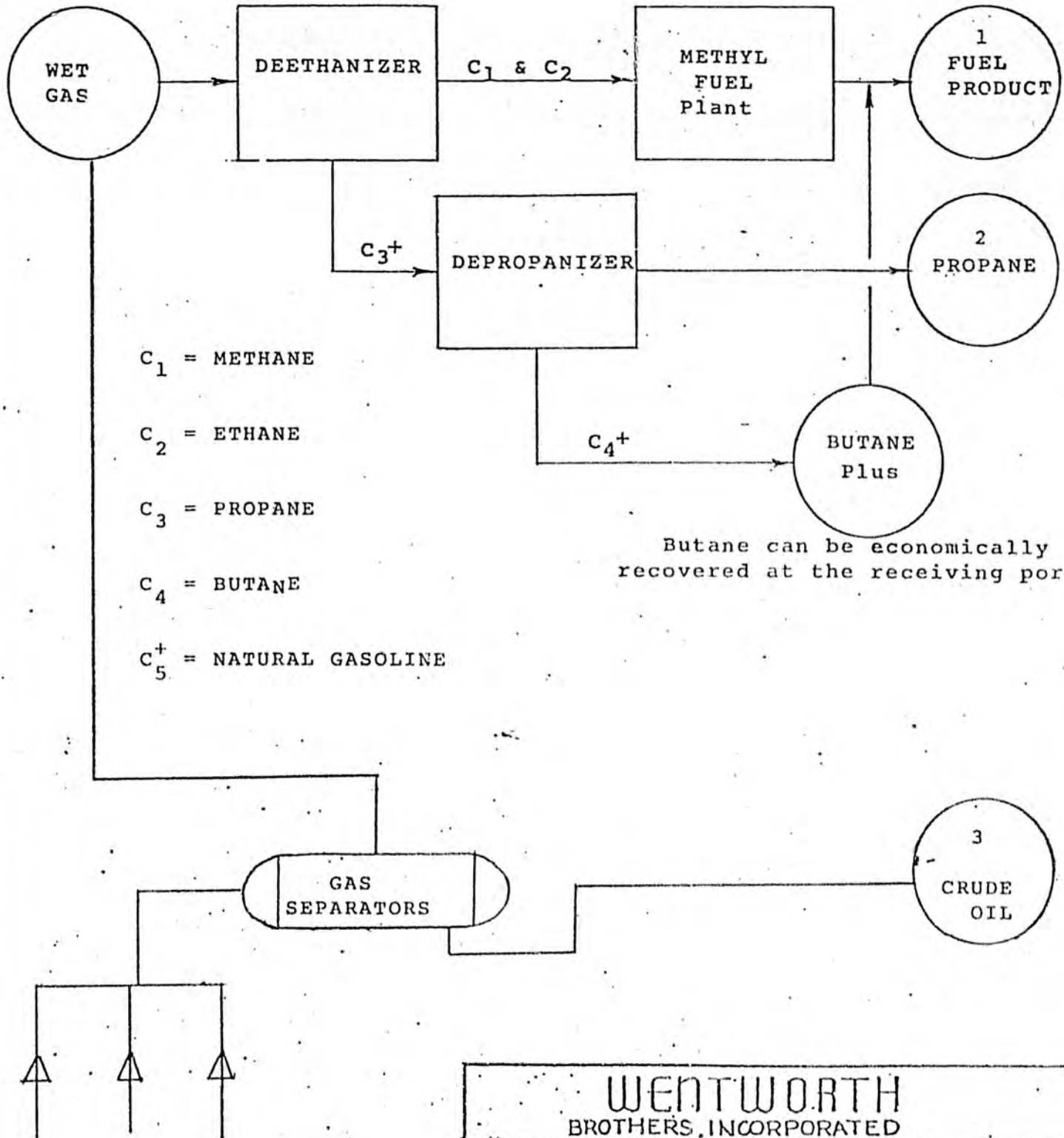
SYSTEMS



WENTWORTH
BROTHERS, INCORPORATED

BLOCK FLOW DIAGRAM
GAS HANDLING
CONVENTIONAL CASE

AGO 545929



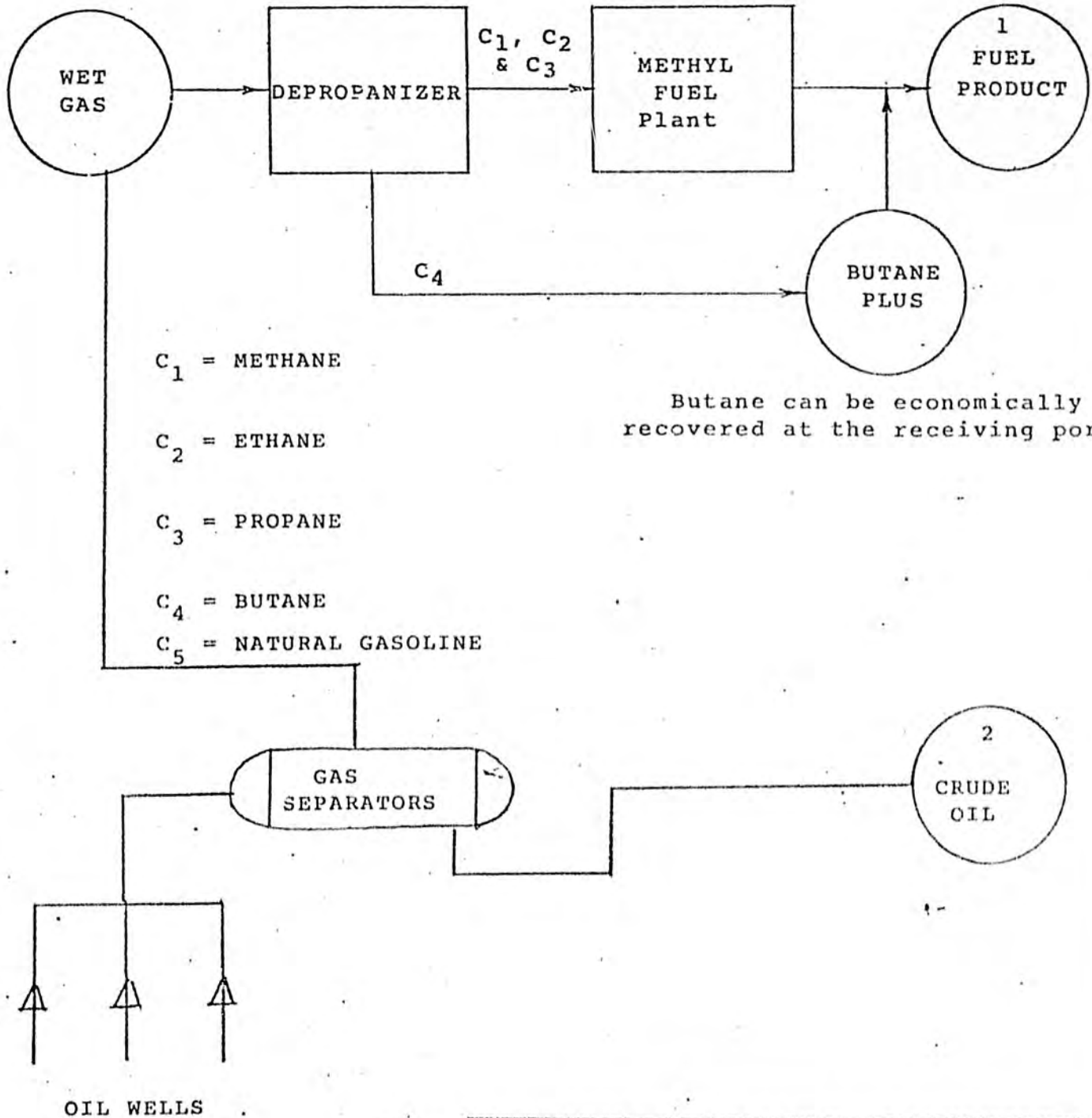
C_1 = METHANE
 C_2 = ETHANE
 C_3 = PROPANE
 C_4 = BUTANE
 C_5^+ = NATURAL GASOLINE

Butane can be economically recovered at the receiving port

WENTWORTH
 BROTHERS, INCORPORATED
 BLOCK FLOW DIAGRAM
 GAS HANDLING
 ALTERNATIVE I

AGO 545930

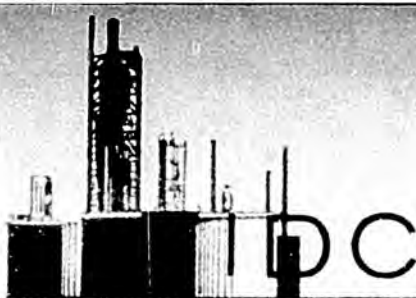
SYSTEMS



WENTWORTH
BROTHERS, INCORPORATED

BLOCK FLOW DIAGRAM
GAS HANDLING
ALTERNATIVE II

AGD 545931



DR. WILLIAM R. WOOD
EXECUTIVE VICE PRESIDENT

FAIRBANKS INDUSTRIAL DEVELOPMENT CORPORATION
Phone 907 452-5400 or 452-5752 619 Eleventh Avenue Fairbanks, Alaska 99701

February 5, 1976

Senator John Rader, Chairman
Joint Gas Pipeline Impact Committee
Alaska State Legislature
Juneau, Alaska, 99801

Dear Senator Rader:

The undersigned, representing a number of leading labor, business, professional, and industrial groups and more than seven thousand jobs for as many thousands of workers and their families in the Fairbanks area, have studied with deep interest the "Moody Report" submitted to your committee on 14 January 1976.

We heartily commend your foresight in authorizing a study of such fundamental significance for all Alaskans. Your selection of Mr. Rush Moody, a former member of the Federal Power Commission, to conduct the analysis of Alaska's natural gas issues was most wise and fortunate.

Mr. Moody's informative, forthright, yet restrained and objective report to you and your committee clearly reflects the deep-seated concerns of the Alaska tax-paying residents whom we represent. With all of the complexities involved, including the authority of the FPC to fix the well-head price of gas, conceivably Alaska could derive little or no benefit from its great store of natural gas, a rare and precious commodity in the world today. Specifically, we endorse the following basic concepts presented in the Moody Report:

1. "The State should pursue an affirmative, aggressive course of enlightened self-interest" to meet its present and future natural gas needs.

February 5, 1976

2. The State should "place less emphasis upon direct revenue and more emphasis upon cooperative development" with the private interests involved in exploration, extraction, transportation, processing in Alaska, and marketing to insure that Alaska "share in the benefit of a secure and reliable source of natural gas for use as a non-polluting heat source and as a raw material feedstock." In particular, it is essential that the State establish forthwith a stable business climate conducive to such cooperation with potential purchasers or processors of Alaska royalty gas.
3. The State should adopt a basic energy policy that will encourage and stabilize interest in the wisest possible use of its natural gas resources, emphasizing processing within the State to provide the benefits of meaningful and productive employment opportunities for Alaskans on a long-term basis. Such basic policy is required for orderly and economical development of both present and potential commercial oil and gas fields of Alaska.
4. The State should consider in depth the advantages to be gained by the "enactment of legislation to hold State owned resources within the State unless ... surplus to the needs of the State" and thus encourage the making in Alaska of more of our own consumer products through the good use of our own human and other natural resources.
5. Since "a natural gas stream has enormous potential value", the State should promptly and aggressively explore all potential uses ... "where conversion within the State, or liquids extraction within the State" strengthens the State's control of its own resource and ... diminishes the range of FPC controls." Especially the State might well consider how best to arrange for the conversion of natural gas to methanol and ways of removing butane, propane, and other LPG's "from the natural stream prior to transportation or sale in interstate commerce."

We pledge our full support of prompt and responsible legislative action as suggested in the conclusion stated in the Moody Report that will effectively secure for Alaskans the

Senator John Rader, Chairman -3-

February 5, 1976

opportunity to make the best use of the State's natural gas resource. It strikes us as an urgent necessity that strong action on these vital issues be taken now without further delay. Clearly, at this point the regulation and taxation are less significant than stimulation and encouragement to make wise use of our resources.

Sincerely yours,

Dave Rasley
Dave Rasley, Secretary-Treasurer
Central Labor Council

Wally Baer
Wally Baer, General Manager
Chamber of Commerce

James Kelly
James Kelly, Manager, Fairbanks Chapter
Associated General Contractors

John C. Morris
John C. Morris, M.D., Fairbanks
Chairman, OMAR

J.A. Kornfeind
J.A. Kornfeind, Manager, Alaska Chapter
National Electrical Contractors Assn.

Al Seeliger
Al Seeliger, Secretary-Treasurer
Fairbanks Industrial Development
Corporation

WRW/kb

- cc: Members, Committee
- Senator J. Butrovich
- Representative F. Brown
- Senator T. Stevens
- Senator M. Gravel
- Congressman D. Young
- Governor J.S. Hammond
- Commissioner L. Motley
- Commissioner G. Martin

OUTLINE OF TESTIMONY TO THE GAS PIPELINE IMPACT COMMITTEE

I am Thomas R. Stahr, Manager of the Municipal Light and Power Department (ML&P) of the Municipality of Anchorage. I am testifying on behalf of the Municipality of Anchorage.

Municipal Light & Power consumed 6.3 Billion cubic feet (BCF) of natural gas for electric power generation in 1975. Our projections indicate 14.6 BCF of gas will be required by 1985. The projected figure is based on the use of waste heat recovery and other conservation measures. Significant improvements in efficiency cannot be anticipated beyond then so the annual increase in usage will be somewhere between 6 and 12%, 8-9% appearing as most likely unless major hydro power projects are built. In the latter case, natural gas consumption for power generation will likely decrease somewhat.

Alaska Gas and Service Company states their total sales are approximately 30 BCF for all purposes and anticipate a one BCF increase annually. It is our (ML&P) opinion they have slightly under-estimated the increase in electric power generation but the difference is not critical.

The Stanford Research Institute in their report titled "Natural Gas Demand and Supply to the Year 2000 in the Cook Inlet Basin of South-Central Alaska" projects a household-commercial usage of 55 BCF by the year 2000 and requirements for electric power generation as high as 150 BCF per year. Based on the previously cited study and general considerations it appears that the local needs of the area plus the proposed exports cannot be supported over the next 25 years by the now known reserves in the Cook Inlet area. While it is likely that additional local sources will be found, there is no certainty to this. Even if Hydroelectric power becomes available we certainly do not have a secure energy future unless additional reserves are secured. I believe the needs of Alaska should be served before our energy resources are irretrievably committed to others.

Commissioner Guy R. Martin
Chairman, Alaska Royalty Oil and Gas
Development Advisory Board
Department of Natural Resources
Juneau, Alaska

I have been authorized by the El Paso Company to make a formal proposal to purchase the State of Alaska's royalty gas which is excess to the State's needs in Alaska. The following is a draft Memorandum of Agreement which sets forth El Paso's proposal:

(Quote)

WHEREAS, THE EL PASO COMPANY (El Paso), either singly or in conjunction with others is willing to construct and operate facilities to transport natural gas in a large diameter pipeline from the North Slope of Alaska across Alaska to a point on the south central coast, providing outlets for markets enroute, and thence by LNG tankers to markets in the lower forty-eight states ("The Alaska Project");

WHEREAS, the implementation of the plan contemplated by the Alaska Project is in the maximum interest of Alaska and the nation in coping with the critical energy shortage; and

WHEREAS, the State of Alaska ("the State") is entitled to take in kind its royalty share of natural gas produced on state-owned lands within Alaska ("Royalty Gas");

NOW THEREFORE, to the end that the Alaska Project may be realized and the State's objectives achieved, the parties hereto agree as follows:

1. El Paso agrees that the Alaska Project will be constructed and operated in a manner suitable to the handling of the State's Royalty Gas to achieve its objectives herein set forth;

2. The State, having indicated a desire to make its Royalty Gas available for use within the state, will authorize such gas to be delivered to the Alaska Project for transportation to such points along the route of the pipeline as it shall designate;

3. Those quantities of the State's gas determined by it to be surplus to its economic and sociological needs ("Surplus Gas") shall be sold to and purchased by El Paso at the terminus of the pipeline;

4. The charge for the transportation of the State's Royalty Gas shall be that fixed by the appropriate regulatory agency;

5. El Paso shall pay the State for the Surplus Gas at a rate equal to the highest price paid by any responsible purchaser from time-to-time for gas of which the State's Royalty Gas is a portion;

6. If from time-to-time the State shall have available to it additional quantities of Royalty Gas, El Paso agrees to transport and/or purchase such additional quantities of gas on the same terms and conditions set forth herein;

7. The term applicable to the purchase of the Surplus Gas shall be for a period of such years and for such amounts as shall be determined by the State to be surplus to its needs. The State agrees to quantify these amounts and to enter into a further definitive agreement to implement the Alaska Project within one month after signature of this agreement;

8. The State may withdraw any portion of its Surplus Gas from sale to El Paso whenever additional gas is made available to El Paso by others in a volume equal to that withdrawn by the State;

9. At the end of the term of the agreement which will be entered into pursuant to paragraph 7 herein, the State shall have the option to sell and El Paso agrees to purchase the volumes of such gas then determined by the

State to be surplus to its economic and sociological needs for an additional term of similar duration and upon the same terms herein set forth;

10. The undertakings of both the State and El Paso are subject to the receipt of all requisite government approvals, provided, however, that either party shall have the right to cancel this agreement upon thirty (30) days written notice to the other party if El Paso's application to construct and operate the Alaska Project is denied by the Federal Power Commission, or if the certificate which may be issued contains conditions which are unacceptable to El Paso, or to the State, or conditions which render El Paso unable to perform its contract with the State; and

11. At the appropriate time, the State and El Paso will execute a definitive agreement which shall incorporate the general principles covered by this Memorandum of Agreement and which shall include other terms and conditions as may be required and agreed upon.

DATED this _____ day of _____, 1975.

THE STATE OF ALASKA

EL PASO COMPANY

By: _____

By: _____

(End Quote)

Prompt execution of such an agreement will achieve the following:

- A. Express to the Federal Power Commission the State's position on ownership of its royalty gas while being transported within Alaska.

- B. Preserve the State's freedom to determine the best uses of its royalty gas within the State, while insuring a ready market for the surplus royalty gas.
- C. Insure that the State receives the best price for its surplus royalty gas.
- D. Demonstrate by affirmative action the State's support for the Trans-Alaska Gas Pipeline, thereby strengthening the position of El Paso in the current hearings before the Federal Power Commission.

If the Board wishes to revise the agreement, discuss its provisions with El Paso representatives, or requires additional data from El Paso, we are prepared to respond promptly.

Thank you for your consideration of our proposal.

JOHN C. BENNETT
VICE PRESIDENT
EL PASO ALASKA COMPANY

El Paso COMPANY

2727 ALLEN PARKWAY
P.O. BOX 2185
HOUSTON, TEXAS 77001
PHONE 713 524-3911

HOWARD BOYD (CHAIRMAN OF THE BOARD)

February 11, 1976

Senators Henry M. Jackson
and Warren G. Magnuson
United States Senate
Washington, D. C. 20510

Dear Messrs. Chairmen:

Thank you for the opportunity to contribute to the updating of your respective committees on the vital question of how and when Prudhoe Bay natural gas will reach the consumers of the United States. Enclosed are responses to the questions recently published by your committees. I hope you and your colleagues will find our contribution useful.

Having worked intimately with LNG projects for some thirteen years and having devoted five years of thought and effort to the Alaskan proposal, I hope you will find some general observations concerning El Paso's Trans-Alaska Project worthy of consideration.

There are many questions of fact which cannot be answered with absolute accuracy until a project of this unique magnitude has been undertaken. Costs of materials, wage rates, inflation rates, future taxation policies, reservoir deliverability--none of these facts can be finally determined five to six years before the project will come on-stream. Great effort has been expended to quantify such factors, but they will remain open to argument until actual implementation of the project refines the data once and for all. It is imperative that we focus on those major elements of decision-making which, unlike the details of execution, are now well known and which facilitate a response to the central question: How can Prudhoe Bay natural gas be delivered to American consumers?

There are basically four issues: timing, economics, environmental impact, and security.

First, there is timing. Any delay in bringing the gas to market will increase hardship throughout the country, escalate costs, and erode consumers' confidence in their governmental and industrial institutions. The trans-Alaska project will be completed sooner than the trans-Canadian project (Arctic Gas) for several major reasons:

- The availability of Alyeska's haul road, work pads, camps, and equipment.
- Only American approvals are required to launch the El Paso project.

AGO 545940

- Litigation protesting the trans-Canadian project's crossing of the Arctic National Wildlife Range could delay construction for years.
- Alaskan native claims are settled; agreement even to negotiate Canadian native claims is still in the future.
- The critical cooperation of the State of Alaska is assured in expediting our project's execution.
- The cooperation of American Labor is assured (44 national and international unions support our project).
- The Department of Interior's "Report to the Congress" estimates that the risk of delay in completion of El Paso's project is half that of the trans-Canadian project.

The second issue is economics. The trans-Alaska project will benefit the United States as follows:

- It will provide 9.3 billion dollars more in taxes to U. S. governmental entities than will be paid by the trans-Canadian project.
- Were the trans-Canadian project approved, the American consumer would pay (at present tax rates) more than 7 billion dollars in Canadian taxes, versus zero for the trans-Alaska project.
- It will provide more American jobs than will the trans-Canadian project--by a margin of 345,000 man-years.
- El Paso has committed to procure all possible goods and services within the American economy, in contrast to billions of dollars to be spent by the trans-Canadian project in Japan, Canada, and Europe.
- Interstate pipeline systems have not been able to add new supplies of gas sufficient to offset the decline in existing sources. The trans-Alaska project will utilize the idle capacity in these existing systems--presently being paid for by the American consumer--in bringing Alaskan gas to markets served by these systems.
- If the Arctic Gas project is viewed under realistic assumptions, neither project would enjoy a significant advantage in the cost of transportation. If credit be given to the trans-Alaska project for the huge amount of additional U. S. taxes paid by it, the advantage is tilted in its favor. Construction changes and delays experienced in building across thousands of miles of unpenetrated hostile terrain selected by Arctic Gas could result in a dramatic advantage in favor of the trans-Alaskan route.

- 120
- All of the U. S. consumers' payments for El Paso's transportation of gas will remain in the U. S. economy; under the trans-Canadian project, more than half of such payments would flow into the Canadian economy (for twenty-five years).
 - By redesigning certain of the liquefaction facilities, the "shrinkage" (consumption of natural gas) of the trans-Alaska project is substantially the same as the trans-Canadian project. However, in the trans-Alaska project, that portion of the "shrinkage" attributable to the transformation of gas into a mass of "super cold" will be available for future use in the making of industrial gases and in food processing, as now employed in connection with LNG projects in France and Japan, and for other uses.
 - All aspects of the trans-Alaska project over its entire life will be subject exclusively to the national interest of the United States as expressed from time to time by the U. S. Congress and implemented by the Federal Power Commission.

Third, the widespread support of El Paso's project among environmental groups (both American and Canadian) stems from persuasive facts:

- While El Paso's pipeline will follow the routing of Alyeska's oil pipeline (in the most exhaustively studied corridor in the world), the trans-Canadian project would lay 5500 miles of pipe, much of it in new corridors in Canada and the United States.
- The trans-Canadian project would require more than five times as many minor waterway crossings, and six times as many major waterway crossings as will El Paso.
- Concerning LNG technology, the U. S. Coast Guard has reported that LNG shipment is among the safest seagoing operations being carried on today. LNG has been shipped for more than twelve years--covering more than 1400 deliveries--without a cargo release.

There is also the question of security--not in the sense of a threat of war, but peacetime requirements for pipeline security and the need for future expansion as other supplies of gas and oil in Alaska (e.g., NPR-4 and the Beaufort Sea) are produced:

- The Department of Defense has concluded that the "Alaska-LNG route permits full U. S. physical control and does not require reliance on a foreign government for defense in war and security in peace."

- Were the trans-Canadian project approved, future expansion of pipeline capacity in order to market additional increments of Alaskan gas would be subject to Canadian regulatory approval, Canadian corporate control, and Canadian political factors.
- Failure to obtain timely expansion of a trans-Canadian line could adversely affect production of new Alaskan oil discoveries, with which additional natural gas may be associated, including the oil produced in the Naval Petroleum Reserve contiguous to the Prudhoe Bay field.
- The recently initialled ad referendum agreement with Canada provides no answer to American concerns regarding the foregoing. In addition, it does not provide guarantees against increased provincial ad valorem taxes, etc. As to this latter aspect, the State Department is on record that "the impact of State and Provincial taxes on an Arctic pipeline and other issues relating to a specific pipeline can most effectively be addressed in the context of a protocol negotiated after the approval of the treaty." (Emphasis added.)

I might add that support in Canada for the Foothills and Polar Gas all-Canadian projects to market Canada's arctic reserves raises serious doubts as to whether the Arctic Gas project will gain Canadian approval. Neither Congress nor the Federal Power Commission can assure that the numerous Canadian approvals will be forthcoming within the critical time frame facing this country, if at all. For example, the ruling National Liberal Party adopted a resolution at its November, 1975 convention giving first priority to northern Canadian pipeline schemes that are all Canadian in ownership and which are designed to serve the Canadian public first.

Again, my thanks for this opportunity to contribute to the record of your deliberations. El Paso is at your service should you feel that we can be of help in your consideration of this vital issue of delivering Prudhoe Bay natural gas to the American people as quickly, economically, and securely as possible with an absolute minimum of adverse environmental effects.

Very truly yours,



Enclosures

TESTIMONY OF HOWARD A. SLACK, VICE PRESIDENT
ATLANTIC RICHFIELD COMPANY
BEFORE THE GAS PIPELINE IMPACT COMMITTEE
JUNEAU, ALASKA
FEBRUARY 19, 1976

Mr. Chairman, my name is Howard A. Slack. I am a Vice President of Atlantic Richfield Company and Manager of our North American Producing Division's Alaska Region. I am responsible for Atlantic Richfield's exploration and production activities in the State of Alaska and the adjacent offshore areas.

Atlantic Richfield Company welcomes the opportunity to assist the Committee in its deliberations today. I will address the three topics set forth in your letter of January 30, 1976 - namely, the Rush Moody Report, the State's Reservoir Analysis, and Royalty Gas Options - and I will endeavor to be responsive to the several specific questions raised in your letter.

THE RUSH MOODY REPORT

Mr. Moody's "Legal analysis of issues relating to natural gas transportation" has been studied by Atlantic Richfield's counsel. We do not disagree in any material respect with the principals of

law discussed by Mr. Moody. We do, however, note that Mr. Moody's suggestions concerning State taxation options in his letter to Senator Rader must be read in light of his legal conclusions that taxing schemes that burden interstate commerce or conflict with federal interests are suspect. It should also be noted, that Mr. Moody's legal memorandum and cover letter of January 14, 1976, appear to suggest that the State could, among other things, employ its "as yet unused powers of taxation", including new or increased taxes on producers such as Atlantic Richfield, as a counter to "bargain effectively" with Federal agencies regarding route selection and reservations of gas for State usage. To the extent that Mr. Moody's comments might be construed to advocate such a course of action, we would have contrary views.

As a first step toward a decision concerning natural gas sales, the State should decide whether or not it plans to exercise its option as set forth in its oil and gas leases to take royalty gas in kind and market this production separately from working interest gas. We believe that a prompt decision to permit royalty gas in excess of the State's needs to flow to markets in the South 48 States is essential to both maximize state gas royalty revenues and help insure the viability and early construction of a gas transportation system from the North Slope area. However, to insure that provision will be made for the State's gas needs, we endorse Mr. Moody's view that "the State's power to call upon the gas resource

when needed in the future can, in reasonable probability, be exercised if the State's rights and obligations are fully spelled out, fully presented to the Federal Power Commission (FPC) and accepted by the FPC as an integral part of the transportation system which is certified by the FPC". Once basic agreement has been reached between the State and the FPC, the prospective purchasers of royalty gas can be designated by the State and contracts negotiated which will permit reasonable reservations of gas to meet future Alaskan needs. Atlantic Richfield supports, and believes that Mr. Moody's legal analysis supports, a State policy which would favor:

- (1) early construction of a gas transmission system from the North Slope of Alaska to the South 48 States,
- (2) the marketing of State royalty gas in the South 48 States coupled with a reasonable reservation of royalty gas volumes to meet future Alaskan needs, and
- (3) the adoption of taxation and regulatory policies which would be reasonably calculated to foster such a gas transmission system. To further insure the economic viability of a North Slope gas transmission system, Atlantic Richfield also urges the State to adopt a policy which will include cooperation with Federal regulatory agencies and the oil and gas producing industry to bring about prompt exploration and development of undiscovered Alaskan gas reserves.

In our view, both the national interest and the best interests of the State of Alaska require the earliest possible certification and construction of a viable gas transmission system to permit early gas sales. Design and optimization of such a gas transmission system is dependent upon the proved and potential volume of gas reserves which are estimated to be available for delivery. The State's royalty gas share, even if subject to future Alaskan needs, is a significant factor in determining both economic feasibility and line design. We, therefore, urge an early clarification of the State's intention and a prompt and cooperative resolution of its posture with the FPC. Massive investments will be required to facilitate early gas sales, and we urge the State to adopt and maintain fiscal policies which will facilitate such investments and not handicap an industry already burdened with enormous exploration and development costs.

Atlantic Richfield Company has responded to the Federal Power Commission's interrogatories in connection with the pending FPC proceeding pertaining to transportation of Alaskan natural gas. A copy of the Company's submittal to the FPC is attached to the written copy of my testimony as you have requested.

With regard to the Committee's inquiry pertaining to Atlantic Richfield's commitments for the sale of gas, the company, in accordance with Federal Power Commission Order No. 499, entered into advance payment agreements with Panhandle Eastern Pipeline Company and Texas

Eastern Transmission Corporation committing to each of them a call on 20% of Atlantic Richfield's share of the Prudhoe Bay field gas production. A funding agreement was signed with Pacific Lighting Gas Development Company (PLGD), granting the California company a call on the remaining 60% of Atlantic Richfield's Prudhoe Bay gas. On December 31, 1975, the FPC retroactively terminated the advance payments program for Alaska and the California PUC then scheduled hearings to reconsider its prior approval of the Atlantic Richfield - PLGD funding agreement. As a result of these actions the PLGD funding agreement has been terminated and the advance payment agreements with Panhandle Eastern Pipeline Company and Texas Eastern Transmission Corporation will be terminated if the decision of the FPC becomes final.

While this action on the part of the FPC purports to be in the public interest, in our opinion it is misguided and contra productive where the State of Alaska is concerned in that:

- (1) Cancellation of all advance payment agreements will deprive U.S. gas transmission companies and distributors of their former rights to purchase Prudhoe Bay gas and lessen their incentive to invest equity capital in any Alaskan gas transmission facility.
- (2) Alaska producers, including the owners of the Prudhoe Bay Field, will be deprived of a source of financing - financing which, in the absence of current Alaskan gas

revenues, is necessary to insure industry capability to find new reserves and develop known reserves at the earliest possible date.

Atlantic Richfield's position as to its gas sale commitments has been clearly set forth in our response to the FPC interrogatories. As we indicated in that response, all of our agreements with prospective purchasers contemplated the ability and willingness of such purchasers to accept deliveries of Prudhoe Bay gas through any gas transmission system which was certificated and constructed. Such an understanding should be an essential ingredient of any other commitment of Prudhoe Bay gas made prior to selection and certification of a gas transmission system. Indeed, both competing route proposals contemplate nationwide delivery capability.

Hence, relative to SCR 66, we can categorically state that our existing commitments to Panhandle Eastern and Texas Eastern are in no way detrimental to the certification of a trans-Alaska natural gas pipeline nor can we conceive of any situation in which we would make a pre-commitment of Prudhoe Bay gas to a market which could not be served by any gas transmission system that might be constructed.

THE STATE'S RESERVOIR ANALYSIS

The Committee has expressed a concern about the effect of the recently published State of Alaska, Department of Natural Resources Study on Sadlerochit Reservoir conservation and specifically whether this study, or the lack of production history, will affect the FPC decision on certification of a gas transmission system. Atlantic Richfield does not believe that the Van Poolen study which was done for the Department of Natural Resources will influence the FPC decision on route selection or certification, nor do we expect it to have any adverse effect upon the financing of the approved gas transmission project. The various points raised in the Van Poolen study had been recognized and incorporated in our studies prior to the time of the Van Poolen report. We have found nothing in the report which will lead us to alter in any way our plans for Prudhoe Bay gas production.

The studies of the Prudhoe Bay Field Sadlerochit Reservoir which have been made by Atlantic Richfield Company and those reported by the state and federal governments differ in a fundamental and important manner. That difference lies in the fact that the various reservoir simulation studies of the Prudhoe Bay Field that have been published were undertaken with different objectives in mind. On the one hand, our studies have as their objective the optimum reservoir management for maximum economic

recovery of oil and gas. On the other hand, we believe the state and federal studies have as their objective the determination of recoveries of either oil or gas for a range of different operating conditions.

The question has been raised concerning the reliability of a model in the absence of production history. It is certainly true that the availability of production history can provide a useful check of a study and a basis for modification. However, Atlantic Richfield has a high degree of confidence in its predictions of Prudhoe Bay reservoir performance. This confidence stems from the fact that in the Prudhoe Bay modeling effort the major elements of the model have been subjected to thorough sensitivity testing. In sensitivity testing the first step is to identify those parameters having the greatest effect on the answer and define those parameters to the fullest extent possible. Our thorough application of this approach and the subsequent follow-up work, both field and laboratory, has given us a high degree of confidence in our current forecast of the Prudhoe Bay Field performance. We are convinced that, although some adjustments may be made to the model as production history is developed, our present studies are adequate to demonstrate that, from a reservoir performance standpoint, early gas sales from the Sadlerochit reservoir would be non-injurious.

As we stated in our response to FPC Question II(5) of the "Interrogatories", Atlantic Richfield believes that the Trans Alaska oil pipeline can be expected to begin operation in Mid-1977 at 600,000 barrels per day, reach a sustained throughput of 1.2 million barrels per day before year's end and have a 1.5 million barrels per day production rate commencing on January 1, 1979. We also believe that at such oil production rates, gas sales of 2.0 to 2.5 billion cubic feet per day would be consistent with good reservoir management.

ROYALTY GAS OPTIONS

We have made no study of the market for State royalty gas inside of Alaska. As to the market for State royalty gas outside of Alaska, in our view the opportunities are virtually unlimited. We are aware that the Department of Natural Resources has solicited offers from potential gas buyers and that many have responded. If the State should decline to separately dispose of its share of the gas, the producers, pursuant to their leases, would be obligated to sell such gas on the same terms that producers' gas would be sold. As noted earlier, prompt State action to resolve the "in kind versus in value" issue and active cooperation with the FPC will expedite early construction of the optimum gas transmission facility.

Thank you again, Mr. Chairman, for affording me the opportunity to testify before your Committee today. Atlantic Richfield's response to your letter of January 15, 1976, is also attached to my statement. If you have any questions concerning my testimony today, I shall be happy to attempt to answer them.

Alaska Region
Post Office Box 360
Anchorage, Alaska 99501
Telephone 907 277 5637



Howard A. Slack
Vice President &
Resident Manager

February 19, 1976

Senator John Rader, Chairman
Gas Pipeline Impact Committee
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Senator Rader:

Thank you for your letter of January 15, 1976, and the opportunity to comment on the recently published study entitled "Prediction of Reservoir Fluid Recovery, Sadlerochit Formation, Prudhoe Bay Field" which was prepared by H. K. Van Poolen and Associates for the State of Alaska. The specific questions set out in your letter and our responses are as follows:

QUESTION NUMBER 1

What effect does the recent study, "Prediction of Reservoir Fluid Recovery, Sadlerochit Formation, Prudhoe Bay Field" have on marketing plans for Prudhoe Bay gas?

ANSWER

We do not expect the referenced study prepared by Van Poolen and Associates to have any effect on our plans for marketing Prudhoe Bay gas. The observations reported in this study were recognized and considered in the studies we have prepared with regard to sale of gas from the Prudhoe Bay Field.

QUESTION NUMBER 2

How does this study differ from industry and federal studies?

ANSWER

The state and federal studies differ from Atlantic Richfield's studies primarily because they were undertaken with different objectives in mind. The stated purpose of the Van Poolen

study prepared for the State of Alaska was to "evaluate the oil recovery potential from the Sadlerochit Reservoir at Prudhoe Bay under a number of different operating conditions." The Aerospace study prepared for the Department of the Interior was designed "to determine estimates for gas reserves and deliverability for a range of reservoir characteristics and operating assumptions." These objectives are much more limited in scope than the objectives of our studies. Over the past five years we have made and are continuing to make reservoir studies oriented toward maximizing economic recovery of both oil and gas reserves. In addition to the broader objectives, our conclusions benefit from the inherent advantages of a more lengthy study time and better analytical resources as well as the fact that we are closer to the source of physical data, and better able to define the key input parameters.

QUESTION NUMBER 3

How accurate can a model be without production history?

ANSWER

In Prudhoe Bay Field, extensive physical data has been gathered on the Sadlerochit Reservoir from well logs, cores, geological studies, laboratory analysis of fluid samples, well tests, etc. These data have been used in preparing mathematical reservoir simulation models. Reservoir performance history associated with field production is very useful in reservoir modeling, but it is not essential. Such data are commonly used to adjust reservoir models so that their calculated performance will match history. As longer periods of performance are compared to the model, confidence in the model's ability to predict future performance is usually increased. However, history matching during the primary stage of production does not necessarily assure a reasonable prediction of secondary recovery performance. Some of the most important parameters in the projection of future performance may not be calibrated during the history match.

Although production history is a valuable source of information for developing reliable reservoir models, sensitivity testing of the model parameters is also important. Without production history, sensitivity testing becomes essential in establishing confidence in the model forecasts. The first step in such testing is to identify those parameters having

the greatest impact on the answer and then concentrate on defining those parameters to the fullest extent possible. We have conducted numerous such sensitivity studies for the Prudhoe Bay Field.

During the past five years, we have made very detailed studies of the Sadlerochit Reservoir for alternative reservoir management programs and we are continuing to make such studies. In view of the extensive physical data available for use in preparing the model and the sensitivity studies that we have made with regard to the key factors influencing reservoir performance, we have a high degree of confidence that the effects of gas production from the Sadlerochit Formation can be predicted with reasonable accuracy.

QUESTION NUMBER 4

Will some production history be necessary before an accurate model is established that will prove feasibility of a gas pipeline for marketing of Sadlerochit gas?

ANSWER

No. As expressed in our answer to question 3, we believe the extensive reservoir data available and the detailed reservoir model studies that have been and are being made based on this data will provide reasonably accurate results that are fully adequate for making decisions with regard to timing and rate of gas sales.

QUESTION NUMBER 5

How critical are the results of this study in obtaining FPC certification and financing for the gas pipeline project?

ANSWER

Conditions leading to the observations made in the Van Poolen study have been recognized and considered by industry in developing plans for marketing of Prudhoe Bay gas. We see no reason for such study to have any impact on the FPC decision on pipeline certification or upon the financing of a gas pipeline project.

Senator John Rader, Chairman
Gas Pipeline Impact Committee
February 19, 1976

Page Four

I want to thank you for the opportunity to comment on this important study. If you have any additional questions or if we can be of further assistance, please let me know.

Yours very truly,

Howard A. Slack.

Howard A. Slack

HAS/jt

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL POWER COMMISSION

EL PASO ALASKA COMPANY, ET AL.) Docket No. CP75-96, et al.

ATLANTIC RICHFIELD COMPANY RESPONSES TO INTERROGATORIES

I. POLICY

QUESTION 1. Were you ever a member of a group investigating the feasibility of bringing gas from Prudhoe Bay and/or the Mackenzie Delta to the Lower 48 states?

ANSWER 1. Yes.

QUESTION 1. a. If yes, please describe your participation in the group.

ANSWER 1. a. Atlantic Richfield Company has participated in two such feasibility studies. Atlantic Richfield joined with El Paso Natural Gas Company in a study to determine the economic feasibility of bringing gas from Prudhoe Bay to the West Coast of the United States by means of a trans-Alaska gas pipeline, gas liquefaction and regasification facilities and LNG tankers. Atlantic Richfield contributed its expertise and financial support to this study from April 23, 1973 to October 23, 1974.

Atlantic Richfield has participated in a study to determine the economic feasibility of bringing gas from Prudhoe Bay and the Mackenzie Delta by means of a trans-Canadian pipeline to markets in Canada and the Lower 48 states. Atlantic Richfield contributed its expertise and financial support to this study from July 14, 1970 to November 30, 1975.

QUESTION 1. b. Are you still a member of such a group; and if not, please explain the reasons for departing.

ANSWER 1. b. No. Atlantic Richfield withdrew from these groups since we felt that the purpose for which we had joined, i.e., to determine the feasibility of transporting arctic gas to the Lower 48 states, had been accomplished and that our further participation was unnecessary. We continue to cooperate with both groups.

QUESTION 2. Why haven't firm gas purchase contracts been executed for Prudhoe Bay?

ANSWER 2. As a result of the FPC's Order of December 31, 1975, in Docket R-411, et al., and subsequent action by the California PUC in, sua

sponte, reopening of CPUC decision #84729, Atlantic Richfield's funding agreement with Pacific Lighting Development Company (PLGD), which gave PLGD a call on 60% of its Prudhoe Bay gas, has been terminated. Our advance payment agreements with Texas Eastern Transmission Corporation and Panhandle Eastern Pipeline Company covering the remaining 40% of Atlantic Richfield's Prudhoe Bay gas will be terminated should the FPC Order become final. Under present circumstances we have no basis for negotiation of a definitive gas purchase contract. Neither unit agreements nor a plan of development for the field have been formally submitted to or approved by the State of Alaska.

Additionally, in light of certain language appearing in the Commission's Order of December 31, 1975, in Docket No. R-411, et al., we are uncertain as to whether any gas purchase contract would be certificated or if the Commission would require a full-blown allocation case for North Slope gas.

QUESTION 3. Please explain the relationship of a unitization and operation agreement for Prudhoe Bay to the execution of gas purchase contracts.

ANSWER 3. The Prudhoe Bay Field consists of a gas cap and an oil rim. The field has a diversity of ownerships in the tracts with differing interests in the gas cap and oil rim. Efforts are underway to unitize the entire field so that it might be developed and operated in the most efficient manner. The plan of development agreed to by the producers must then be approved by the State of Alaska. Until such time as these events occur, it is not known what precise amount of gas production and oil production will be owned in the unit by each party nor is it known to what extent and at what time the State will permit gas sales.

QUESTION 4. Do you have any present intention to provide equity for either the El Paso Alaska project or the Arctic-Canadian gas project should either of them be issued a certificate?

ANSWER 4. No.

QUESTION 5. If the natural gas pipeline and distribution companies are unable to commit the amount of equity required by lenders as necessary for either the Arctic Gas or the El Paso project, would your company be willing to help provide some of the needed equity?

ANSWER 5. A decision on the question would be dependent upon conditions at the time such a need becomes apparent; however, it seems highly unlikely that our other capital requirements would permit such an investment.

QUESTION 6. Will your company bear the cost of gathering and treatment facilities on the North Slope? If no decision has been made on this, what factors would influence a decision and by when would such a decision have to be made?

ANSWER 6. The cost of gathering and treatment facilities on the North Slope will be borne in accordance with gas purchase contracts yet to be negotiated. Under our remaining advance payment agreements (which will be terminated in the event the Commission's Order issued December 31, 1975, in Docket No. R-411, et al., becomes final), Atlantic Richfield would bear the initial cost of installing the gas gathering system but would have the option to require the gas purchaser to purchase all gas handling facilities. A decision relative to exercising such option would have been made at the proper time in light of circumstances existing at the time. It was contemplated that the gas conditioning

plant (treatment facilities) would be installed and operated by or for the gas purchasers.

QUESTION 7. Can your company categorically guarantee that the purchase price of Prudhoe Bay gas under future gas purchase contracts would be no higher than the commodity price of gas in the market area to be served adjusted for applicable cost to market?

ANSWER 7. No. So long as the price of natural gas sold for resale in interstate commerce is subject to Federal Power Commission regulation, producers will receive no more than the regulated price permitted at the wellhead. In the event of price decontrol, Atlantic Richfield hopes to receive fair market value at the wellhead for its gas. The commodity price (which is subject to many variables) of gas in any particular market area to be served, adjusted for applicable delivery cost to that market, may or may not have relevance in determining the regulated rate or fair market value at the wellhead.

QUESTION 8. Would your company oppose any attempt by a potential gas purchaser to place a minimum daily delivery volume provision in a gas

purchase contract for the Alaskan North Slope?

ANSWER 8. Yes. We cannot guarantee to deliver any specific volume of gas at any period of time. As mentioned in answer I, 3., the unitization agreement and State action will have a bearing on the volume of gas that can be sold by each company at Prudhoe Bay. As in all oil or gas fields, it is impossible to predict with certainty what volume of gas will be available from day to day.

QUESTION 9. How did you choose or how will you choose a purchaser or purchasers for your Prudhoe Bay gas? Explain the steps that will be taken or have been taken in this matter.

ANSWER 9. In July, 1974, Atlantic Richfield sent letters to 17 prospective gas purchasers, requesting bids for its share of the natural gas in the Prudhoe Bay Field. With the FPC's Order No. 499 advance payment program in mind, Atlantic Richfield stated that it was interested in offers which include interest-free loans repayable over time as gas is delivered.

Eleven of the 17 companies responded by making offers for Atlantic Richfield's Prudhoe Bay gas. Interstate pipeline companies generally offered to make advance payments

-8-

pursuant to Order No. 499 in the form of interest-free loans. Pacific Lighting Gas Development Company (PLGD) offered to make an advance payment for Prudhoe Bay gas, but stated that it was not feasible for PLGD to raise the funds needed to make an interest-free loan. Instead, it offered to make payments to Atlantic Richfield to cover the interest expense and other costs associated with Atlantic Richfield's raising the money through the sale of a production payment.

The offers made by Pacific Lighting Gas Development Company (PLGD), Panhandle Eastern Transmission Corporation and Texas Eastern Pipeline Company, most nearly fulfilled Atlantic Richfield's needs and we proceeded to conclude agreements with them. As noted in the answer to question I (2), the PLGD agreement has been terminated and if the FPC's Order in Docket R-411, et al., becomes final, the remaining advance payment agreements will be terminated. All of these agreements expressly recognize that certification and construction of either of the

AGO 545965

proposed Alaskan Gas transmission systems would be satisfactory to both seller and buyer.

In light of the confusion brought about by the Commission's Order in Docket No. R-411, et al., and other uncertainties existing at this time, Atlantic Richfield is in the process of reevaluating all options open to it and has made no decision as to its future action.

II. RESERVES

QUESTION 1. Please describe your exploration and development activities on the North Slope of Alaska through 1975 indicating, among other things, the following:

a. Total amount of acreage held in Prudhoe Bay Field as defined by the Alaska Oil and Gas Conservation Committee;

ANSWER 1. a. Atlantic Richfield Company holds interests in 181,689 gross acres or 94,490 net leasehold acres in the Prudhoe Bay Field as defined by the Alaska Oil and Gas Conservation Committee.

QUESTION 1. b. Number of wells presently drilled in the Prudhoe Bay Field and the success ratio of well completions;

-10-

ANSWER 1. b. Fifty-three wells have been drilled on the Atlantic Richfield Company/Exxon Company, U.S.A. acreage in the Prudhoe Bay Oil Pool limits. Six of these wells are not commercial.

QUESTION 1. c. An estimation of the total amount of gas reserves in Prudhoe Bay held by your company and an estimate of its deliverability;

ANSWER 1. c. DeGolyer and MacNaughton, our reserve consultant, has estimated that the proved gas reserves in the Prudhoe Bay Field total 24 Tcf of hydrocarbon gas, with Atlantic Richfield Company's net share calculated to be in excess of 7.08 Tcf. Atlantic Richfield's share of the gas deliverability from Prudhoe Bay Field will depend on the outcome of unitization. Insofar as the total field is concerned, gas production will begin with the start of oil production; but gas sales cannot begin until the gas transportation system is built, gas conditioning facilities constructed and a plan of operation which includes gas

-11-

sales is approved by the working interest owners and by the Alaska Oil and Gas Conservation Committee.

QUESTION 1. d. Total amount of acreage held on the North Slope including the offshore area outside of Prudhoe Bay and location of such leases;

ANSWER 1. d. Atlantic Richfield holds interests in 817,734 gross acres or 417,016.41 net leasehold acres on the North Slope of Alaska including the offshore portion and the interest set out in answer II, 1., a., above.

QUESTION 1. e. Number of wells drilled outside of the Prudhoe Bay Field on the North Slope, including offshore areas, their location and an indication whether they were successful; and

ANSWER 1. e. Atlantic Richfield Company has participated in the drilling of 31 wells outside of the Prudhoe Bay Field on the North Slope through 1975. These wells, their location and results are as follows:

ARCO No. 1 Colville, 25-12N-7E, Dry and Abandoned (D and A)

ARCO No. 1 Itkillik, 10-8N-5E, D and A

-12-

ARCO No. 2 Kavik, 11-3N-22E, D and A
ARCO No. 3 Kavik, 8-3N-23E, gas
ARCO No. 1 Little Twist, 34-3S-4W, D and A
ARCO No. 1 Nora Federal, 5-2N-14E, D and A
ARCO No. 1 North Franklin Bluffs,
20-8N-14E, D and A
ARCO No. 1 Schrader Unit, 18-3S-5E,
D and A
ARCO No. 1 Susie Federal, 22-2N-13E,
D and A
ARCO No. 1 Toolik Federal, 4-8N-15E,
D and A
ARCO No. 2 Toolik Federal, 5-8N-12E,
D and A
ARCO No. 3 Toolik Federal, 4-8N-9E, D and A
ARCO No. 1 Ugnu, 22-12N-9E, oil
ARCO No. 1 West Sak River, 2-11N-10E, oil
ARCO No. 2 West Sak River, 22-11N-10E, oil
ARCO No. 3 West Sak River, 26-11N-9E, oil
ARCO No. 5 West Sak River, 11-10N-10E
(confidential)
ARCO No. 6 West Sak River, 29-11N-11E
(confidential)
Pan Am Kavik No. 1, 7-3N-23E, gas
BP East Ugnu No. 1, 17-2N-10E, oil
BP East Umiat No. 1, 19-1S-2E, gas
BP Kemik Unit No. 2, 6-1S-21E, D and A
BP Itkillik Unit No. 1, 11-1N-6E, D and A
BP Shale Wall Unit No. 1, 2-5S-5E, D and A

AGO 545969

Exxon East Mikkelsen No. 1, 17-9N-21E,
D and A

Forest Kemik Unit No. 1, 17-1N-20E, gas

Mobil Beli Unit No. 1, 8-4N-23E, D and A

Mobil Echooka Unit No. 1, 32-1N-16E,
D and A

Mobil West Kadleroshilik No. 1, 14-5N-14E,
D and A

Texaco East Kuparuk Unit No. 1, 10-2S-8E,
D and A

Texaco West Kavik Unit No. 1, 20-5N-20E,
D and A

QUESTION 1. f. Total amount of gas reserves estimated to be held on non-Prudhoe Bay field lease and their deliverability.

ANSWER 1. f. DeGolyer and MacNaughton, our reserve consultant, has not assigned any proved reserves on the North Slope outside the Prudhoe Bay Field.

QUESTION 1. Explain the method and data used in determining any reserve estimates.
(cont'd.)

ANSWER 1. DeGolyer and MacNaughton has said that "since Prudhoe oil pool is essentially a shut-in field with no reservoir performance data, we have based our reserve estimates on the volumetric method. By volumetric method we mean that we have used individual well data -

-14-

logs, cores, fluid samples, and flow tests - to determine the sand thickness in each well and to determine certain average reservoir properties. We then used standard mapping techniques to determine the oil and gas in place throughout the field, including the Atlantic Richfield acreage. Then we have estimated an overall recovery factor based on our experience with other fields of similar reservoir characteristics."

QUESTION 2. Has your company made an independent estimate of the amount of potential reserves on the North Slope of Alaska? If yes, please describe your findings.

ANSWER 2. Yes. Atlantic Richfield has estimated the potential reserves yet to be discovered on the North Slope of Alaska using a method based on recovery factors times the cubic miles of sediment capable of containing hydrocarbons. The area included extends northward from the Brooks Range to the 300 foot water depth at the edge of the Continental platform in the Chukchi and Beaufort Seas. A large part of this area lies under the Polar ice cap. We estimate that recoverable reserves

-15-

could range up to 45 billion barrels of oil and 135 Tcf of gas. Estimates of potential reserves derived by this method for untested frontier areas are generally regarded as being optimistic.

QUESTION 3. Based upon your company's drilling experience to date, does it appear that the areal extent of the Prudhoe Bay Field as defined by the Alaska Oil and Gas Conservation Committee is larger than anticipated?

ANSWER 3. No. However, additional wells drilled on either Atlantic Richfield or other companies' acreage may allow the boundary to be moved.

QUESTION 4. Has your company studied the possibility of drilling in the Yukon-Kandik Basin, Middle Tanana Basin and Copper River Basin areas of Alaska? If yes, what do your studies indicate, what has been your past experience in such areas, if any, and what are your company's current and future plans with respect to such areas?

ANSWER 4. Yes, Atlantic Richfield has made evaluations of the Yukon-Kandik, Middle Tanana and Copper River Basins. Atlantic Richfield's experience in these basins has been as follows:

a. Yukon-Kandik Basin

Atlantic Richfield conducted a field program in the basin in 1962. Several areas of interest were found, however, the

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86 / 2

529 SCOMM16: JOINT SPEC. COMM. ROYALTY OIL & GAS 1977-78

529

structural fabric was complex and was accompanied with a very limited sedimentary section with good reservoir characteristics.

b. Middle Tanana Basin

No meaningful rocks are exposed in the basin for examination. A well drilled in the basin in 1962 revealed a thin, non-marine tertiary cover.

c. Copper River Basin

Atlantic Richfield drilled two of the eight wells in the Copper River Basin. We did not find significant shows of hydrocarbons in these wells, nor adequate amounts of reservoir quality rock. In addition, the presence of permafrost and surficial volcanic rocks make it difficult to obtain the quality geophysical data necessary for pinpointing new drill site possibilities.

We have no current plans for additional evaluation of these areas.

-17-

QUESTION 5. With respect to oil production from the Prudhoe Bay Field, what are the anticipated deliverability rates for the first 12 years? Will this affect the deliverability of your gas? What effect would a 2.25 Bcf deliverability capacity pipeline have on oil production during this period?

ANSWER 5. The production rate for the early years in the Prudhoe Bay oil field will be limited by the completion, expansion and operation of the Trans-Alaska Oil Pipeline. In later years the oil production rate (as well as gas deliverability) will be determined by field performance. It is not possible to predict with certainty either of these events. Thus, the oil production rates which can be forecast today must be viewed only as reasonable estimates.

The Trans-Alaska Oil Pipeline is expected to begin operation in mid-1977 at 600 thousand barrels per day and reach a sustained throughput of 1.2 million barrels per day before the year's end. As yet, no agreement has been reached on pipeline expansion; however, this expansion could take place by the first of 1979. We have assumed that this expansion will take place as early as possible and have

projected a 1.5 million barrels per day production rate from the Prudhoe Bay Field commencing on January 1, 1979, and continuing until field performance can no longer sustain that rate. The field performance predictions used in this production forecast are based on numerical simulation studies conducted during the past five years. These studies have been conducted for several alternative methods of reservoir management. The studies have also considered the sensitivity to many of the reservoir unknowns. Based on these studies, Atlantic Richfield believes that the following is a reasonable projection for the oil production rate from the Jurassic-Triassic formation and is consistent with 2.0 to 2.5 BCF/D gas sales:

Prudhoe Oil Pool Production^{1/} 1977-1988

<u>Year</u>	<u>Rate, MB/D</u>
1977	900 ^{2/}
1978	1,200

(cont'd.)

1/ Production forecast for the Jurassic-Triassic crude oil only, does not include condensate or crude oil from other zones, such as Lisburne or Cretaceous formations.

2/ Average for the last six months of 1977.

-19-

(cont'd.)	<u>Year</u>	<u>Rate, MB/D</u>
	1979	1,500
	1980	1,500
	1981	1,500
	1982	1,500
	1983	1,500
	1984	1,500
	1985	1,485
	1986	1,280
	1987	1,020
	1988	900

QUESTION 6. Please describe your proposed exploration and development activities for the North Slope, if any, for 1976.

ANSWER 6. A. Exploration

Atlantic Richfield will continue its geological studies on the North Slope during 1976. The Company plans to drill four exploratory wells in search of oil. We have no plans for geophysical work on the North Slope this year.

B. Development

Atlantic Richfield will be drilling development wells with two rigs through-

-20-

out 1976. This activity should result in the completion of 20 to 22 wells. In addition, eight to 10 gas injection wells will be drilled and existing wells will be completed and perforated for production.

III. FACILITIES AND COSTS

- QUESTION 1. What is the type of gas that will be produced from your Prudhoe Bay leases?
- ANSWER 1. Solution gas and gas cap gas will be produced.
- QUESTION 2. What type of facilities would be needed to process and/or treat each type of gas?
- ANSWER 2. Gas handling and conditioning facilities will be required. The gas handling facilities include the gas compression and treating facilities at the flow stations as well as the gas gathering pipelines, compression facilities, gas injection pipelines and injection wells. The gas conditioning facilities will include equipment to achieve dehydration and removal of excess liquids and carbon dioxide from the gas.
- QUESTION 3. Which facilities mentioned in interrogatory 2 will be constructed and operated by the producer and which will be required to be purchased entirely or partly by pipeline purchaser? Who will operate those owned by the pipeline?

-21-

ANSWER 3. Our advance payment agreements contemplated that the producer would construct and the gas purchaser would acquire, at Atlantic Richfield's option, those gas handling facilities from the outlet of the oil and gas separators and flash tanks at each flow station or separation center to the gas conditioning plant. No decision was made and no discussions were held as to who would operate these facilities. The gas conditioning plant (at the entrance of the gas pipeline system) would have been constructed and operated at the expense of the gas purchaser or the gas pipeline system.

These agreements have been or will be terminated if the FPC Order becomes final.^{3/}

QUESTION 4. What is the quality of the gas at the wellhead and what will be the acceptable quality for pipeline delivery?

ANSWER 4. The gas at the wellhead, in addition to containing the basic hydrocarbon constituents, also contains approximately 12% CO₂ and will

^{3/} See Answer I, 2.

be saturated with water. Although this gas could be delivered to a pipeline specifically designed to handle this quality of gas, gas purchasers (or transporters) will probably condition the gas to meet such requirements as the gas transportation system may determine.

QUESTION 5. It is noted that certain agreements between various producers on the North Slope and pipeline purchasers reserve the right of the producer to process Prudhoe Bay gas in the Lower 48 states. What type of processing is contemplated by your company, where, when and how much? What type of transportation arrangements would be necessary to implement this provision?

ANSWER 5. At the present time, Atlantic Richfield does not have in mind any specific plans for processing in the Lower 48 states. Any transportation arrangement would have to be made with the gas purchaser and gas transporter and presumably approved by the FPC.

QUESTION 6. What would be the cost of each separate facility mentioned in interrogatory 2 ?

ANSWER 6. The current estimates of costs of the gas handling and conditioning facilities are \$1.333 billion and \$877 million respectively. It should be noted that it is extremely difficult to estimate these costs at this

time due to the uncertainties of the timing of these facilities and the cost inflation which will occur prior to installation of the facilities.

QUESTION 7. How would you allocate the cost between oil and gas production with the facilities which would be either owned by the pipeline or jointly with your company? Please explain your rationale for such allocation.

ANSWER 7. We do not anticipate the joint ownership by a pipeline company and Atlantic Richfield of any facility handling oil and gas production.^{4/} If we were to utilize any facilities owned by the pipeline for such purpose, we would expect to negotiate a charge for such use.

QUESTION 8. If the Prudhoe Bay gas is to be processed through facilities owned by the pipeline or jointly by the producer, who will have benefit of the liquid products and how will the operation and maintenance costs be allocated and on what basis?

ANSWER 8. If your word "processed" is intended to mean conditioned or treated, then under the present agreements^{5/} on our Prudhoe Bay gas, Atlantic

^{4/} See Answer I, 6.

^{5/} See Answer I, 2.

-24-

Richfield would have the option to take in kind any liquid hydrocarbons incidentally recovered therein. Details were never negotiated but, since it was contemplated that the gas would be sold on a BTU basis the purchaser would have been compensated for the heating value of any liquids extracted and redelivered to the producer.

QUESTION 9. Provide the (a) length and size of the gathering facilities for your operation, (b) estimated cost of such line, (c) ownership of such lines, and for those lines to be owned by the pipeline purchaser or jointly with the producer how will costs be allocated for that portion of the facilities attributable to the transportation of gas?

ANSWER 9. (a) Assuming that your question pertains to natural gas gathering facilities, the natural gas gathering facilities consist of lines connecting the six separation centers to a conditioning facility. These lines are expected to be as follows: 30" diameter, 7 miles; 34" diameter, 5-1/2 miles; 38" diameter, 5-3/4 miles; 42" diameter, 5-1/2 miles. These data are for the entire field.

(b) The cost for these lines is currently estimated to be slightly in excess of

-25-

\$60 million.

(c) See Answer to I, 6.

- QUESTION 10. What type of design would be required for the gas gathering system, i.e., buried, above group pipe, chilling facilities, etc.?
- ANSWER 10. The gathering system will be installed on supports above ground and insulated.
- QUESTION 11. Would your cost estimates vary depending upon whether the Arctic Gas or El Paso project were certificated?
- ANSWER 11. No. We assume that the pipeline delivery specifications, both as to gas quality and pressure, would be identical for either project.
- QUESTION 12. What percentage of gas available at the wellhead will be lost in treatment and/or processing?
- ANSWER 12. We anticipate that approximately 6% of the hydrocarbon gas could be consumed in conditioning the gas to pipeline requirements. This estimate does not include fuel for operation of the Prudhoe Bay Field.
- QUESTION 13. What state approvals will have to be obtained in relation to Alaskan North Slope gas production and when will your company make the necessary filings to obtain such approvals?
- ANSWER 13. The lease owners of the Prudhoe Bay Field are actively engaged in discussions to

-26-

unitize the field. The Prudhoe Bay Field should be unitized prior to commencement of oil production and the agreement must be approved by the Alaska Oil and Gas Conservation Committee. The unitization agreement should contain a plan for the development and operation of the Prudhoe Bay Field, including gas sales timing and volumes, as well as facilities, wells and liquid production rates. The Prudhoe Bay Field owners expect to request approval of these documents during the last half of 1976.

Respectfully submitted,
ATLANTIC RICHFIELD COMPANY

BY P. T. Davis ERX
P. T. DAVIS

AFFIDAVIT

DISTRICT OF COLUMBIA)

EDWARD R. LEAHY, being duly sworn, deposes and says that he is an attorney for Atlantic Richfield Company; that he is authorized to verify and file this document; that he has examined the statements contained in the submittal and that all such statements are true and correct to the best of his knowledge, information and belief.

Edward R. Leahy
EDWARD R. LEAHY

Subscribed and sworn to before me this 13th day of February, 1976.

Sandra M. Pascoe
NOTARY PUBLIC

(SEAL) My Commission Expires: March 15, 1977

Testimony of
Exxon Company, U.S.A.
To
Joint Gas Pipeline Impact Committee
Juneau, Alaska
February 20, 1976

Mr. Chairman, Members of the Joint Gas Pipeline Impact Committee, Mr. Moody. My name is W. Ray Booth, Assistant General Manager of the Natural Gas Department of Exxon Company, U.S.A., P. O. Box 2180, Houston, Texas 77001. I am appearing on behalf of Exxon Company, U.S.A. (A division of Exxon Corporation) pursuant to your letter, Mr. Chairman, dated January 30, 1976 addressed to W. Monte Taylor.

You have requested that Exxon testify with respect to a number of matters contained in the January 30 letter. We have filed separately with the Committee a document containing our full answers thereto. My comments will summarize these answers. The principal questions relate to the State's policy with respect to the sale of royalty gas as discussed in the Rush Moody report, routing of a gas pipeline, and the effect of the gas production on reservoir behavior in the Prudhoe Bay field as reflected in the Van Poolen study.

Rush Moody, Jr. Report

Question 1 of your letter requested comments on the report prepared by Rush Moody, Jr. The legal and policy advice in the report is so extensive that it would not be appropriate to agree or comment fully. Our counsel advises

that he would generally agree with Mr. Moody's legal analysis of the effect of the Natural Gas Act on the shipments of the State's royalty gas in interstate commerce, since once it begins its path in interstate commerce, control thereof will be in the hands of the FPC.

Let me state here at the outset that we have always been aware of the right that the State has preserved in its leases to take its royalty gas in kind. We agree that the State must assess its risks in this matter and act in its best interest. Whether the State takes its royalty gas in kind, or whether it permits its gas to be sold under the producer contracts will not unduly affect Exxon's ability to market its gas.

With respect to the question of "banking" which has been raised in these hearings, we are not opposed to exploring with with state the concepts of a banking arrangement. We would observe that lease owners at Prudhoe Bay will be selling gas to different purchasers and that short term balancing provisions are the norm for the situation where multiple sellers and purchasers exist in the same field. If a balancing concept is extended to include banking of gas for the State on some basis other than for temporary operating purposes, additional operating costs and risks to the banking parties must be considered. Further, some delivery problems could be created for the gas purchasers - i.e., the purchasers would have difficulties in determining their respective future allowable gas takes. Since the lease does not provide for banking, we would have to

consider the State's banking its royalty gas in the light of any specific proposal made by the State.

Mr. Moody indicates the commitment of the state's royalty gas to either of the proposed pipeline projects is of critical significance to their economic viability. The state royalty gas will amount to 250-300 MMcf/d under the 2-2.5 Bcf/d gas production plan. We do not feel that this amount of gas removed from viable systems which are designed for a capacity of 2.4 to 4.5 Bcf/d will affect such viability.

Our counsel advises that he is not in agreement with some other portions of Mr. Moody's letter and particularly the portions which speculate as to the power of the State to take certain actions as lessor which would otherwise be beyond its power as a governing body. I am not sure that this necessarily differs with Mr. Moody's opinion, as he stated affirmatively that he does not offer an unqualified opinion that such legislation would withstand court challenge. From Exxon's point of view, the state has leased certain lands for a valuable consideration. There are equities to the lessees that should be considered, and the State should not continue to reduce the value of what it has leased, appropriating those values to itself.

FPC Interrogatories

We have supplied a copy of Exxon Company, U.S.A.'s answers to the FPC interrogatories which were requested and

believe them to be self-explanatory. These answers generally reflect information which has previously been provided to various Alaska State agencies.

Commitments for Sale of Prudhoe Gas

Regarding commitments for the sale of Prudhoe gas, Exxon Corporation, as of February 27, 1976, will have no agreements with any potential purchaser for its share of Prudhoe Bay gas reserves. Prior agreements between Exxon and potential purchasers providing for negotiating rights in exchange for advance payments have been terminated by mutual agreement of the parties due to the action of the Federal Power Commission on December 31, 1975, which eliminated, retroactively, rate base treatment for advances made by these pipelines for Alaskan gas reserves.

Senate Concurrent Resolution 66

With regard to Senate concurrent resolution 66, we can fully understand why many people in Alaska feel it is to the best interest of the State to have a gas pipeline built through Alaska rather than principally through Canada. However, our involvement in the implementation of this resolution gives us some concern. First, Exxon Company, U.S.A. is not engaged in the transportation of natural gas in interstate commerce, nor does it intend to invest in either one of the competing gas pipeline proposals. Exxon Company, U.S.A. intends to sell its gas in the field as a conventional producer

sale. As a seller of gas in the field, Exxon cannot legally commit its purchasers as a condition of sale to transport the gas over a designated route. Our recently terminated agreements with prospective purchasers included a provision recognizing the right of the prospective purchaser to enter into any transportation arrangement suitable to it.

Second, we have in mind the fundamental principal of gas economics that where transportation costs are minimized, the wellhead value is more likely to approach its consumer price. Based on information filed with the FPC the transportation costs of gas from the North Slope to markets in the lower 48 states are less when transported by pipeline through Canada than through Alaska by pipeline and then by tanker as LNG. Such lower transportation costs could benefit the Prudhoe Bay gas owners, including the State of Alaska.

We recognize that there are other counter-balancing factors which the State of Alaska may consider, the primary one being that the trans-Alaska route of the pipeline would make the gas more available to Alaska markets should these markets later develop. On the other hand, if the State would adopt an orderly schedule of oil and gas development and maintain a stable investment climate, gas for later developing markets could be available.

From a practical standpoint, however, it must be recognized that the final decision on the gas pipeline certifica-

tion will be made by the FPC, or perhaps even the U.S. Congress. If available information indicates that the Alaska route is in the national interest, giving full consideration to construction costs and environmental impact, then it may be expected that the Alaska route will be certified. In any event, all of the factors which Alaska deems to be of importance in developing the best route will no doubt be presented so that the proper decision will be made. Therefore, it is not proper for Exxon to make commitments in support of a trans-Alaska natural gas pipeline routing, or for that matter, for any particular routing.

Sadlerochit Reservoir Study

Question 1(a) refers to questions in Senator Rader's letter of January 15, 1976. Exxon's answers to these questions on the Van Poolen study are contained in Exhibit "B" to the written response which has been submitted to you. Please note that our answers are based only on a preliminary review of the report prepared by Van Poolen. We expect that when economics of the total field production are considered the results of the Van Poolen study will be consistent with other studies which indicate that the optimum producing plan for the Prudhoe Bay field will involve gas deliveries of 2 to 2.5 Bcf/d beginning as soon as a gas pipeline is available. You are aware that the field working interest owners advised the Division of Oil and Gas that they plan a technical review of the field operating plans in July of this year, at which

time the Van Poolen reservoir study can be discussed in more detail.

Royalty Gas Options

Prospective Purchasers for State Royalty Gas - In Exxon's opinion, the prospective purchasers of the State of Alaska's royalty gas are the same firms which are prospective purchasers of portions of Exxon's share of the gas. Most of the large gas transmission and distribution companies with markets in the lower 48 states have demonstrated substantial interest in purchasing some Prudhoe Bay gas.

Household or Industrial Use Within Alaska - Exxon has no detailed independent study relative to the possibilities of household or industrial use of natural gas within Alaska. We are aware of Mr. Ward's report of the Arctic Gas study of prospective Fairbanks area gas demand, prepared about two years ago. That study concluded that substantial use of natural gas in Fairbanks was unlikely even if gas were available.

Conclusion

In conclusion, I would refer you to the testimony of Judd Miller, Jr. presented to this Committee on December 10, 1975 on behalf of Exxon Company, U.S.A. We reiterate that the State's interest and the interest of the leaseholders are generally the same. An optimum producing plan for the Prudhoe field will provide maximum economic benefits for all con-

cerned. This will include producing the large gas reserves simultaneously with the oil after a minimum delay of only 3-5 years as required for pipeline approval and construction. These conclusions appear to be supported by the Van Poolen study. Not only does a gas pipeline provide an opportunity to produce gas from Prudhoe Bay, it will also provide the opportunity to sell gas from other fields. This will enhance the overall attractiveness of future exploration in Alaska and increase the value of the State's acreage. Finally, I would like to emphasize the importance associated with the support of all concerned parties and the early approval and construction of a gas pipeline from the Arctic Slope.

171
EXXON COMPANY, U.S.A.

POST OFFICE BOX 2180 • HOUSTON, TEXAS 77001

NATURAL GAS DEPARTMENT
W. RAY BOOTH
ASSISTANT GENERAL MANAGER

February 18, 1976

Joint Gas Pipeline Impact Committee
Alaska State Legislature
425 G Street, Suite 750
Pouch V
Juneau, Alaska 99801

Attention: Senator John H. Rader, Chairman

Gentlemen:

There are enclosed for the Committee's information, the response of Exxon Company, U.S.A. to the questions submitted with your letter of January 30, 1976 to Mr. W. Monte Taylor of this company.

I plan to make a statement on behalf of our company during the hearing on February 19, 1976 in Juneau.

Very truly yours,

W. Ray Booth
Assistant General Manager
Natural Gas Department

WRB/bl
Enclosures

Questions Relating to Topics
To Be Discussed At Hearings of
The State of Alaska Legislative
Gas Pipeline Impact Committee
On February 17-18-19, 1976

Q.1. The Committee solicits your review and comments on the report prepared by Rush Moody, Jr.

a) Are you in agreement with Mr. Moody's legal analysis?

A.1. (a) We are in agreement with a part of Mr. Moody's analysis and in disagreement with other parts as we will briefly comment on in answer to question 1.(b).

Q.1. b) How should this analysis effect state policy with regards to royalty gas, taxation, or state leasing powers?

A.1. b) With respect to state royalty gas, our counsel advises that in general he would agree with Mr. Moody's analysis of the effect of the Natural Gas Act on the shipments of the state's royalty gas in interstate commerce and that, therefore, the state should decide what it proposes to do with its royalty gas, since once it begins its path in interstate commerce, control thereof will be in the hands of the FPC.

With respect to state policy concerning taxation, it is understood that this subject will be considered in extensive legislative hearings in connection with particular statutes that have been introduced. Further, concerning state leasing powers, our counsel advises that he cannot agree with Mr. Moody; this subject has been before this legislature on numerous occasions and has been the subject of extensive litigation in this State. Therefore we have no comment upon either of these topics.

Q.1. c) Could you please supply the Committee with the answers to the FPC "Interrogatories"?

A.1. c) The answers to the FPC "Interrogatories" are attached as Exhibit "A" hereto, entitled "Response Of Exxon Corporation To FPC Interrogatories Dated December 12, 1975, El Paso Alaska Company, et al., Docket No. CP75-96, et al."

Q.1. d) If you are or plan to be a gas producer, what commitments have you made for sale of gas? Are you prepared to support the State's efforts relative to SCR 66?

- A.1. d) Regarding commitments, Exxon Corporation, as of February 27, 1976, will have no effective agreements with any potential purchaser for its share of Prudhoe Bay gas reserves. Prior agreements between Exxon and potential purchasers providing for negotiating rights in exchange for advance payments have been terminated by mutual agreement of the parties due to the action of the Federal Power Commission on December 31, 1975 which eliminated rate base treatment retroactively for advances made by these pipelines for Alaskan gas reserves.

Regarding SCR 66, Exxon expects to sell its North Slope gas at the well or in the field. This would be in conformity with usual practice in the United States.

Because of legal and regulatory restraints, a seller may not control transportation modes of any commodity, including natural gas, after delivery, or attempt to control transportation methods as a condition of sale. The public interest is best served when buyers and sellers compete unfettered by ancillary restraints as to transportation mode. The buyer must be free to choose the transportation mode for the commodity he has purchased. Neither producing nor gas purchasing companies will select the pipeline route. The Federal Power Commission has been holding extensive hearings on the competitive routes. Exxon believes the transportation mode will be chosen not on the basis of which companies have signed gas purchase contracts, but on the determination of the most practical and efficient mode.

- Q.2. Testimony regarding the Sadelrochit Reservoir study recently completed by the Department of Natural Resources:

a) Reference questions in letter of January 15.

- A.2. a) Our responses are enclosed as Exhibit "B" hereto, entitled "Response of Exxon Company, U.S.A. to Questions Posed By Senator John H. Rader By Letter Dated January 15, 1976".

Q.2. b) Reference FPC "Interrogatories", Part II.

- A.2. b) The answers to FPC "Interrogatories", Part II are included in Exhibit "A".

Q.3. Royalty Gas Options

a) What prospective purchasers exist for state royalty gas, inside or outside of Alaska?

- b) What is the possibility of household or industrial use of natural gas within Alaska?

A.3. Royalty Gas Options

- a) Prospective Purchasers for State Royalty Gas

In Exxon's opinion, the prospective purchasers of the State of Alaska's royalty gas are the same firms which are prospective purchasers of portions of Exxon's share of the gas. Most of the large gas transmission and distribution companies with markets in the lower 48 states have demonstrated substantial interest in purchasing some Prudhoe Bay gas. So far, however, potential purchasers with markets inside Alaska have failed to express interest to Exxon.

- b) Household or Industrial Use Within Alaska

Exxon has no independent detailed study relative to the possibilities of household or industrial use of natural gas within Alaska. The most recent study within Exxon's knowledge is an Arctic Gas study of prospective Fairbanks area gas demand, prepared about two years ago. That study concluded that substantial use of natural gas in Fairbanks was unlikely even if gas were available. No doubt, similar studies have been made of the possibilities of increased natural gas utilization in South Alaska.

Possibly useful information regarding the prospects for such gas usage would be found in the responses received to last year's solicitations of interest by the Alaska Royalty Oil and Gas Development Advisory Board.

EXHIBIT "A"

TO

RESPONSE OF EXXON COMPANY, U.S.A.

STATE OF ALASKA

LEGISLATIVE GAS PIPELINE IMPACT COMMITTEE

February 17-18-19, 1976

176

EXXON COMPANY, U.S.A.

POST OFFICE BOX 2180 - HOUSTON, TEXAS 77001

PAUL W. WRIGHT
COUNSEL

February 13, 1976

OGC
El Paso Alaska Company, et al.
Docket No. CP75-96, et al.

Interrogatories

Mr. Kenneth F. Plumb, Secretary
Federal Power Commission
825 N. Capitol St N.W.
Washington DC 20426

Dear Sir:

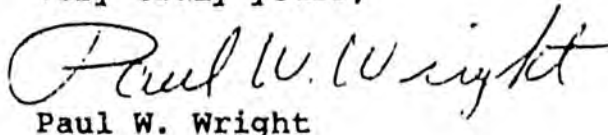
By letter dated December 12, 1975, Commission Staff Counsel Allan W. Anderson, Jr. transmitted to Exxon Corporation a series of written interrogatories in connection with the above-referenced proceeding.

Attached hereto for filing are the original and three conformed copies of the "Response of Exxon Corporation To FPC Interrogatories Dated December 12, 1975". Please direct any inquiries with respect to this Response to one of the following:

Martin N. Erck
Paul W. Wright
Larry W. Lindeen
Exxon Corporation
PO Box 2180
Houston TX 77001
AC713 656-4705

Copies of this filing have been served upon all parties to the restricted service list compiled in this proceeding in accordance with Commission regulations. Please acknowledge receipt of this document by placing your file mark on the enclosed extra copy and return same to the undersigned in the enclosed self-addressed envelope.

Very truly yours,


Paul W. Wright

PWW/bl
Attachments

cc: Hon. Nahum Litt
Presiding Adm. Law Judge

Allan W. Anderson, Jr., Esq.
Commission Staff Counsel

RESPONSE OF
EXXON CORPORATION
TO FPC INTERROGATORIES
DATED DECEMBER 12, 1975

El Paso Alaska Company, et al.

Docket No. CP75-96, et al.

February 13, 1976

178

I. POLICY

1 Q.1. Were you ever a member of a group investigating the
2 feasibility of bringing gas from Prudhoe Bay and/or
3 the Mackenzie Delta to the lower forty-eight states?
4

5 A.1. Yes.
6

7 Q.1.a. If yes, please describe your participation in the
8 group.
9

10 A.1.a. Exxon Company, U.S.A., (a division of Exxon Cor-
11 poration) was one of the six initial participants
12 in the Northwest Project Study Group. Exxon con-
13 tinued its participation from June, 1970 through
14 the merger with the Gas Arctic Study Group in 1972
15 and numerous additions to the membership of the
16 Gas Arctic-Northwest Project Study Group (Arctic
17 Gas), while feasibility studies were in progress.
18

19 Q.1.b. Are you still a member of such a group; and if not,
20 please explain the reasons for departing.
21

22 A.1.b. Exxon Company, U.S.A. withdrew as a participant
23 in Arctic Gas in January, 1975. Our public announce-
24 ment at that time was as follows:
25

26 "Exxon, USA joined a predecessor study group
27 in 1970 because it was interested in the develop-
28 ment of a project that would be capable of moving
29 Prudhoe Bay gas to market. The company believes
30 these initial project development objectives have
31 been accomplished.
32

33 "Exxon, USA is not in the interstate gas trans-
34 mission business. The company has decided to
35 withdraw from the study group now that the Arctic
36 gas pipeline project is nearing an implementation
37 stage."
38

39 Q.2. Why haven't firm gas purchase contracts been executed
40 for your Prudhoe Bay gas?
41

42 A.2. As explained by Exxon Counsel on the record in this
43 proceeding on several occasions and in the "Response
44 Of Exxon Corporation To Oral Motions To Certify" dated
45 December 15, 1975, definitive gas purchase contracts
46 must await a decision on the competitive aspects of
47 the two transportation proposals before the Commission
48 and the completion (and approval by the State of Alaska)
49 of a unitization agreement and operating plan for the
50 Prudhoe Bay field by the working interest owners of

- 1 the field.
2
- 3 Q.3. Please explain the relationship of a unitization and
4 operation agreement for Prudhoe Bay to the execution
5 of gas purchase contracts.
6
- 7 A.3. We anticipate that the Prudhoe Bay field will be
8 unitized prior to initiation of oil production
9 scheduled for mid-1977. The Prudhoe Bay Unitization
10 and Operating Agreements will provide among other
11 things for the allocation of oil and gas production
12 between owners of leases in the field. Upon uniti-
13 zation Exxon will own an agreed upon percentage share
14 of gas produced in the field whether such gas is
15 produced from the gas cap, from the oil zone, from
16 an Exxon interest lease or from a lease in which
17 Exxon has no current interest. Until such agree-
18 ments have been executed by the working interest
19 owners and the unit plan is approved by the State
20 of Alaska, there exists uncertainty as to both
21 Exxon's share and the total quantity of the gas
22 available for sale. For these reasons, the execu-
23 tion of a gas purchase contract prior to unitization
24 would be premature.
25
- 26 Q.4. Do you have any present intention to provide equity
27 for either the El Paso Alaska project or the Arctic-
28 Canadian gas project should either of them be issued
29 a certificate?
30
- 31 A.4. There is no intention for Exxon Company, U.S.A. (a
32 division of Exxon Corporation) to provide equity
33 for either project. Imperial Oil Ltd. in which
34 Exxon Corporation has approximately a 70% interest,
35 is a member of the Arctic Gas consortium and has
36 made a tentative equity commitment.
37
- 38 Q.5. If the natural gas pipeline and distribution com-
39 panies are unable to commit the amount of equity
40 required by lenders as necessary for either the
41 Arctic gas or El Paso project, would your company
42 be willing to help provide some of the needed equity?
43
- 44 A.5. Only as noted in response to interrogatory 4.
45
- 46 Q.6. Will your company bear the cost of gathering and
47 treatment facilities on the North Slope. If no
48 decision has been made on this, what factors would
49 influence any decision and by when would such a
50 decision have to be made?

1 A.6. Exxon plans to sell its gas in the field and thus
 2 plans that the purchaser(s) of its gas will own those
 3 facilities required for handling, gathering and
 4 treating the gas to pipeline quality specifications
 5 downstream of field separation facilities. Exxon
 6 expects to have the right to use a portion of these
 7 facilities subject possibly to Exxon paying a charge
 8 for such usage during periods of required gas injection.

9
 10 Q.7. Can your company categorically guarantee that the
 11 purchase price of Prudhoe Bay gas under future gas
 12 purchase contracts would be no higher than the
 13 commodity price of gas in the market area to be
 14 served adjusted for applicable costs to market?

15
 16 A.7. No.

17
 18 Q.8. Would your company oppose any attempt by a potential
 19 gas purchaser to place a minimum daily delivery volume
 20 provision in a gas purchase contract for the Alaskan
 21 North Slope?

22
 23 A.8. Yes, Exxon certainly would oppose any attempt by a
 24 potential gas purchaser (or the Commission, for that
 25 matter) to impose minimum daily delivery volume pro-
 26 visions. The several valid reasons for this position
 27 have been stated in the following documents which are
 28 in the public files of the Commission and which are
 29 incorporated herein by reference:

- 30
 31 1. Application For Rehearing And Motion For Recon-
 32 sideration, filed by indicated producers, Docket
 33 No. RM76-8, dated November 11, 1975.
 34
 35 2. Motion For Oral Argument, Docket No. RM76-8, dated
 36 December 19, 1975.
 37
 38 3. Application Of Exxon Corporation For Rehearing,
 39 Docket No. CI74-528, dated December 3, 1975.

40
 41 Q.9. How did you choose or how will you choose a purchaser
 42 or purchasers for your Prudhoe Bay gas? Explain the
 43 steps that will be taken or have been taken in this
 44 matter.

45
 46 A.9. Exxon independently will choose the party or parties
 47 with whom it will negotiate gas sales contract(s)
 48 utilizing criteria which are proprietary to it. Exxon's
 49 marketing strategy is completely confidential, recog-
 50 nizing however that under present law sales in

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33
34
35
36
37
38
39
40
41
42
43
44
45
46
47
48
49
50

interstate commerce for resale must be the subject
of Certificates of Public Convenience and Necessity
issued by the Commission.

II. RESERVES

- 1 Q.1. Please describe your exploration and development
2 activities on the North Slope of Alaska through 1975
3 indicating among other things the following:
4
- 5 Q.1.a. total amount of acreage held in Prudhoe Bay field
6 as defined by the Alaska Oil and Gas Conservation
7 Committee;
8
- 9 A.1.a. The Prudhoe Bay Oil Pool limits shown on the attached
10 map are taken from the Alaska Division of Oil and Gas
11 Report dated June, 1974 entitled "In Place Volumetric
12 Determination of Reservoir Fluids Sadlerochit Formation
13 Prudhoe Bay Field". Exxon holds leases on 70,756 net
14 acres within these geographic limits. That acreage
15 shown as Exxon-ARCO is owned on a 50-50 basis with the
16 Atlantic Richfield Company.
17
- 18 Q.1.b. number of wells presently drilled in the Prudhoe
19 Bay field and the success ratio of well completions;
20
- 21 A.1.b. A total of 53 wells have been drilled on Exxon
22 interest acreage within the limits of the Prudhoe Bay
23 Oil Pool, of which 47 were successful, five were dry,
24 and one suspended (as defined in the answer to 1.e.).
25
- 26 Q.1.c. an estimation of the total amount of gas reserves
27 in Prudhoe Bay held by your company and an estimate
28 of its deliverability.
29
- 30 A.1.c. Based on current estimates, Exxon's share of proved
31 Prudhoe Oil Pool gas reserves is 8.7 Tscf.
32
- 33 Based on Exxon's operational, economic and reservoir
34 studies, we believe the optimum producing plan will
35 include the production (when sales commence, cur-
36 rently estimated to be 3 to 5 years after the start
37 of oil production) of an amount of gas sufficient
38 to allow the purchaser(s) to deliver 2 to 2.5
39 Bcf/day of pipeline quality gas to a gas pipeline.
40 Exxon's working interest share of gas deliveries to
41 purchaser(s) is expected to be in the range of
42 0.7 Bcf/day and 0.95 Bcf/day.
43
- 44 Q.1.d. total amount of acreage held on the North Slope
45 including the offshore area outside of Prudhoe Bay
46 and location of such leases;
47
- 48 A.1.d. Exxon currently holds 167,425 net acres. The
49 location of these leases is shown on the attached
50 map.

- 1 Q.1.e. number of wells drilled outside of the Prudhoe
2 Bay field on the North Slope including offshore
3 areas, their location and an indication whether
4 they were successful;
5
- 6 A.1.e. Exxon has participated, on a working interest
7 basis, in eleven wells on the North Slope outside
8 of the Prudhoe Oil Pool Limits. The location of
9 these wells and their status are shown on the
10 attached map. Additional information regarding
11 the status of these wells is included on the attached
12 tabulation. Exxon has participated in three wells
13 classified as suspended. The classification of
14 suspended applies to those wells adjacent to unleased
15 acreage. To maintain the competitive nature of
16 exploration, information on such wells is not released
17 pending the disposition of adjacent acreage.
18
- 19 Q.1.f. total amount of gas reserves estimated to be held
20 on non-Prudhoe Bay field leases and their deliver-
21 ability.
22
- 23 A.1.f. Of the wells not classified as "suspended", seven
24 were dry holes and one (the Kemik Unit #1) is a
25 marginal gas discovery. This discovery will require
26 further drilling before any determination of either
27 reserves or deliverability is possible.
28
- 29 Q.2. Has your company made an independent estimate of the
30 amount of potential reserves on the North Slope of
31 Alaska? If yes, please describe your findings.
32
- 33 A.2. The USGS estimates* of undiscovered gas resources
34 on the North Slope range from 14 to 49 Tcf, with
35 a statistical mean of 28 Tcf. Exxon feels these
36 estimates establish a good base for further analyses
37 by the FPC. Equally important as the amount of
38 potential reserves are such factors as the timing
39 of discovery and development, the size and loca-
40 tion of fields found, plus when and at what rate
41 the gas can be transported to market.
42
- 43 Q.3. Based upon your company's drilling experience to date,
44 does it appear that the areal limit of the Prudhoe
45 Bay field as defined by the Alaska Oil and Gas Con-
46 servation Committee is larger than anticipated?
47
- 48 A.3. No.
49
- 50 Q.4. Has your company studied the possibility of drilling

*Geological Survey Circular 725

1 in the Yukon-Kandix Basin, Middle Tanana Basin and
2 Copper River Basin areas of Alaska? If yes, what do
3 your studies indicate, what has been your past
4 experience in such areas, if any, and what are your
5 company's current and future plans with respect to
6 such areas?
7

8 A.4. Exxon has conducted exploration studies in the
9 Yukon-Kandix, Middle Tanana and Copper River basins
10 and at one time did hold several leases or lease
11 applications. Exploration data developed did not
12 provide sufficient encouragement for additional
13 exploratory effort and the leases were cancelled.
14 Exxon has no immediate plans for lease acquisitions
15 or drilling in these three basins.
16

17 Q.5. With respect to oil production from the Prudhoe Bay
18 field, (a) what are the anticipated deliverability
19 rates for the first twelve years? (b) will this
20 affect the deliverability of your gas? (c) what effect
21 would a 2.25 billion cubic feet deliverability capacity
22 pipeline have on oil production during this period?
23

24 A.5. (a) It is not possible to make precise forecasts of
25 future oil production, especially for such a long
26 period into the future, but the following represents
27 our best current estimate of crude oil production
28 from the Prudhoe Bay field.
29

30 The Trans Alaska Pipeline is expected to begin
31 operation in mid-1977 and sustained throughput of
32 1.2 million barrels of oil per day should be
33 achieved by January 1, 1978. Although decisions
34 on future expansions of the pipeline have not been
35 firmly established at this time, the Prudhoe Bay
36 Field is expected to produce 1.5 million barrels
37 of oil per day by January 1, 1979, and it is antici-
38 pated that the pipeline will be expanded accordingly.
39 If an early expansion to 1.5 million barrels per
40 day is accomplished, a rate decline during the
41 latter part of the first twelve years of operation
42 would be expected, unless reserves are substantially
43 in excess of those currently recognized.
44

45 A.5. (b) No.

46 A.5. (c) None, based on current studies.
47

48 Q.6. Please describe your proposed exploration and develop-
49 ment activities for the North Slope, if any, for 1976.
50

1 A.6. Exxon is continuing its geological and geophysical
2 studies for the North Slope and is contemplating
3 seismic programs during the winter and summer of 1976.
4 Exxon does not plan to drill any wells during 1976 on
5 Exxon operated acreage.

6
7 Planned development activity jointly with ARCO
8 within the Prudhoe Oil Pool Limits in 1976 is
9 expected to consist of the continued development
10 drilling of approximately 30 wells and the continua-
11 tion of the installation of field facilities asso-
12 ciated with anticipated oil production startup by
13 mid-1977.

14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33
34
35
36
37
38
39
40
41
42
43
44
45
46
47
48
49
50

III. FACILITIES AND COSTS

- 1 Q.1. What is the type of gas that will be produced from
2 your Prudhoe Bay leases?
3
- 4 A.1. The natural gas produced at Prudhoe Bay will be
5 associated with oil production and will consist of
6 a mixture of solution gas evolved from oil and gas
7 from the gas cap.
8
- 9 Q.2. What type of facilities would be needed to process
10 and/or treat each type of gas?
11
- 12 A.2. Processing of Prudhoe Bay gas will not be required,
13 although it may be found to be economic, as discussed
14 in 5. below. Treatment of the gas, however, will be
15 required. Based on current planning, the facilities
16 required to handle the produced gas from the gas-oil
17 separators to the inlet of the gas pipeline are:
18
- 19 (a) Gas Facilities At Gas-Oil Separation Centers
20
- 21 Compression for low pressure gas and conditioning
22 to make the gas suitable for gathering from the
23 gas-oil separation centers to the central loca-
24 tion. This conditioning will include cooling
25 and dehydration for hydrocarbon and water dew
26 point control.
27
- 28 (b) Gas Gathering Facilities
29
- 30 Gas gathering lines to gather the gas from the
31 gas-oil separation centers to a central location
32 in the field.
33
- 34 (c) Gas Conditioning Plant Facilities
35
- 36 Gas conditioning to bring the gas to pipeline
37 quality including carbon dioxide removal, hydro-
38 carbon dew point control, dehydration, and com-
39 pression and cooling to pipeline pressure and
40 temperature.
41
- 42 Q.3. Which facilities mentioned in interrogatory 2 would
43 be constructed and operated by the producer and which
44 will be required to be purchased entirely or partly
45 by a pipeline purchaser? Who will operate those
46 owned by the pipeline?
47
- 48 A.3. See response to question I.6. Exxon intends to act
49 as the purchaser's representative in the construction
50 and operation of those facilities.

1 Q.4. What is the quality of the gas at the wellhead
2 and what will be the acceptable quality for pipe-
3 line delivery?
4

5 A.4. The gas will not be available at the wellhead since
6 it will be mixed with oil and condensate. It will
7 be delivered to the purchaser after separation from
8 the oil and condensate. It is anticipated that the
9 separation will be done in three stages which during
10 initial production of the field will be approximately
11 650 psig and 170° F. for the first stage, 80 psig and
12 150° F. for the second stage, and a slight positive
13 pressure (approximately 0.5 psig) and 150° F. for
14 the third stage. Based on our current engineering
15 calculations, the estimated composition and quality
16 of the combined gases from all three stages of
17 separation are as follows:

Composition, Mol Percent		
Methane		72.92
Ethane		6.91
Propane		3.72
Iso Butane		0.58
Normal Butane		1.23
Pentanes plus		1.42
Carbon Dioxide		12.71
Nitrogen		0.51
	Total	<u>100.00</u>

29 Heating Value (Gross,
30 Wet, Actual @ 14.73
31 psia and 60° F.),
32 Btu/cu.ft. 1063

34 Water Content,
35 Lbs/MMcf 820

37 H₂S Content,
38 grs./100 cu.ft. *

41 *Not precisely known at this time, but is
42 less than 1 grain per 100 cubic feet.

43 The low pressure portions of the above gas stream
44 will be compressed to about 650 psig and the com-
45 bined stream, cooled, dehydrated, and reheated
46 before delivery into the field gas gathering
47 system at approximately 620 psig and 100° F. After
48 this treatment, the gas is expected to have the
49 following composition and quality:
50

1	Composition, Mol Percent	
2	Methane	73.34
3	Ethane	6.91
4	Propane	3.67
5	Iso Butane	0.56
6	Normal Butane	1.18
7	Pentanes plus	1.08
8	Carbon Dioxide	12.74
9	Nitrogen	0.52
10	Total	<u>100.00</u>

11
 12 Heating Value (Gross,
 13 Wet, Actual @ 14.73
 14 psia and 60° F.),
 15 Btu/cu.ft. 1046

16
 17 Water Content,
 18 Lbs/MMcf 1 (approx.)

19
 20 H₂S Content,
 21 grs./100 cu.ft. *

22
 23 *Not precisely known at this time, but is
 24 less than 1 grain per 100 cubic feet.

25
 26 It is Exxon's opinion that the Prudhoe Bay gas
 27 composition and quality used by Arctic Gas in the
 28 design of their pipeline facilities will be suit-
 29 able for transmission through the pipeline (or
 30 any other pipeline operating at the same pressure
 31 [1680 psig] and temperature [less than 30° F.]
 32 conditions). The composition was furnished to
 33 Arctic Gas by the Prudhoe Bay producers and is
 34 our best current engineering estimate of the quality
 35 of the gas after treatment to make it suitable for
 36 pipeline operations, pending detail design of the
 37 gas treating facilities. The treated gas composition
 38 is recorded on page 12 of Section 8.b.2. of the Arctic
 39 Gas filing and is shown below for comparison with
 40 the above compositions along with Exxon's estimates
 41 of other characteristics which describe the gas
 42 "quality":

43
 44
 45
 46
 47
 48
 49
 50

1	Composition, Mol Percent	
2	Methane	85.11
3	Ethane	7.70
4	Propane	3.99
5	Iso Butane	0.50
6	Normal Butane	0.73
7	Pentane plus	0.22
8	Carbon Dioxide	1.00
9	Nitrogen	0.75
10	Total	<u>100.00</u>

11
12 Heating Value (Gross,
13 Wet, Actual @ 14.73
14 psia and 60° F.),
15 Btu/cu.ft. 1130

16
17 Water Content,
18 Lbs/MMcf 0.2**

19
20 H₂S Content,
21 grs./100 cu.ft. *

22
23 *Not precisely known at this time, but is
24 less than 1 grain per 100 cubic feet.

25
26 **Tentative, pending results of research
27 work in progress to determine whether a
28 water content this low will actually be
29 required.

30
31 Q.5. It is noted that certain agreements between various
32 producers on the North Slope and pipeline purchasers
33 reserve the right of the producer to process Prudhoe
34 Bay gas in the lower forty-eight states. What type
35 of processing is contemplated by your company, where,
36 when and how much? What type of transportation arrange-
37 ments would be necessary to implement this provision?

38
39 A.5. Exxon plans to reserve the right to process its Prudhoe
40 Bay gas. An adequate evaluation of an operation to
41 exercise such a right is not possible at this time,
42 because of many uncertainties, such as the location
43 of the gas transportation facilities. This will
44 probably not be possible prior to the early 1980's,
45 at which time it should be possible to define
46 clearly and negotiate, if appropriate, the type of
47 arrangement which would be mutually satisfactory
48 to the parties involved.

49
50

1 Q.6. What would be the cost of each separate facility
2 mentioned in interrogatory #2?

3
4 A.6. Estimated costs of the facilities are as follows:

Facility	Estimated Cost, \$MM	
	<u>7/1/75</u> Basis	Escalated Basis
Gas Facilities at Gas-Oil Separation Centers (including IDC of)	527 (98)	634 (118)
Gas Gathering Facilities (including IDC of)	57 (8)	63 (8)
Gas Conditioning Plant Facilities (including IDC of)	1252 (286)	1590 (360)
TOTAL (including IDC of)	1836 (392)	2287 (486)

23
24 Q.7. How would you allocate the costs between oil and
25 gas production for the facilities which would be
26 either owned by the pipeline or jointly with your
27 company. Please explain your rationale for such
28 allocation.

29
30 A.7. We do not envision that an allocation of costs will
31 be necessary. All the facilities enumerated in
32 III.A.2. and A.6. will be required for the handling,
33 gathering and conditioning of the gas by the pur-
34 chaser prior to delivery to a gas pipeline.

35
36 Q.8. If the Prudhoe Bay gas is to be processed, through
37 facilities owned by the pipeline or jointly by the
38 producer, who will have benefit of the liquid
39 products and how will the operation and maintenance
40 costs be allocated and on what basis?

41
42 A.8. The removal of hydrocarbon liquids which will be
43 required at Prudhoe Bay will be a treating, not a
44 processing, operation. Excess liquid hydrocarbons
45 removed in treating will not be sold to the gas
46 purchaser(s). Although firm plans have yet to be
47 made concerning disposition of these liquids, Exxon
48 expects that they will either be used as fuel or
49 transported in the oil pipeline. Exxon expects to
50 bear the costs, if any, to store and transport its

1 share of these liquids. If processing should be
2 found to be economic, it would be conducted under
3 arrangements yet to be negotiated.
4

5 Q.9. Provide the (a) length and size of the gathering
6 facilities for your operations (b) estimated costs
7 of such lines (c) ownership of such lines, and for
8 those lines to be owned by the pipeline purchaser or
9 jointly with the producer how will costs be allocated
10 for that portion of the facilities attributable to
11 the transportation of gas?
12

13 A.9. (a) The gas will be gathered from the six gas-oil
14 separation centers to the central gas conditioning
15 plant in the following lines:
16

	<u>Diameter, inches</u>	<u>Length, miles</u>
17		
18		
19	30	7.0
20	34	5.6
21	38	5.7
22	42	5.4

23
24 (b) See cost estimate table in response to III.6.

25
26 (c) Exxon's plans are that the portion of these
27 facilities which is necessary for gathering Exxon's
28 gas will be owned by the purchaser(s) of its gas.
29 The matter of allocation is dealt with in the
30 response to III.7.
31

32 Q.10. What type of design will be required for the gather-
33 ing system, i.e. buried, above ground pipe, chilling
34 facilities, etc.?

35
36 A.10. The pipelines will be insulated and will be laid
37 above ground on supports.

38
39 Q.11. Would your costs estimates vary depending upon
40 whether the Arctic gas or El Paso project was
41 certificated?
42

43 A.11. No, assuming pipeline quality and pressure specifi-
44 cations are the same.
45

46 Q.12. What percentage of the gas available at the wellhead
47 will be lost in treatment and/or processing?
48

49 A.12. Of the gas available for sale at the separator
50 outlets, approximately 12% will be removed as

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33
34
35
36
37
38
39
40
41
42
43
44
45
46
47
48
49
50

carbon dioxide and approximately 6% will be consumed as fuel. The gas available for sale at the separator outlets does not include field fuel requirements.

Q.13. What state approvals will have to be obtained in relation to Alaskan North Slope gas production and when will your company make the necessary filings to obtain such approval?

A.13. The Prudhoe Bay Field Working Interest Owners plan to unitize the field prior to initiation of oil production. The Alaska Department of Natural Resources must approve this unitization plan. Associated with this approval will be approval of a unit operating plan including a plan for gas sales.

Negotiations are underway by the Prudhoe Bay Working Interest Owners and the request for State approvals will be made as soon as possible.

EXXON COMPANY, U.S.A. WORKING INTEREST WELLS DRILLED ON NORTH SLOPE

OUTSIDE OF THE PRUDHOE OIL POOL LIMITS

EXXON OPERATED











<u>Map Code</u>	<u>Well Name</u>	<u>Completion Date</u>	<u>Status</u>
1	E. Mikkelsen Bay State #1	6/16/71	D & A
2	Canning River Unit A #1	7/10/74	D & A
3	Canning River Unit B #1	4/22/75	D & A
4	Alaska State A #1	9/21/75	Suspended

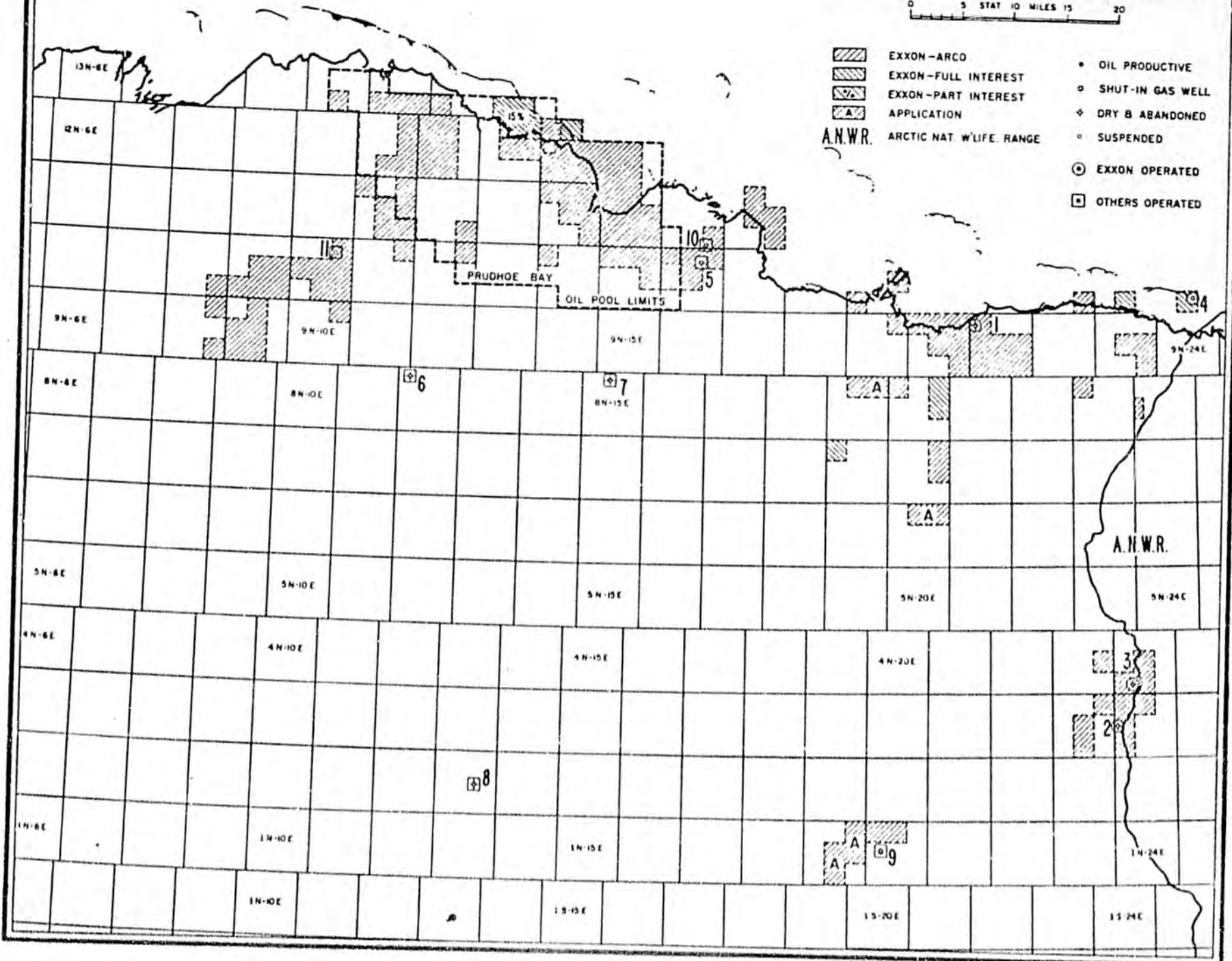
OTHER OPERATED

<u>Map Code</u>	<u>Operator</u>	<u>Well Name</u>	<u>Completion Date</u>	<u>Status</u>
5	Atlantic Richfield	Delta State #1	2/27/69	D & A
6	Atlantic Richfield	Toolik Federal #2	9/14/69	D & A
7	Atlantic Richfield	Toolik Federal #1	4/15/69	D & A
8	Atlantic Richfield	Susie Unit #1	1/9/67	D & A
9	Forest	Kemik Unit #1	6/17/72	Shut-in gas well
10	Atlantic Richfield	Delta State #2	5/17/75	Suspended
11	Atlantic Richfield	West Sak River #5	2/27/75	Suspended

NORTH SLOPE, ALASKA

0 5 STAT 10 MILES 15 20


-  EXXON-ARCO
 -  EXXON-FULL INTEREST
 -  EXXON-PART INTEREST
 -  APPLICATION
 -  OIL PRODUCTIVE
 -  SHUT-IN GAS WELL
 -  DRY & ABANDONED
 -  SUSPENDED
 -  EXXON OPERATED
 -  OTHERS OPERATED
- A.N.W.R. ARCTIC NAT. W'LIFE. RANGE



AGD 546016

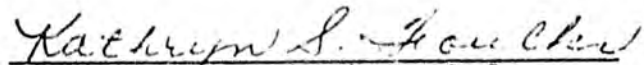
VERIFICATION

W. Ray Booth, being duly sworn, deposes and says that he is Assistant General Manager of the Natural Gas Department of Exxon Company, U.S.A. (a division of Exxon Corporation); that he is authorized to verify and file this document, that he has examined the statements contained in the submittal and that all such statements are true and correct to the best of his knowledge, information and belief.



 W. Ray Booth

Subscribed and sworn to before me by the said W. Ray Booth, this 13th day of February, 1976.



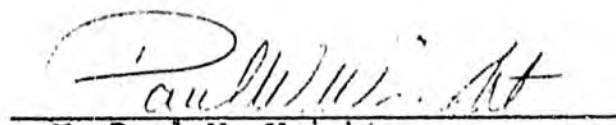
 Notary Public in and for
 Harris County, Texas

KATHRYN S. FOULKS
 Notary Public in and for Harris County, Texas
 My Commission Expires June 1, 1977

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon the restricted service list in these proceedings, in accordance with the Commission's Rules of Practice and Procedure.

Dated at Houston, Texas, this 13th day of February, 1976.



 Paul W. Wright

Of counsel for
 Exxon Corporation

EXHIBIT "B"

TO

RESPONSE OF EXXON COMPANY, U.S.A.

STATE OF ALASKA

LEGISLATIVE GAS PIPELINE IMPACT COMMITTEE

February 17-18-19, 1976

TO QUESTIONS POSED BY
SENATOR JOHN H. RADER
BY LETTER DATED JANUARY 15, 1976

The letter of Senator Rader contained a list of five questions relating to the potential impact of a recent Prudhoe Bay reservoir performance study conducted by H.K. Van Poolen and Associates, under contract to the State of Alaska. Exxon has received only a brief summary report on the Van Poolen Study. It is understood that a more detailed report will be issued within the next few weeks. The summary report does not provide adequate information to allow Exxon to evaluate the technical methods employed in the study; therefore, the enclosed responses to the Senator's questions are based only on the study results as presented in the summary report and the results of studies that Exxon has conducted.

Q.1. What effect does the recent study, "Predictions of Reservoir Fluid Recovery Sadlerochit Formation Prudhoe Bay Field", have on marketing plans for Prudhoe Bay gas?

A.1. None. The major Prudhoe Bay leaseholders have indicated that it is desirable to commence gas deliveries at a rate of 2 to 2.5 Bcf/D as soon as a gas pipeline can be approved and constructed (estimated to be 3-5 years after the start of oil production). The results presented in the Van Poolen summary report do not conflict with this basic plan.

The Van Poolen study indicates that a reduction in ultimate oil recovery could occur with increasing gas delivery volumes under certain conditions wherein reservoir management plans were not optimized. However, the Van Poolen results demonstrate that there is potential for minimizing, or eliminating completely, such reductions by modifying the reservoir management plan. For example, by modifying certain operating conditions in a 2 Bcf/D gas delivery case (Case 21), Van Poolen was able to eliminate a potential reduction in oil recovery and, in fact, obtain slightly higher oil recovery with gas delivery than in a similar oil rate no gas delivery case (Case 11).

Q.2. How does this study differ from industry and Federal studies?

A.2. The summary report does not provide adequate technical information to permit a detailed comparison of the Van Poolen study technique with other studies. When the results of the Van Poolen study become available and have been analyzed with appropriate consideration given to cost and other relevant factors, we expect that the conclusions will indicate that the optimum producing plan for the field will involve gas deliveries at a rate of at least 2 Bcf/D beginning as soon as a pipeline is available. This finding would be consistent with our studies, other operators' studies, and the Gruy study for the Department of Interior, all of which have concluded that deliveries of 2 to 2.5 Bcf/D are desirable early in the producing life of the field.

Q.3. How accurate can a model be without production history?

A.3. The accuracy of reservoir simulator model studies depends primarily on the validity of the description of reservoir rock and fluid properties, and, to a lesser degree, on the refinement of the modelling program. Based on Exxon's experience and technical judgment, if reservoir properties are accurately described and a technically sound program is utilized, model predictions can be accurate enough without production history to develop reasonable reservoir management plans.

Prior to fieldwide production, reservoir description is based principally on fluid samples, rock samples, production tests, pressure data, and log analysis from wells which have been drilled in the field. Once production commences, it is possible to add information to the reservoir description. It is often the case that development of new fields proceeds such that the reservoir data obtained prior to production is limited. However, at Prudhoe Bay ample reservoir data has been collected and thoroughly analyzed. Consequently, model studies prior to production at Prudhoe Bay are considered to be more accurate than is typical of other new fields where less data are available.

Q.4. Will some production history be necessary before an accurate model is established that will prove feasibility of a gas pipeline for marketing of Sadlerochit gas?

A.3. No. We believe that model predictions prior to production can be reasonably accurate and demonstrate the feasibility of early gas deliveries in the range of 2.0-2.5 Bcf/D. Exxon model studies have shown that reservoir management plans developed prior to production which include early gas deliveries can be modified, if necessary, during the producing life of the field to adapt to variations in actual reservoir performance that may be encountered.

Q.5. How critical are the results of this study in obtaining FPC certification and financing for the gas pipeline projects?

A.5. It is our opinion that the FPC and potential investors as well as interested regulatory bodies, particularly the Alaska Division of Oil and Gas, will consider the results of several studies before making decisions which would affect the gas pipeline project. Studies of Prudhoe Bay reservoir performance have been conducted by the major leaseholders and we expect that these studies will receive due consideration.

As indicated in our response to question 2, we expect the results of the Van Poolen study will be consistent with other studies, which indicate that the optimum producing plan for Prudhoe Bay will involve gas deliveries of at least 2 Bcf/D beginning as soon as a pipeline is available.

V I

CONSULTANTS

ACU 546024

JOINT PUBLIC HEARINGS
of the
ALASKA STATE LEGISLATURE
on

SCR 3, 4, 5 and HCR 11, 12, 13

"THE PROPOSED SALE OF ROYALTY GAS"

January 31, 1977 - February 7, 1977

Juneau, Alaska

VOLUME I

CONSULTANT PRESENTATIONS

Arlon Tussing

Institute of Social and Economic Research,
University of Alaska..... p. 1

Carl Swanson

Jensen Assoc., Inc..... p. 62

Richard Kilgore

W. J. Levy Consultants..... p. 128

Rush Moody

Vinson, Elkins, et al, Attorneys at Law..... p. 166

1 DR. TUSSING: I just have one comment. In my opinion the
2 report of the administration's Gas Pipeline Task Force
3 is an exceptionally thorough, fair and objective review
4 of the relative merits of the three competing gas trans-
5 portation systems. In view of the political sensitivity
6 of the issue and the compulsion that agencies generally
7 have to find the most favorable arguments for the policies
8 adopted, I think that this is a really admirable document.

9 There are only a few points in the report on
10 which I would have a different emphasis and there are a
11 number of assumptions in Dr. Knudson's report that I think
12 were biased in favor of the kind of answer that supported
13 the policy. But I don't think these are crucial to the
14 main conclusions of the Task Force report, and when I
15 start my presentation I'll summarize what I think are the
16 principal conclusions and what the implications of those
17 would be.

18 SENATOR RADER: Unless the Committee objects, why don't we
19 go ahead and listen to your presentation and then open
20 questions to both of you. Would that be appropriate?

21 DR. TUSSING: Yes.

22 SENATOR RADER: Is there any objection to that procedure,
23 Committee? Fine.

24 DR. TUSSING: Okay. I didn't come with a prepared statement.
25 I have some fragments of things, two of which I would

1 like to introduce into the record. One is -- let me
2 back up for a moment and identify myself, as you re-
3 quested. I'm Arlon Tussing. I'm a professor of Eco-
4 nomics at the Institute of Social and Economic Research
5 at the University of Alaska. I have been affiliated
6 with the University for twelve years. I have also
7 served as chief economist of the U.S. Senate's National
8 Fuels and Energy Policy Study under Senator Jackson and
9 continue to serve Senator Jackson as an economic advisor
10 on energy and natural resources.

11 During the last year I have also served as an
12 advisor on oil and gas issues to the State of California,
13 the Provinces of Nova Scotia, Ontario and British
14 Columbia. I have served for a little over a year on the
15 Royalty Oil and Gas Development Advisory Board, during
16 the period of which the initial negotiations were --
17 took place on these contracts. I have given consideration
18 in a number of forums and for a number of agencies to
19 various aspects of the Alaska gasline question.

20 There are a great number of issues I would like
21 to comment on, if I have time. I realize your time is
22 limited and I'm going to try to confine myself to some
23 of the high spots and then let you proceed.

24 SENATOR RADER: You have two documents that you wanted
25 entered as exhibits?

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

DR. TUSSING: Yes.

SENATOR RADER: Would you identify those for us?

DR. TUSSING: One is an article headed "An Inkling of the Long Journey", published in "Northern Perspectives", which is the newsletter of the Canadian Arctic Resources Committee. This was published only last month but I wrote it in June. So to the extent that there is anything dated in it, you can understand that.

SENATOR RADER: That would be Exhibit No. 11, according to my records. Is that correct, Recorder?

DR. TUSSING: Yes. Oh.

SENATOR RADER: All right.

DR. TUSSING: The second paper is entitled "Natural Gas Supply Outlook for the West" and it is a summary of my comments at a workshop on economic growth in the West in Los Angeles in August.

SENATOR RADER: And that will be Exhibit No. 12.

(Whereupon Exhibits 11 and 12 were duly marked)

DR. TUSSING: The most important conclusions of the State Task Force report are generally consistent with every other important study and with intuitive common sense, and they are the following: Firstly, that El Paso's Trans-Alaska pipeline LNG tanker system would, if it could be approved, financed, and built and operated in the manner proposed by its sponsors, result in the greatest net revenues to the State treasury and the

1 greatest increase in Alaska gross product, personal
2 income and population. The Alcan systems impact would
3 be second in these respects and Arctic Gas third.

4 Secondly, with the Arctic Gas system, if it
5 could be approved, financed, built and operated in the
6 manner proposed by its sponsors, would result in the
7 lowest gas transportation costs to the Lower 48. In this
8 respect, the Alcan system seems to be second best and the
9 LNG system worst among the three.

10 The Task Force report makes one other crucial
11 point but without the emphasis I believe it deserves.
12 In view of the respective routes, design and construction
13 plans, the Alcan system seems to be least vulnerable to
14 cost and schedule overruns, and Arctic Gas the most
15 vulnerable, with El Paso somewhere in between.

16 Because of the questionable viability and the
17 financing problems of any transportation system for North
18 Slope gas, the prospect of substantial overruns may be
19 the most critical economic issue in choosing among them.

20 Moving to the contracts for a moment. I intend
21 to get back to the problems of financing. I make no
22 recommendation on whether the Legislature should ratify
23 these contracts. The members should understand, however,
24 that there is no amount of propaganda for lobbying by
25 Alaska or by the three purchasers which will produce a

1 decision in favor of an LNG system unless Canada makes
2 it clear that an overland pipeline system will not be
3 licensed or that Canada will not be able to come to a
4 decision in the foreseeable future.

5 I personally expect an unbroken chain of decisions
6 in the United States in favor of Arctic Gas by the FPC
7 staff, Judge Litt, the Federal Power Commission and
8 President Carter, based upon the record in the FPC hearing
9 and the investigations of other federal agencies. I do
10 not mean to imply that Arctic Gas is certain to be ap-
11 proved and to be able to build its system, but if the
12 Arctic Gas momentum is to be broken, it will not be the
13 result of any domestic politicking, but of some objective
14 development. For example, a clear signal of Canadian
15 intentions one way or another. While it is remotely
16 possible that El Paso or Alcan might get an important
17 endorsement somewhere along the line, what is almost
18 inconceivable is that the United States Congress would
19 overturn a presidential determination in favor of a
20 Canadian overland pipeline system to substitute its
21 judgment in favor of an LNG system.

22 The manifest superiority from a national point
23 of view of the overland pipeline system as available is so
24 overwhelming and the regional interests in the construction
25 of such a system in preference to an LNG system is so

1 overwhelming that the number of Congressmen, the number
2 of State Utility Commissions and the number of Governors
3 that the purchasers will be able to move on this is only
4 a small time fraction of the existing lead that Arctic
5 Gas has in this matter.

6 I think that it is instructive that in El Paso's
7 principal market area that there is virtually no support
8 for its project and in fact great skepticism about El
9 Paso's project for a number of reasons, not least that the
10 gas distributors do not want to be exclusively dependent
11 upon El Paso, as they would be, for all the gas entering
12 their market area. And secondly, they don't want the
13 State of California to be exclusively dependent on a
14 single point for the delivery of their gas, a point which
15 could be interrupted by, for example, a fire at Valdez,
16 which would leave them without any gas supply whatever
17 as their existing supplies would have been displaced east-
18 ward into markets or, for example, in the Tenneco and
19 Southern systems, for example.

20 There is simply no possibility, in my judgment,
21 that Congress would endorse an LNG system. Particularly
22 in the face of the cold wave that has now confronted the
23 Midwest and the East and which will have reinforced its
24 determination to get direct delivery of gas, and in view
25 of the developing Westcoast glut of crude oil which is

1 retrospectively viewed in Congress as the result of the
2 fact that they approved the wrong pipeline in the first
3 place for the oil.

4 These are circumstances that -- there is nothing
5 which the State of Alaska can do to change. I believe it
6 is clear the United States will favor an overland pipeline
7 through Canada. It also seems likely, that rightly or
8 wrongly, the Federal Power Commission, the Administration,
9 and Congress will accept Arctic Gas argument that an early
10 attachment of the Mackenzie reserves is in the United
11 States' interest and that the Mackenzie route has signif-
12 icant economies of scale compared to the proposed Alcan
13 system. But, the decision will in fact be made in Canada,
14 not in the United States. The United States will accept
15 any overland system that Canada is willing to build in
16 preference to any alternative system.

17 Canada's orders of preference between the Mackenzie
18 and Alcan routes are not so clear. There are a number
19 of reasons why the Alcan system may make more sense to
20 Canada and with your permission I would like to read a
21 couple paragraphs of my article in "Northern Perspectives"
22 on some of the Canadian reasons for favoring an Alcan
23 system.

24 "The probable reception of any Alcan proposal by
25 Canadian authorities has been a most difficult issue to

1 forecast. A major appeal of the Arctic Gas project is
2 purportedly its early (if not necessarily more economical)
3 attachment to the Mackenzie reserves. Without this
4 feature, it may be asked, what is the advantage to Canada
5 of accommodating the United States in moving Alaska gas?"

6 "The attachment of the Mackenzie reserves may, on
7 the other hand, be seen as a major disadvantage of the
8 Arctic Gas system, from at least one Canadian standpoint.
9 There is no particular reason why Canada should not ac-
10 commodate the United States with a transit line across
11 Canadian territory; after all, a substantial portion of
12 Canada's oil and gas supplies transits the United States.
13 There would seem to be little objection in Canada on
14 nationalistic grounds to American gas moving in either an
15 American or a Canadian-owned pipeline across Canada.
16 The Mackenzie project, in contrast, raises the issue of
17 an American-dominated consortium developing an important
18 frontier area of Canada. The fact that an early MacKenzie
19 connection is being justified in the United States by the
20 (doubtful) proposition that it would lead to greater
21 Canadian exports to the United States aggravates its
22 potential difficulties in Canada. Both its timetable and
23 logistics would be dictated by the convenience of the
24 American interests. The native claims and environmental
25 complications of this route are well known."

1 And incidentally, I expect that Justice Berger,
2 who is the commissioner for the Canadian government in
3 examining native claims and environmental implications
4 of the Mackenzie pipeline, will come out strongly against
5 the Arctic Gas proposal and against any major pipeline
6 development in the Arctic pending the settlement of the
7 native claims and the resolution of some presently un-
8 resolvable environmental issues. He will point out, I
9 believe, that neither of these objections is nearly so
10 strong with respect to a pipeline through the Yukon
11 Territory along the Alcan route.

12 "The 60 trillion cubic feet of proved reserves
13 in the western provinces", I think it's now about 62
14 trillion cubic feet in Alberta,"are enough to sustain
15 the expected growth of Canadian demand plus present export"
16 commitments "for about ten years. This would be the case
17 even if there were no further discoveries" in Canada, "but
18 recent exploratory results in Alberta have been rather
19 encouraging, more so in fact than in the delta area. For
20 this reason a decision on an Arctic pipeline carries much
21 less urgency for Canada than it does for the United States."

22 In other words, Canada does not need a pipeline
23 connection to its frontier areas for ten or eleven years
24 even if there were no further -- to be no further dis-
25 coveries in Alberta or British Columbia.

1 "More importantly, however, a decision today in
2 favour of immediate development of the Mackenzie Delta-
3 Beaufort Sea region can be seen to prejudice whether that
4 region or the Arctic Islands (where recent exploration
5 seems to have been more successful) shall be developed
6 first. Either project could strain the capacity of
7 domestic capital markets so that simultaneous construction
8 of the two major pipeline systems under Canadian majority
9 ownership is almost out of the question."

10 And I go on to say that it is not obvious which
11 of these considerations will finally come to play, but
12 "A decision in favour of Arctic Gas would" "be a reluctant
13 one". It would have to be in the face of a firm decision
14 by Justice Berger who in a sense occupies a similar
15 position as Judge Litt in the procedures in the United
16 States, and it "would be opposed by many quarters within
17 the Canadian federal government, by several provinces and
18 by a large body of Canadian opinion."

19 As you probably know, the Trudeau government faces
20 an election no later than the fall of 1978. The liberal
21 party is in great trouble, Trudeau is very unpopular at
22 the present time and to run over the Natives and the
23 environmentalists at this time in favor of an Arctic Gas
24 pipeline is probably unlikely, it would be a very im-
25 politic. So there is on the other hand and I have absolute

1 confidence in this, there is a determination at the
2 highest levels of the Canadian government to work out
3 some joint accommodation with the United States for
4 transportation of oil and gas and through exchanges of
5 oil and gas. And I believe that the Alcan proposal offers
6 a very important way out for the Canadian government of
7 its way out of its dilemma.

8 Turning back to our contracts and the prospects
9 of the Trans-Alaska Pipeline, the only serious substantive
10 argument for the El Paso system from a national stand-
11 point, the only one that has any credibility is that
12 Canada will not license an overland pipeline under terms
13 acceptable to the United States. Only Canada can prove
14 or disprove the truth of this proposition and the
15 Administration and Congress are going to wait for this.

16 Now the -- I do not want to say that there is
17 no chance for a Trans-Alaska pipeline. There is no
18 chance for a Trans-Alaska pipeline so long as there is
19 a chance of a Trans-Canada pipeline and there is nothing
20 that Alaska or El Paso or any of the purchasers can do
21 to influence the decision from the United States in that
22 respect.

23 The corollary proposition advanced by El Paso
24 that the Canadian government is incapable of granting
25 acceptable terms for an international pipeline because

1 its treaties don't bind the provinces is without merit
2 and can be easily dismissed. The premieres of both
3 British Columbia and Alberta have expressed their in-
4 tention to lay this question to rest to the extent
5 that the Canadian federal government cannot bind the
6 provinces. The provinces have independent authority to
7 make treaties and those of you who are familiar with the
8 Columbia River treaty will recall that it is a treaty
9 between -- or among the United States, Canada and the
10 province of British Columbia. Both Premier Lougheed of
11 Alberta and Premier Bennett of British Columbia have made
12 it absolutely clear that they have no objection to joining
13 in any protocol providing for nondiscriminatory treatment,
14 taxation, regulation, and for that matter a complete
15 quitclaim of regulatory jurisdiction over a transit pipe-
16 line that carries United States gas. So I think that
17 that issue is totally a red herring.

18 The scenario I see developing on the approval of
19 the pipeline -- or on the determination of a pipeline
20 route is that the Federal Power Commission will find in
21 favor of Arctic Gas, along the same lines as Judge Litt's
22 finding, on the basis that it is environmentally superior
23 on the basis that results in lower cost to consumers,
24 the basis it can be built faster, that it is more easily
25 expansible, and the whole range that the Federal Power

1 Commission will find it superior in every respect.

2 At about the same time the Berger Commission
3 findings in effect vetoing Arctic Gas will come out in
4 Canada. Now if you'll recall the language of the Alaska
5 Natural Gas Transportation Act, it says the presidential
6 determination -- the FPC recommendation, the presidential
7 determination shall be made without respect to whether
8 Canada has reached a decision on this.

9 What the FPC decision for Arctic Gas and the
10 Berger decision against Arctic Gas will trigger is
11 negotiations between the United States and Canadian
12 government and among the various proponents of gas pipe-
13 line systems to see what kind of system can -- is agree-
14 able to all the parties. And it seems to me that the
15 system that is going to be most acceptable to all the
16 parties is a system along the Alcan Highway but departing
17 in some degree from Northwest's and West Coast's strategy
18 for that. In other words it would be a higher capacity
19 pipeline than envisioned by the sponsors. As -- one
20 combination would be to use El Paso's engineering and
21 pipeline design for the northern part of the route.
22 El Paso believes that with high pressure, with 1670 psi
23 they can move up to 3 1/2 bcf a day through a 42 inch
24 pipe. I think that a 42 inch pipe is one of the
25 strongest elements in the Alcan design because that is

1 the kind of pipe that can be rerolled in existing North
2 American facilities.

3 A disadvantage of the Arctic 48 inch scheme is
4 that it requires the building of a new plant by Stelco
5 for the production of that pipe and it introduces another
6 -- just another of a whole series of uncertainties into
7 what I believe is an oversized -- already an oversized
8 project.

9 So returning again to the contracts, I do not
10 see what the State accomplishes in terms of the advancing
11 of its goal by selling the gas now. I will -- in response
12 to questions I'd be willing to elaborate on what I think
13 the significance of these contracts are, but I would
14 like to go ahead and spend a couple minutes on what I
15 think some of the problems of building and financing an
16 Arctic Gas pipeline are, regardless of who built it.

17 There -- these projects are enormously risky no
18 matter what the sponsors and their financial advisors say.
19 Their ability to be financed in conventional -- by
20 conventional private means is extremely suspect. And
21 that -- I'm sure that Whitewell's representation to
22 El Paso and the financial advisor's representations to
23 Arctic Gas and to Northwest are qualified in the same way.
24 That is, if you get as much gas as you say you are going
25 to move through this system and if your costs are the

1 costs that your engineers say you will have and your
2 schedule is what your engineers say you can accomplish
3 and if you do get all the necessary approvals, then the
4 financial -- and you do get the all events full cost of
5 service tariff from the Federal Power Commission and the
6 state utilities that govern the distributors -- or the
7 customers of the system, then you can finance this
8 through conventional project financing.

9 What I would question is whether all those --
10 whether all of those conditions are certain enough that
11 the insurance company's pension funds and the other
12 institutional investors that have to buy this pipeline
13 would be willing to risk what may be Ten to Twenty Billion
14 Dollars in financing.

15 In the first place, there is uncertainty about
16 the gas supply. Now the -- I believe the State's
17 reservoir engineers project a probable production,
18 permissible production, or optimum production of about
19 2 bcf a day. Now that is about or perhaps below the
20 minimum threshold of Arctic and El Paso. That is about
21 the design threshold for Alcan.

22 Now it is conceivable that after two or three
23 years experience in oil production the Alaska conservation
24 authorities may conclude that that rate of production is
25 not in the State's interest, that the loss of oil -- the

1 value of the oil foregone by that production is greater
2 than the value of the gas produced. Nobody knows what
3 this is going to be. The fact that all the producers
4 and the State of Alaska and the gas purchasers all
5 believe that they can produce say two bcf a day safely
6 isn't good enough for the lenders. They have to have
7 some notion of what the likelihood -- the downside
8 likelihood is. And the downside likelihood -- if there
9 is only a ten percent chance that production will be
10 1.6 bcf per day and 1.6 bcf per day is not enough to
11 guarantee the payment of the debt on this pipeline,
12 then you just won't be able to go into the capital market.
13 We have the problem of delays in capital cost overruns.
14 Actual construction costs may exceed estimated costs by
15 substantially more than they affect general inflation.

16 Two years ago, with the help of the Library of
17 Congress, I did some research on this and was unable to
18 come up with a single large custom engineered construction
19 project in the United States over the last ten years
20 which had not exceeded its initial engineering cost
21 estimates by a factor of less than two. And the experience
22 in North America with big custom-engineered construction
23 projects has been that they typically cost two or three
24 times their original projections, even including an
25 allowance for inflation. The cost estimators are like

1 accountants and they prefer a solid, empirically based
2 figure. That is, so many cubic yards of cement at so
3 many dollars a cubic yard to a realistic figure. "They
4 do attempt to project the increase in anticipated labour
5 rates and in the prices of specific materials", and the
6 inflation rates for those specific materials, "but they
7 don't take into account the fact that huge projects,
8 particularly if they involve new technology", as both
9 systems do, both Arctic and El Paso does, "or a remote
10 construction site," and this would apply more to Arctic,
11 "usually don't work the first time around, nor that both
12 the purchaser and the licensing authorities change their
13 minds several times in the course of construction. The
14 cost engineers don't appreciate that such projects are
15 usually clumsily managed and are subject to a number of
16 re-organizations during their design and construction.
17 They don't allow for the fact that materials and equipment
18 are always late and often mis-specified or defective,"
19 and that such "enterprises" "suffer not normal, but
20 abnormal labour cost increases. Because of their size
21 and urgency, they are especially vulnerable to wage
22 pressure," and "to featherbedding, and" also "to
23 racketeering."

24 And I needn't go into great lengths on the
25 problems of the Trans-Alaska oil pipeline, which will --

1 whose costs will exceed by ten times the initial estimates
2 by the sponsoring companies. I do not project a ten time
3 overrun for Arctic Gas but I think that a doubling of
4 their present projections would not be an unreasonable
5 anticipation in view of the history of large projects in
6 North America. Let's assume that Arctic Gas or that El
7 Paso's project would cost Twenty Billion Dollars and that
8 it would have to be paid for in twenty years and "assume
9 that the investors should receive a 15 percent pre-tax
10 rate of return on total" investments. "Under a conventional
11 utility accounting scheme, the project would need a first
12 year cash flow of four billion dollars just to cover its
13 fixed costs. On a discounted cash flow basis" which is
14 a more rational financial way of looking at it but is not
15 customary in utility accounting, "the annual fixed charge
16 would be about \$3.2 billion."

17 But "with a throughput" of about "a trillion cubic
18 feet" a year; that is about three bcf, "we are talking"
19 about "\$3.20 to \$4.00 per thousand cubic feet" for
20 transportation costs alone. If less gas can be delivered,
21 if we are talking about two bcf a day, we are talking
22 about Five to Seven Dollars a thousand cubic feet. Now
23 "this charge doesn't include the cost of developing the
24 gas fields, any return to the producers," to the royalty
25 owners, any "operating costs or" any "costs of distribution."

1 Now both El Paso and Arctic insist that the
2 consumers will accept any price because of the rolled in
3 feature. Now not everybody agrees with this and in fact
4 none of the government sponsored studies -- the Aerospace
5 -- FEA study estimated that "no market for Prudhoe Bay
6 gas would exist in 1985 at a 'city gate' price exceeding
7 \$2.40 per million BTU (in 1975 dollars). The Interior
8 Department's study reaches a similar conclusion." Now
9 this price you are almost certain to get, "even without
10 implausibly large cost overruns or shortfalls" in the
11 gas distribution system.

12 Now, "one assumption of" these "studies mentioned"
13 "is that natural gas" prices have been decontrolled,
14 "and that the Alaska gas is" therefore "priced incrementally."

15 Incidentally, the -- I don't want to spend a lot
16 of time on it but it is not clear whether deregulation
17 would increase or reduce the price of Alaska gas. I
18 think there is a very strong case for expecting that it
19 would make Alaska gas less valuable for a number of
20 reasons. Deregulation would increase the price of gas
21 in the Lower 48 and therefore reduce consumption in the
22 Lower 48, increase production from the Lower 48 and reduce
23 the gap -- the shortage.

24 It would also reduce the amount of low priced gas
25 that the pipelines and distributors get which they can

1 roll together with expensive gas to come out with a
2 price that satisfies their consumers. Now I don't want
3 to predict absolutely that deregulation would make Alaska
4 gas less valuable, but I think that that's the probable
5 effect, that by easing the gas shortage in the Lower 48,
6 they make it less willing for gas distributors to pay
7 more for that gas than it is worth at the burner tip.

8 What it is worth at the burner tip to the average
9 consumer is roughly the price of fuel oil. Now there is
10 some consumers that will pay substantially more and some
11 who will pay only the price of coal or residual oil and
12 so on. But the average consumer is competing with fuel
13 oil. In a deregulated market, after a few years, you'll
14 find that gas distributors will not pay more than that
15 for gas because they don't have any cheap gas to average
16 it with.

17 So, anyway there are market risks -- there are
18 gas supply risks, market risks, cost overrun risks, and
19 of course you know about the political regulatory and
20 other institutional issues, things like native claims in
21 Canada, the fact that virtually nobody seems able to get
22 any sort of terminal in California. I have looked at
23 this problem again for several different agencies and I
24 wouldn't count on any proposal which requires a major
25 terminal in California at this time until there is a

1 substantial change in the internal institutions of that
2 state or a substantial change in federal-state relation-
3 ships.

4 It may be that there is just no way to put a
5 major terminal in California. Anyway you have these
6 problems, so you have the -- so these risks generate the
7 financing problems.

8 "The financial consequences of the risks I have
9 listed are magnified by the fact that neither "El Paso
10 nor Arctic" can be built in smaller self-sustaining
11 stages." Each is a total "integrated system which" will
12 not flow any gas or flow any cash until the whole thing is
13 completed. "Most of the capital invested", that is
14 Ten to Twenty Billion Dollars or more, will be exposed
15 to all the risk factors for the entire planning and
16 construction period.

17 Now private lenders "simply will not accept the
18 risks of this sort, and neither project's sponsors are
19 financially large enough to carry them, even if they were
20 willing to do so", and they are not willing to do so. All
21 of the projects propose an "all events" tariff in which
22 the sponsors would be guaranteed a return on equity, as
23 well as a return to debt service, whether or not any gas
24 is ever carried by their project.

25 El Paso proposes to use federal loan guarantees

1 and Arctic has talked about federal indemnification
2 for overruns. But, neither the "full cost of service
3 all-events tariffs" nor government guarantees are presently
4 in the works and none of these projects can be financed
5 without some sort of government backup. And this is
6 something that I think is independent of the numbers you
7 come out with on any particular thing.

8 The financing schemes are very conditional and
9 I think that all the sponsors are -- expect they will
10 ultimately have to go to the federal trough either for a
11 subsidy or a loan guarantee, which is the same thing as
12 a subsidy, because they will not be able to produce the
13 cash flow that they project and they will have overruns.

14 The President, when he makes his recommendations,
15 or the President in his negotiations with Canada, are
16 going to have to come up with something that can be
17 financed.

18 Now, turning to Judge Litt's conclusions on this,
19 Judge Litt is in effect asking somebody to build an over-
20 sized pipeline on speculation. He is saying that in view
21 of the vast amount -- the vast potential of the North
22 Slope, all the way from Pet Four through the State leases,
23 through the wildlife range, through the Beaufort Sea and the
24 Mackenzie Delta, there may be a vast amount of gas and
25 it is wasteful to build a minimum scale system as Alcan

1 proposes, simply to handle most economically the gas
2 that we know for certain can be produced. But, he is
3 asking somebody to take the risk and the somebody is
4 basically the investment community that is not going to
5 take the risk, even if the probability that the through-
6 puts necessary for Arctic Gas are -- say even if it is
7 a ninety percent probability that Arctic Gas is viable,

8 Then he turns around and says, "well, the oil
9 companies ought to take this risk." Well, the oil
10 companies are not in this business. The oil -- he is
11 asking the oil companies to put Three, Four, Five Billion
12 Dollars on top of the Four to Seven Billion Dollars it
13 is going to take to develop the field to produce the gas.
14 He is asking them to put it -- to take money that they
15 could use in high return risky ventures and put it into
16 an operation that is going to have a public utility rate
17 of return, where their going to be constrained to make
18 nine percent or something like that. And it just isn't
19 going to happen. It is an appeal to patriotism or
20 altruism or something like that that is completely un-
21 realistic.

22 If Judge Litt and the Federal Power Commission
23 and the President want a big diameter, high pressure
24 pipeline from the North Slope, they are going to have
25 to get the American people to pay for it and to accept

1 the risks through the political system and there is
2 nothing wrong, say with the principal of an all events
3 tariff as long as the probabilities are good, as long
4 as consumers have a substantial chance of benefiting,
5 why shouldn't the consumers take part of the risk? It
6 is not going to happen that way. The Public Utility
7 Commissions don't think the risks justify it, they don't
8 like the idea of socializing private risk in a situation
9 where the investors are guaranteed their return while
10 the consumers and the public take -- have the downside
11 risks. So, when the President of the United States and
12 the Premier of Canada get together to figure out what
13 the system is going to be, they are going to have to
14 look hard at the financing and the other system.

15 Now, looking at the faults of the Alcan system,
16 there is something from the point of view of the Federal
17 Power Commission. It seems to me that this principal
18 fault can easily be resolved. It is desirable to have
19 a forty-two inch pipe because that pipe can be built and
20 can be rolled in present mills and its -- the technology
21 is a lot more practicable.

22 El Paso believes that it can run a lot of gas
23 through -- a lot more gas at a higher pressure through
24 the pipe. If the Alcan people were granted a certificate
25 on the condition they would put in a heavy guage pipe.

1 which could operate with sixteen hundred seventy psi,
2 if the gas were available, by adding more power the
3 incremental costs would be relatively small.

4 I think these things can be settled but they
5 probably have to be settled in negotiations. It seems
6 to me in conclusion that none of the systems as presently
7 proposed and none of the financing arrangements are
8 presently viable, and that we have yet to see the last
9 of the combinations and permutations. I would say,
10 however, that there is nothing the State of Alaska can
11 do to advance a Trans-Alaska Pipeline LNG system within
12 the U.S. political system. If there is going to be
13 such a system, it will be selected by the Canadians
14 because of their inability or unwillingness to authorize
15 the prompt construction of an overland pipeline by one
16 route or another.

17 SENATOR RADER: Representative Meekins?

18 REP. MEEKINS: I don't know exactly where to begin.

19 SENATOR RADER: Maybe a motion to adjourn. As a matter of
20 fact we should have a recess motion. Let's take a
21 recess here for ten minutes.

22 (Whereupon the hearing was recessed at
23 4:00 p.m. and reconvened at 4:15 p.m.)

24 SENATOR RADER: The Committee will come back to order.

25 During the recess we had several conferences and we

1 decided that no matter what we did, we would have lots
2 of authority for doing it. So, and that includes
3 nothing, I guess. As I recall, Representative Meekins,
4 you had the floor when we recessed.

5 REP. MEEKINS: Thank you, Mr. Chairman. I hate to try to
6 characterize what you said, but as I understand it, you
7 say that while it is clear that the El Paso line provides
8 great benefits to the State, that in your view it seems
9 very clear that the contracts that were -- that are the
10 subject of this -- of these committees are irrelevant
11 to the decision upon which -- about which gasline will
12 win final approval and that the actual decision will be
13 made in Canada. If that is the case and if it is as clear
14 to you as it seemed in your presentation, how do you
15 explain the fact that administration experts say the
16 opposite?

17 DR. TUSSING: Well, I think that may be more your speciality
18 than mine. The purpose of these contracts is essentially
19 an internal Alaska political purpose. Suppose you were
20 the Governor and you had become -- and you were under
21 assault from OMAR and the Anchorage Times and from the
22 Anchorage business community for not having given one
23 hundred percent support to everything that the El Paso
24 enthusiasts wanted. And suppose as Governor you were
25 also convinced by your own investigations that El Paso

1 had very little chance and you're -- you would probably
2 be concerned that when Arctic Gas got the final nod
3 that these people would point the finger at you and say
4 that it is only because you didn't sell the royalty gas,
5 or its only because you made these noises about Alcan
6 being an acceptable second choice and that you didn't
7 dump all over the Canadians like we wanted to.

8 Well, it would seem that it would be an astute
9 political move to go ahead and call everybody's bluff.
10 You will recall that the Legislature almost unanimously,
11 under the leadership of Senator Rader, urged the -- in
12 fact, demanded that the administration go ahead and do
13 this. So the Governor now can come back to the Legis-
14 lature with what I think is really a contract that doesn't
15 mean anything for the --

16 REP. MEEKINS: Is this the hypothetical Governor?

17 DR. TUSSING: Yes, this is the hypothetical Governor. He
18 now comes back to the Legislature with this can of worms.

19 SENATOR RADER: A realistic can of worms, huh?

20 REP. MEEKINS: And a real Legislature.

21 DR. TUSSING: And you look at it and you decide there is some
22 problems with it, that the State may give up too much in
23 it and I think that Mr. Moody and Dr. Swanson have some
24 valid criticisms -- technical criticisms of the contract
25 or that maybe you shouldn't have sold all the gas, or a

1 whole series of reasons. Or, you may not be convinced
2 that you are buying any political influence. But, what
3 happens if you vote it down? And say -- where is the
4 finger going to point when Arctic Gas gets approved? El
5 Paso can say -- pick up its marbles and go home or some-
6 thing like that. It becomes a real psychological blow,
7 at least within Alaska, to the El Paso effort. And, you
8 guys, by voting this thing down bear the onus. You're
9 the ones who defeated the Trans-Alaska Gas Pipeline.

10 If you pass it, this hypothetical Governor has
11 exercised his leadership over this hypothetical fractious
12 and undisciplined Democratic Legislature and carried the
13 ball for Alaska. And, when and if Arctic gets the ap-
14 proval, he can show that he has done everything he could,
15 and, in fact more than anybody reasonably expected him
16 to do. He has done just what the enthusiasts for El Paso
17 -- what OMAR has been saying he should do all along. They
18 can't fault him on that. He has managed to carry along
19 these legislators who were riding off in every direction.
20 So, that -- that is what I think the fundamental signifi-
21 cance of these contracts are and that is why I say I am
22 not sitting in your seat, so I won't -- and I'm probably
23 not the kind of person who could ever get into one of
24 your seats. And so I won't advise you -- I won't advise
25 you of what you are doing.

1 SENATOR RADER: Representative Meekins still has the floor.

2 REP. MEEKINS: Mr. Chairman, I just want to thank you for
3 pointing that out. I never would have thought of it. I
4 would also like you to direct him to be more forthright.

5 SENATOR RADER: Quit beating around the bush, now. Senator
6 Colletta?

7 SENATOR COLLETTA: Yes. Dr. Tussing, you know that opened
8 an area that, since you are venturing opinions, it seems
9 to me out of the presentation on the political activities
10 rather than the economic ones that affect the line. You
11 missed the first day but the entire congressional delegation,
12 without regard to party, also say that on the national
13 level they want unanimity of support for this line.
14 Now, am I, you know -- should I believe from a conclusion
15 of your answer to the last question, that all of us are
16 playing a game and isn't the parallel to this line
17 identical to the oil line that came to Alaska on a one
18 vote measure?

19 You know, I can't help but infer, at least in my
20 own mind, from what you are saying is that regardless of
21 what we do or the congressional delegation does, not only
22 Alaskans, that this decision will be made by two beings
23 and they don't need us, we're playing the game and I
24 would suggest that is wrong. I take offense to it,
25 because in the oil line there were those people who felt

1 very strongly that possibly a route other than through
2 Alaska was beneficial and stood up and took the flak.
3 And I would suggest that in this body right here there
4 are those who still have not concluded that maybe the
5 all Alaskan route is the way to go.

6 I really take great offense that you are lumping
7 us into playing a show, and that isn't true.

8 DR. TUSSING: Well, let me deal with the first question --
9 or the second question, and that is the parallel with
10 the Alaska oil pipeline. I don't see a significant
11 parallel. In that case there was only one proposition
12 before the Congress. There were no responsible corporate
13 sponsors for a Trans-Canada pipeline. There was the
14 unanimous support, the State of Alaska, the oil companies
15 and the administration behind that proposal. Yet the
16 opposition to it managed to mobilize something like
17 forty-two votes for a Canadian alternative which didn't
18 exist.

19 Now, we have an entirely different situation.
20 The momentum and the weight of the responsible corporate
21 sponsorship, the weight of the agency endorsements within
22 the federal government are all with the Trans-Canada
23 system. The momentum is there. When the Trans-Alaska
24 Pipeline bill was before the Congress in 1973 it was
25 right at the height of the Arab embargo and it was the

1 only thing there that Congress could possibly ratify.
2 And, it -- there is some question of whether it would
3 have gone through without all that -- without all those
4 preconditions. Now the momentum, the establishment,
5 the route to be azoic -- and it's got a far higher --
6 it starts with a far higher proportion of support,
7 despite the fact that it has got responsible corporate
8 opposition and it has got the State of Alaska and a
9 number of other entities opposed to it. It starts --
10 Arctic starts stronger in Congress than the Trans-Alaska
11 Pipeline -- oil pipeline ever got in Congress. So,
12 that I don't think it is parallel.

13 Now, going to the question of the delegation.
14 I hate to -- I'm a little diffident about beating my
15 own drum, but on major national, political questions
16 concerning Alaska, the biggest ones, our delegation,
17 whoever they have been, with perhaps one exception,
18 and our administrations, whoever they have been, have
19 been one hundred percent wrong on these issues and I
20 think that I have got a little better record on that.

21 Going back, for example, to the question of
22 whether the Secretary of the Interior could or would
23 lift the land freeze and be able to authorize the pipe-
24 line without the settlement of Alaska native claims, or
25 to a more fundamental issue, whether there was any legal

1 merit or political horsepower nationally behind the
2 native claims. That were -- with the exception of the
3 second in which Senator Gravel, when he did come in in
4 1970, was an advocate of the native claims, our delegation
5 and our State administration dismissed the possibility
6 that this could hold up the pipeline and I was practically
7 stoned out of Anchorage in 1969 when I told the Chamber
8 of Commerce that there couldn't be an oil pipeline for
9 maybe seven years and going through the things that had
10 to be done. Well, this was against the unanimous
11 consensus of our administration and our delegation.

12 Come again to about 1972, when the question of
13 the destination of the oil and the West Coast supply/
14 demand balance, you had unanimous profession by the
15 industry, by the federal administration, by the State
16 administration and by our delegation that demand on the
17 West Coast would exceed production, combined California
18 and Alaska production, and that the question of exports
19 to Japan was not a real question because there would
20 never be a surplus of oil on the West Coast. And, again,
21 I think that I was probably alone in the State in
22 maintaining that this would be a problem.

23 Our delegation and most Alaska public officials
24 suffer a disease which is endemic to isolated colonial
25 areas and that is, that it is very easy to believe ones

1 own propaganda, to have wishful thinking. Now, I can't
2 believe that our delegation really believes that there is
3 a substantial chance that they could get a majority political
4 vote for the Trans-Alaska pipeline.

5 I do know that it would hurt them very badly
6 politically in Alaska to come in and do the same kind of
7 thing I do, that is, deliver the bad news. Again, I have
8 very little chance of replacing Senator Stevens or
9 Senator Gravel because I do tell the voters and the
10 politicians the bad news rather than the good news. And
11 so, I can't go into their heads and say why is it that
12 they give unanimous support. I just ask you, what would
13 be the political -- what are the political risks to them
14 of saying there is nothing you can do to advance the
15 Trans-Alaska pipeline, better forget it, buddy. You
16 know what would happen to them, regardless of whether that
17 is their best judgment. There is no political to them
18 at all in saying, "Go, man, go. Let's do everything we
19 can for El Paso." So, I don't know what -- you know, I
20 don't know what is in their heads but I don't think that
21 you can really weigh their statements as an accurate
22 objective judgment of what is going to happen in the
23 United States Congress.

24 SENATOR RADER: Any further questions?

25 REP. CHATTERTON: Yes.

1 SENATOR RADER: Mr. Chatterton?

2 REP. CHATTERTON: Thank you, Mr. Chairman. Dr. Tussing, I
3 am told that there was a recent poll conducted by the
4 Rowan group of public opinion and the findings of that
5 indicated in the order of eighty to eighty five percent
6 of the citizens of Alaska favored an all-Alaska gas
7 line. Are you suggesting in the comments you just made
8 that we who represent those people should subvert their
9 opinions?

10 DR. TUSSING: Not at all. I'm saying that you -- you as
11 members of the Legislature have to make this judgment
12 for yourself on the basis of the way you judge public
13 opinion, and the way you judge what's right and wrong.
14 That is not for me to say. I said I will not recommend
15 the vote one way or another on this.

16 SENATOR RADER: Representative Gruening?

17 REP. GRUENING: Well, this may be a clarification of
18 Representative Chatterton's question, but, is public
19 opinion subverted whether we reject or approve these
20 contracts? As I understand it, the question before us
21 is approving these contracts and not necessarily the
22 support or non-support of the El Paso line. In your
23 testimony the two are not necessarily, in terms of actual
24 effect, are not synonymous.

25 DR. TUSSING: Is that a question?

1 REP. GRUENJNG: Yes.

2 DR. TUSSING: I don't -- I agree with you that the -- that it
3 is possible to be in favor of the Trans-Alaska pipeline
4 and to be against this contract, or say to conclude that
5 this contract doesn't affect the outcome.

6 SENATOR RADER: Representative Miles was seeking the floor.

7 REP. MILES: Dr. Tussing, you indicated that there was no
8 support for the El Paso project in its market area, I
9 believe. Am I correct there?

10 DR. TUSSING: No. I said there is no substantial support in
11 California. I was talking of California's principal
12 market area.

13 REP. MILES: Just California only?

14 DR. TUSSING: Yes.

15 REP. MILES: I see. Well, this is a major market area, I
16 understand.

17 DR. TUSSING: Yes, California is El Paso's biggest market
18 area.

19 REP. MILES: Why -- getting off of politics and onto economics
20 for awhile, why would El Paso spend so much money in
21 developing a project if there is no support there? Am
22 I missing something? I obviously am.

23 DR. TUSSING: Well, again you are asking me to speculate
24 about peoples motives and I can just try to put myself
25 in their place. El Paso, in the first place, wants to

1 assure its customers that it is doing everything it can
2 to obtain gas and a major campaign to build a pipeline
3 system -- a transportation system from Alaska into their
4 market area is such a gesture and it may earn them some
5 Brownie points even if they -- you know, even if they
6 aren't successful. That is one consideration. Now,
7 El Paso is also getting very heavily involved in LNG
8 technology all over the world and wants opportunities
9 to develop and expand this technology.

10 Now, whether or not how great a probability of
11 success they have, or they believe they have, I don't
12 know. I think it's probably a good gamble for El Paso
13 to stay in the race in the expect. -- on the possibility
14 that Canadians might not come through. That then El Paso
15 is posed with an alternative system.

16 I would not say surely that the El Paso system
17 will be approved even if the Canadians can't get their
18 act together or if they turn down Arctic and Alcan, but
19 at least El Paso is certainly number one -- number one
20 in the line with this and they would -- if they success-
21 fully complete it -- financed it and completed it and
22 operated it, they would add more cash flow to the
23 corporate treasury.

24 Now, why do they want the gas? Why do they want
25 the royalty gas, because they are in the gas business.

1 They want gas to flow through their system. They would
2 want the gas to flow through their system regardless of
3 what system were chosen. I'm sure that once -- that if
4 a system other than El Paso was approved, El Paso will
5 be back here at the state trying to buy the royalty gas
6 and will be back trying to buy gas from the producers.

7 I don't think there is any mystery of what their
8 general motivation to the enterprise is and for risking
9 money for the enterprise. It is a perfectly legitimate
10 kind of corporate venture.

11 SENATOR RADER: Representative Swanson and then Senator Huber

12 REP. SWANSON: Yes, I just -- I'll turn the clock back just a
13 couple of minutes and something has disturbed me through
14 all of these hearings, that we are here talking about a
15 gas contract and using data that is two years old. Now
16 I'm one of the people who endorsed a all-Alaska route two --
17 going on three years ago and we are still using that
18 support in the propaganda used today. We have not
19 passed a resolution since we came to this Legislature
20 endorsing --

21 SENATOR RADER: Representative, do you have a question of
22 the witness?

23 REP. SWANSON: Yes. Well, I kind of resented what was said
24 here awhile ago and I feel a little bit like that I have
25 the right at this table or any other table to state

1 that I don't think that the --

2 SENATOR RADER: If you feel you have been attacked, you
3 have a right of personal privilege but the purpose of
4 this hearing is to make answer -- ask questions of these
5 witnesses now.

6 REP. SWANSON: All right.

7 SENATOR RADER: If you wish to why proceed.

8 REP. SWANSON: I feel like you do, John. I would like to
9 ask you, in your remarks concerning the support of the
10 El Paso route, do you take of what has happened today
11 or two years ago?

12 DR. TUSSING: I'm not sure what you are referring to.

13 REP. SWANSON: Well, in your -- in your statements of the
14 Legislature totally supporting the El Paso route.

15 DR. TUSSING: Oh, the last session of the Legislature
16 adopted a resolution urging the administration to make
17 a gas sale to El Paso and to other supporters in the
18 Trans-Alaska route.

19 As far as I know, you are perfectly correct,
20 this Legislature has not adopted any resolution to that
21 effect.

22 REP. SWANSON: Thank you. Thank you, Mr. Chairman.

23 SENATOR RADER: Senator Huber?

24 SENATOR HUBER: Thank you, Mr. Chairman. Mr. Tussing, the
25 Four Dollar price that you mentioned on gas, is it correct

1 to assume that was an mcf and that it would compare to
2 Twenty Four Dollar a barrel oil price or Sixty-five to
3 Seventy-five Dollar a ton coal price with eight or nine
4 thousand BTU's assumed?

5 DR. TUSSING: Well, those -- those are the equivalent prices.
6 I don't want to be pressed to give a specific price
7 because one of my points is that nobody knows what the
8 price is going to be. It is very likely to be much
9 higher than the sponsors of any of these projects are
10 telling us, but whether the overruns are going to be
11 five percent or five hundred percent, we can only
12 speculate and so --

13 SENATOR HUBER: Would you care to expound on the saleability
14 of Four Dollar gas compared to Twenty-four Dollar oil,
15 at this time?

16 DR. TUSSING: That's -- it's a complicated question. The
17 value -- as I said before, the value of gas to the
18 average homeowner or commercial user is roughly the
19 value of fuel oil plus the -- say, some amortization
20 of his cost of conversion if he has to convert from oil
21 to gas, and so, so at the burner tip, gas is on the
22 average worth maybe Two Dollars and Twenty-five, Two
23 Dollars and Fifty Cents a million BTU today.

24 Now, if we expect the OPEC oil price to go
25 up roughly with inflation, maybe six percent a year.

1 and so on. We can expect that average value of gas to
2 go up. Now, the gas distributors gather together gas from
3 various sources at various prices and they sell it at an
4 average price. The gas distributors and the pipelines
5 are also required by their franchises or by their licenses
6 to provide this service -- to provide gas to all comers
7 at a cost of service price. And so, if they have a
8 shortage, if their demand is greater than their supply,
9 they're often -- they will be willing to pay more than
10 the gas is actually worth at the burner tip to acquire
11 it and put it in their system.

12 Otherwise, they have consumers in which they have
13 legal -- to whom they have a legal obligation to serve,
14 who go short. So that for small amounts of gas, at the
15 seasonal peak, or when there is some sort of emergency,
16 the gas distributors may be willing to pay Ten Dollars,
17 may be willing to pay the equivalent of One Hundred
18 Dollar a barrel oil to avoid turning off the valve to
19 their consumers. So -- but you can't take Ten Dollars
20 a thousand cubic feet as the value because you have got
21 to look at the whole cycle. Now, if the gas coming out
22 of the pipeline costs the distributors Six Dollars a
23 million cubic feet and he has got to -- or a thousand
24 cubic feet and he has got to sell it at an average price
25 of say Two Fifty, that means he has got to get a hell of

1 a lot for it in the peak season. He may have to get Ten
2 Dollars for it at the peak season and then he has got
3 surplus gas, he's paying for the gas that comes through
4 that pipeline in midsummer even though his regular
5 residential customers don't need it. And, in that case,
6 he has got to sell it in competition with coal for a
7 dollar or residual fuel oil for Two Dollars.

8 So, it's not -- there is no single market value
9 price and to know how much, say six hundred fifty bcf of
10 gas or say one hundred million cubic feet of gas per day
11 is worth to a gas distributor in Chicago or Los Angeles
12 depends upon how short they are, how much they have already
13 cut off their low priority customers, what their other
14 alternative gas supplies are. Do they have a lot of
15 flowing -- of gas flowing under old regulated contracts
16 where they are paying Thirty Cents or Fifty Cents and to
17 be used to subsidize the purchase of expensive gas. You
18 have to look at all of these things and then each
19 distributor figures out what the gas is worth to it and
20 what the cheapest alternative is. If it goes to -- say
21 it goes to Four or Five Dollars, they will look at making
22 synthetic methane from oil which is very expensive for
23 base load supply. It is more than the average consumer
24 will pay but if they are trying to -- if they are just
25 trying to fill a gap, it is a lot less risky to build a

1 propane air plant or a plant to make methane out of
2 naphtha for Four Dollars an mcf than it is to commit
3 yourself to twenty years of take or pay year in and year
4 out Four Dollar gas from Alaska. So, Four Dollars is
5 cheaper from an SNG -- from an oil SNG plant than it is
6 from a gas pipeline and I just can't give you the answer
7 and say at what point, at what price Alaska gas prices
8 itself out of the market.

9 The Interior Department's -- the FEA study that
10 says Two Forty -- Two Forty, that's too low in view of
11 their opportunity to roll it in. The El Paso's assertion
12 that the distributors will accept the price no matter how
13 much it costs is pure crazy. There is just no substance
14 for that, there is a limit and I can't tell you --
15 probably Dr. Swanson's firm has done work in this as to
16 what the long term limit to the city gate price is, but I
17 can't tell you. It is somewhere between Two Forty and
18 infinity. And I don't think its -- I really don't think
19 it's much more than Four or Five Dollars.

20 DR. SCOTT: Somewhat short. This way from infinity.

21 SENATOR RADER: Senator Huber?

22 SENATOR HUBER: Mr. Chairman, the other question I have, I
23 have trouble in phrasing it and I have noticed that you
24 have returned to being a bit on the tough side and I don't
25 think you will give me the latitude that you gave Senator

1 Colletta, so I'll let it go.

2 SENATOR RADER: Well, now that we have established that I'm
3 an unfair chairman, are there anymore questions? Mr.
4 Carpenter.

5 REP. CARPENTER: I'm going to make an extension of Senator
6 Colletta's question. Dr. Tussing, you said that you
7 angered the Chambers of Commerce by saying there was going
8 to be a hiatus in construction of a Trans-Alaska oil pipe-
9 line due to land claims and so forth?

10 DR. TUSSING: Yes.

11 REP. CARPENTER: Well, refreshing your memory a little bit,
12 you actually angered them because you said there was no
13 political chance of a Trans-Alaska oil pipeline, there
14 was going to be a Trans-Canadian oil pipeline and that is
15 what got everybody on you.

16 DR. TUSSING: I never said that. Never, never, ever.

17 REP. CARPENTER: Our memories differ.

18 SENATOR RADER: Are there any other -- I'd like to ask every-
19 body to keep themselves on the subject of inquiry here.
20 There is opportunity -- there will be opportunity for each
21 of us to express ourselves at a later time as to whether
22 Dr. Tussing's remark characterized a hypothetical or a
23 real governor or legislature or a congressman. We needn't
24 confront him with that today. Our purpose here today is
25 to take his testimony on the subject before us and I

1 would like to limit the questions to that if we might.
2 Senator Croft?

3 SENATOR CROFT: Could I interrupt your remarks and ask a
4 question? I am curious what you think the prospects are
5 that any pipeline, Arctic, El Paso, Alcan, or another
6 one if it is proposed, will actually begin construction
7 sometime in 1978. Judge Litt talks about a dollar well-
8 head value being about the upper limit and all of the
9 projections are that these -- each of these projects will
10 have a higher amount than that. You have talked about
11 all events tariffs and types of public financing that
12 haven't even been considered yet. What do you think the
13 prospects are? You have indicated Arctic is likely to be
14 approved, do you think that means that they can actually
15 begin the construction on the time schedule they are
16 talking about?

17 DR. TUSSING: I don't -- I'm very skeptical as to whether
18 Arctic can be built. I think it can be approved, that's
19 the -- I think it can be approved in the United States
20 and all other things being equal, it will be approved in
21 the United States. It will get the endorsement of the
22 FPC. But, shortly after the FPC decision we'll get the
23 Berger decision, the National Energy Board in Canada will
24 be second phase hearings next month. The NEB -- I don't
25 know what the NEB will do, it will probably hand the hot

1 potato to the cabinet -- to the Canadian cabinet. But,
2 once the FPC makes its decision and once Berger in effect
3 makes a contradictory decision, what is on the agenda is for
4 negotiations between the United States and Canada as to
5 what can be worked out. And the final decision depends
6 first on those negotiations and second on resolving a lot
7 of questions that involve both government and industry
8 that really haven't been confronted yet. One is the
9 financing question and in what manner shall the respective
10 governments provide the guarantees against the risks in
11 this system and practically any proposal is going to be
12 extremely controversial. Loan guarantees come -- again,
13 raise the question that your socializing the private risk
14 and letting the private owners have the profit, and there
15 is going to be a lot of antagonism in both countries.

16 You may recall that the Diefenbaker government
17 fell as a result of things resulting from the loan
18 guarantees to the Trans-Canada pipeline. The -- so that
19 -- it's a sensitive issue in Canada.

20 Another issue that hasn't yet become -- begun to
21 be confronted which is relevant to this royalty gas sale,
22 is how the gas is going to be allocated. If the -- if
23 there is still wellhead price control by the FPC, every
24 gas company in the United States is going to want some
25 of that gas and no company can offer the producers or

1 the State of Alaska more favorable economic terms than
2 any other company. So, there is going to be a lot more --
3 there is going to be a lot more demand for that gas than
4 there is supply, assuming that some sort of viable pipe-
5 line system is hooked up.

6 The FPC is going to have to decide whose contracts
7 are going to be approved. And even though there is no --
8 there is no current legal authority for the FPC to
9 allocate gas and -- at least in non-emergency times
10 among pipelines the way it can allocate today and say --
11 say to Columbia, "you know, Tenneco needs the gas more
12 than you do, so we will turn down the Columbia contract
13 in the -- the proposed contract with Columbia in the
14 public interest because this other system is cut -- it's
15 jeopardizing its number one and number two priority
16 customers while you're still serving threes and fours."
17 So, the FPC is going to decide who gets the gas. That is
18 one of the reasons the producers aren't going out of their
19 way to sign contracts, because -- you know, why should
20 they choose one over another? They are not going to get
21 any price advantage and the contracts -- a lot of them
22 will probably be turned down anyway because the FPC wants
23 somebody else to have the gas. Well, that hasn't yet been
24 dealt with and if gas contracts are going to be used to
25 finance the pipeline, then these have to be executed

1 before a final financial plan goes together. So, in
2 summary, I don't see much chance for construction in --
3 beginning in '78 unless the U.S. and Canadian governments
4 bite the bullet and say, "we will provide the interim
5 financing and we'll guarantee the thing until you put
6 the final -- until all the final arrangements are made."
7 And I really don't see -- I don't see that. Maybe next
8 winter, if the questions before Congress and the Parliament,
9 and we have got another cold spell like this years, they'll
10 be willing to do it. They may send the Corps of Engineers
11 out to build the thing for all I know but -- but, I don't
12 see it starting in '78.

13 SENATOR RADER: Senator Croft, were you through?

14 SENATOR CROFT: No, I have another question. To what extent
15 do you feel that the assumption of the amount of gas that
16 is available on the reserves in the Arctic, Prudhoe Bay,
17 as well as the Mackenzie is an unrealistically high
18 assumption? Both El Paso and Arctic are big volume lines.
19 To what extent do you think their estimates of their
20 potential build up of throughput are realistic or un-
21 realistic?

22 DR. TUSSING: Well, if by the time -- by the time the system
23 is completed, I think there is a good chance that there
24 will be a lot more gas than we know about now. That isn't
25 enough to get -- to get the kind of debt financing I'm

1 talking to. A good chance isn't enough. A good chance
2 is enough to make a risk venture, but if you are risking
3 your own money and you say "I think there is going to be
4 plenty of gas there that we'll be -- that by the time the
5 thing goes on stream we would be able to produce four and
6 one-half bcf from those two areas and that's -- that's
7 the way to average expectation, and I'm willing to gamble
8 my money on that." That's fine, but the bond -- the bond-
9 holders want a ninety-nine percent assurance.

10 I think that there is merit to the notion that
11 society, that is, that the U.S. and Canadian governments
12 should take the risk and build a pipeline that is cheap
13 to expand. Now, if the governments are not going to do
14 it then the -- then the rationale -- the strategy of Alcan
15 is the only one that makes sense. You put in absolutely
16 minimum capital investment necessary to start that gas
17 and that cash flowing. I think that they have -- that the
18 Alcan people haven't scaled down their system as far as
19 they could. That, for example, they could drop Northern
20 Border out of the system and say, "we're going to -- we
21 expect the NEB to authorize or compel Trans-Canada to move
22 this east and then we'll take it through a Great Lakes
23 pipeline and we'll increase the power or whatever is
24 necessary there."

25 I think -- now, Judge Litt wants a western leg on

1 the Arctic pipeline and all the Western States want it
2 because they don't believe that they will get the gas
3 under reasonable prices by displacement. Well, the
4 western leg is physically superfluous, at least up to,
5 say one and one-half bcf going to -- going to western
6 systems. Well, so -- so, as part of the political
7 compromise you put the western leg into the system but
8 you don't build it until after the gas starts flowing and
9 the production builds up.

10 So, but if -- but if Canada and the United States
11 are willing to bite the bullet and say, "our best
12 geological assessment is that there is sixty or one hundred
13 tcf up there which can be discovered within the next ten
14 years, then let's go haul the hog, let's put in a high
15 capacity pipeline. Let's put a MacKenzie link, whether
16 it is on the Dempster Highway or the foothills or whatever,
17 as part of the phase two and build the thing so it is
18 compatible with the Mackenzie link and so on."

19 SENATOR CROFT: What you are saying is that a sale of the gas
20 will not have any effect on the route decision. What I
21 was really getting at to get you to comment on, do you
22 feel a -- (a) a refusal to sell any gas or (b) a refusal
23 to allow production of gas might influence a route decision?

24 DR. TUSSING: No. There is no credibility to such a threat
25 by Alaska because once the decision is made, the State's

1 got no -- the State's got no alternatives and all you do
2 by not allowing the gas to be produced -- you may cause
3 problems for oil production which causes the State a lot
4 of problems and you forego the revenue. And, I just can't
5 believe the State is stupid and spiteful enough to refuse
6 to produce the gas just because the rest of the country
7 didn't do -- didn't build the route the State wanted.
8 It just doesn't make sense. And so that threat has
9 absolutely no credibility. In the calculation of rates of
10 return or costs assuming only seven-eighths of the
11 production are just meaningless, you are just not going
12 to do that and nobody will believe that you'll do that.

13 SENATOR CROFT: What about the holding down the rate of
14 production?

15 DR. TUSSING: Well, there are some difficult -- there are some
16 difficult problems. Suppose your reservoir engineering
17 studies show that the optimum rate of production is 1.6
18 bcf below -- is below the economic threshold of any pipe-
19 line system but that you -- but you do run into trouble
20 by keeping injecting that gas and you're not going to
21 flare it. You have some tough -- you have got some tough
22 problems and I don't have an answer to that and let's hope
23 we don't have to face that one. But, it is entirely
24 plausible that you may have the level of production large
25 enough to give you problems as to what to do with the gas,

1 but not large enough to make any transportation system
2 viable. And, of course in the past what was done in that
3 sort of situation is what is being done in Saudi Arabia
4 and Venezuela and the other big isolated fields in the
5 world, they just burn the stuff.

6 SENATOR CROFT: Mr. Chairman. If a one in ten chance which you
7 referred to earlier is sufficient to keep investors from
8 backing any gas line, isn't the uncertainty about levels
9 of production such that it might -- that itself might
10 cause a delay in the pipeline?

11 DR. TUSSING: Yes, I think so. The --

12 SENATOR CROFT: Particularly when it is coupled with the
13 possible decision by the U.S. Government on deregulation
14 which may make Alaska gas -- not only might they face
15 a lower volume of Alaska gas but a less valuable Alaska
16 gas, if you couple the two together.

17 DR. TUSSING: Yes, all of these are just parts of a big
18 package of uncertainties that are going to cause difficulties
19 for any of these proposals.

20 SENATOR CROFT: Thank you.

21 SENATOR RADER: Representative Gruening?

22 REP. GRUENING: Dr. Tussing, as I understand what you said
23 earlier was that the Canadian government was going to
24 make the choice as to whether it was for either Alcan or
25 Arctic. How is the President going to feel comfortable

1 with making a decision, certifying a route without that
2 stage in the negotiations being very certain? Are they
3 going to amend the Alaska Natural Gas Transportation Act
4 so he has more time? In other words, he has until July --
5 or September first and then ninety days if he wants to
6 extend it. Is he going to feel comfortable with making
7 that kind of decision without those things resolved?

8 DR. TUSSING: I think what he is going to do is as soon as
9 the FPC decision comes down, and it may be happening right
10 now, he is going to start talking with responsible
11 Canadian authorities about -- oh, to what -- what kind
12 of compatible decision we can come out with. And, I
13 don't think that the Canadian authorities know what their
14 political constraints are yet, until Berger has actually
15 published his findings and there has been the -- a chance
16 for a discussion of it and for the bureaucracy -- for
17 them to read the FPC decision in the United States.

18 But, if the President makes the decision, say at
19 the end of '77, you can count on its reflecting his
20 discussions with the Canadians and he is not going to
21 make a decision which is totally incompatible with what
22 he thinks the Canadians are going to do. And both
23 countries are going to bend over backwards not to appear
24 to be forcing the hand of the other and to be blackmailing
25 the other that there -- or leapfrogging or something like

1 that. They're going to try to make it -- they're going
2 to try to come out with compatible decisions, whatever
3 the --

4 REP. GRUENING: You seem to raise the same arguments that the
5 El Paso people raise in terms of the unsolvable Canadian
6 questions and I think, you know, the same statements
7 seem to be made in terms of the problems. Now, are those
8 problems going to be resolved to the extent that the
9 President can make a decision certifying say a Canadian
10 route and not -- coming back at a later time and say,
11 "I'm sorry, we can't -- the Canadians just decided that
12 they can't go either route, we're going to have to go to
13 an El Paso --"

14 DR. TUSSING: Well, the law says that he has to make the
15 decision whether or not Canada has -- he has to make a
16 decision on its merits whether or not Canada has made a
17 decision. And, irrespective of what the process in
18 Canada is, in reality it's going to be a joint decision
19 once the -- once the thing has gone through the regulatory
20 and hearing phases of it and I don't know the exact
21 mechanism by which the United States and Canada will
22 consult on this. I'm sure no mechanism has been set up.
23 But, it's not an insoluble problem, it's a problem whose
24 answer -- whose outcome is impossible to predict with
25 competence now. I don't think anybody can come out with

1 a solid prediction of what will happen in Canada, much
2 less -- I'm as willing to do it as any Canadian. There
3 is no authoritative -- there is nobody who has the
4 authoritative position in Canada to say what Canada's
5 position is on this. But, Canada will have a position
6 of some sort and it will influence the President's decision.

7 I think that the -- that there is a good chance
8 that the compromise between the FPC's decision in favor
9 of Arctic and Justice Berger's decision against Arctic
10 will be some kind of expanded Alcan system. That is my
11 guess, but I wouldn't give it more than a fifty percent
12 probability. One substantial possibility is that Canada
13 will not authorize any pipeline or will postpone it till
14 after the elections and the President may decide that we
15 have to go ahead with our own system because of our
16 internal needs, even though it's not -- even though it is
17 the second best. So, my ability to forecast or prophecise
18 is strictly limited on that.

19 SENATOR RADER: Representative Meekins?

20 REP. MEEKINS: Thank you, Mr. Chairman. Dr. Tussing, you
21 stated in your comments that this contract, in your view,
22 was not essential, that we weren't -- essentially that you
23 weren't getting very much in the contract but looking at
24 it from the other perspective, what are we losing, if
25 anything? Are we losing anything by approving it?

1 DR. TUSSING: Well, it is -- it is conceivable that the Trans-
2 Alaska route, or for that matter an Alcan route, after the
3 State shifts to it, if it does, will be approved and that
4 these contracts will be the basis of contracts under
5 which gas actually flows.

6 I'm rather doubtful, even in this situation,
7 whether the FPC will approve just these contracts for a
8 number of reasons. But -- but it's possible you may be
9 stuck with these terms and they are probably not -- not
10 the best terms you could get in a bidding situation after
11 the -- after the pipeline is -- route is clear. Certainly
12 there may be opportunities in a deregulated situation to
13 get a more favorable situation. I don't want -- I don't
14 want to speculate too far on that, but your other
15 consultants who have examined the contracts in detail
16 point out ways in which the State has given up options. So --
17 So, in case they go into effect you have given it up. I
18 do have one specific criticism of the contracts even
19 starting -- even from the presumption -- the premises
20 from which the administration is starting, that is, that
21 you are going to buy some political support.

22 And, I don't know why you had to commit one hundred
23 percent of the gas and I think there is some -- there are
24 a couple reasons why you probably shouldn't commit one
25 hundred percent of the gas. Firstly, you have this most

1 favored nation clause, that is, that the price is the
2 highest price paid by any interstate purchaser. Now,
3 it may well be possible for the State, if it kept some --
4 held some gas back to find a purchaser who would pay a
5 higher price than any of the others and jack up the fate.
6 If it kept some -- twenty-five percent out and waited
7 until -- waited until the bidding process at the time
8 of the completion of the pipeline, you might be able to
9 get a higher price than any of the sales from the -- by the
10 operators because the State might be in a position to
11 sell to a nonjurisdictional purchaser, or to one that
12 has a special tax advantage, like a state entity.

13 And, I would like to see you have the opportunity
14 to use that twenty-five percent to jack up the price on
15 the remaining seventy-five. Then the other is -- in the
16 administration's presentation and within the whole rationale
17 for the thing, there seems to be a high probability of
18 a shift in route -- of a shift to Alcan, for example.
19 And, if that is serious, if that is not just window
20 dressing, then it would seem to me you would want to keep
21 twenty-five percent out to -- and to offer it to Northwest
22 at that time that the State moves to the Northwest position.
23 Otherwise, the option of shifting doesn't seem terribly
24 great. So, even if I were -- even if I accepted all the
25 other premises, I don't see the reason for selling more

1 than three-quarters of the gas at this time.

2 SENATOR RADER: Representative Meekins?

3 REP. MEEKINS: Do you happen to know if that -- if the most
4 favored nation provision, as you call it, in there would
5 apply to sales to users? I'm not sure it would.

6 DR. TUSSING: I don't have it in front of me but if I recall
7 the language, it's in any interstate sale. It doesn't --
8 or any interstate purchase and so it doesn't characterize
9 the purchaser. It would seem to me it would -- frankly,
10 I don't see why in a deregulated situation it should be
11 limited to interstate sales since -- since, if the gas
12 is worth Two Dollars in-state, to an in-state purchaser,
13 you shouldn't sell it for One Dollar to an out-of-state
14 purchaser.

15 But, as Mr. Moody says in his prepared statement,
16 it may not be that you can get any contract which includes
17 a -- you know, includes that -- all these provisions.
18 That's a matter of judgment that is up to the negotiator,
19 he really has --

20 REP. MEEKINS: Well, I'm trying to find out if there is any-
21 thing we are really losing, in your view, in approving
22 this contract. You know, we've heard that that -- that
23 problem that you point out that we may be losing a higher
24 price by not having reserved the twenty-five percent so
25 we can jack up the most favored nation provision in there.

1 That might not be a realistic concern because the FPC
2 wouldn't approve of such a contract anyway in their
3 regulation of the transportation of such gas.

4 DR. TUSSING: Well, no. That's a -- that's one that depends
5 on the -- it's conditional on deregulation. So, it wouldn't
6 require an FPC approval. The FPC will continue to regulate
7 the transportation and the transportation costs but if
8 that's a feature of the wellhead price, conceivably the
9 FPC could reject the whole contract on the grounds the
10 pricing provisions are not in the public interest but I
11 don't see that as a problem. I just -- let's say what
12 you are giving up are the shortcomings identified by Mr.
13 Swanson and Mr. Moody, as far as I can tell. That is,
14 that there -- that you are giving up options or some
15 possible options for getting a higher price by leaving
16 the gas off the market until you see -- until all the
17 circumstances are sorted out. You know -- for example,
18 the amount the gas is worth to a particular gas distributor
19 does depend on the transportation system. Now, the hi-
20 erarchy -- the ranking and the order of preference of
21 the different potential customers would change. For an
22 Alcan system probably -- probably Northwest would be
23 your preferred customer in a deregulated situation be-
24 cause the value of gas in its market is essentially the
25 same as it is anywhere else in the country but it is

1 closer, so you have the lowest transportation costs.
2 And, under the LNG system you would probably -- conceivably
3 El Paso would be willing to bid the highest for two
4 reasons. First, because it would be the point of off
5 loading and be closest, and second, because they are
6 quality problems. California probably has the highest
7 premium but as you know, of course PG & E, which is one
8 of El Paso's customers, is part of the Arctic group and
9 would like to bring the stuff overland to California.
10 Now I don't know how much PG & E would give.

11 REP. MEEKINS: Thank you.

12 SENATOR RADER: Mr. Chatterton?

13 REP. CHATTERTON: Mr. Chairman, Dr. Tussing, this is in effect
14 the same question as Mr. Meekins -- Representative Meekins
15 asked and I am going to ask it so I think that we can not
16 be confused by rhetoric about pipeline routes and stay
17 with just one subject, the contract, and I think you can
18 answer it with a "yes" or "no". My question, do you
19 believe that this legislature in approving these three
20 gas sales contracts would be doing the people of Alaska a
21 disservice?

22 DR. TUSSING: I can't answer that. That's a political question
23 that really goes beyond my competence.

24 SENATOR RADER: Any further questions? We'll adjourn and
25 subject to an adjournment by the House and Senate

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

tomorrow morning we will reconvene at 11:00 a.m.

We'll start with the Alcan people and go from Alcan to Arctic Gas and then probably through our consultants and then into the general public testimony.

We stand adjourned.

(Whereupon the hearing was adjourned at 5:15 p.m.)

60

1 FEBRUARY 4, 1977

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

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

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

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

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

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

10 REP. GRUENING: I guess not.

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

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

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

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

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

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

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

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

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

19 MS. SANDERS: 16.

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

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

Doctor?

(Whereupon Exhibit "16" was duly marked.)

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

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

SENATOR RADER: Excuse me, Doctor, let me interrupt you. I do see some members of the Legislature, and I want to invite you to seat yourselves at the front tables here, if you would care to. It will be easier to participate in the questioning and also address the witness.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 royalty gas in interstate commerce very well.

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

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

1 and their bankers.

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

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

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

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

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

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

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

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

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

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

1 responsibilities to its citizens.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

25 I would submit that the rolled in pricing that

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

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

15 SENATOR RADER: Representative Gruening.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

24 REP. GRUENING: I see.

25 SENATOR RADER: Although we do intend to question them

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

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

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

9 SENATOR HUBER: Mr. Chairman.

10 SENATOR RADER: Yes, Senator Huber.

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

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

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

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

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

8 MRS. SANDERS: Yes.

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

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

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

12 SENATOR HUBER: Yes.

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

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

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

25 Judge Litt, in a report to the Commission in

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

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

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

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

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

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

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

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

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

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

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

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

dubious.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 Amarata, Hess, and five, or six or seven different oil
2 companies. Now, the contracts, under deregulation, in
3 Section 5.3 and 6.4 clearly state that the redetermination
4 shall be the highest price paid any working interest
5 owner on the North Slope. It may well be, though I think
6 the possibility remote, but it may well be that one
7 working interest holder may have a somewhat lower price,
8 stated price, in the contract under deregulation than
9 would be justified by an arm's length not around the back
10 deal.

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

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

1 DR. SWANSON: Yes, they do.

2 REP. PARR: Thank you.

3 SENATOR RADER: Any further questions? Senator Huber?

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

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

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

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

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

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

20 DR. SWANSON: Yes, I have.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

13 SENATOR RADER: All right.

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

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

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

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

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

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

7 SENATOR RADER: Any further questions? Senator Sumner.

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

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

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

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

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

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

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

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

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

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

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

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

7 DR. SWANSON: Unlikely, yes.

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

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

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

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

20 SENATOR COLLETTA: I believe Senator Huber did.

21 SENATOR RADER: Oh, Senator Huber.

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

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

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

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

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

1 DR. SWANSON: Now, the difficulty of a number -- excuse me,
2 Senator, I'm sorry.

3 SENATOR HUBER: Go ahead.

4 DR. SWANSON: The difficulty of a number given, such as that,
5 is that it's a number which can assume greater importance,
6 or it's an easy number to grab ahold of. You asked me
7 the question straight, and I answered it as straight as
8 I could. Maybe it's fifteen percent, maybe it's five
9 percent, maybe it's ten percent, maybe it's two percent;
10 I don't know, but I think when I state ten percent (maybe
11 it's less) I think that's a fair characterization of
12 unlikely. But remember that that ten percent would be
13 further reduced by the point that Senator Sumner has brought
14 up, which is that there are contract terms in the contract
15 you are examining now which might make the vintaging
16 which would allow working interest holders a higher
17 price than applicable, but that's something presumably
18 which will be worked out in the courts, and also it's
19 something that requires legal judgment, which I would
20 suggest you ask of Mr. Moody.

21 SENATOR HUBER: Mr. Chairman, that brings me to the second
22 half of my question. Mr. Swanson, your definition that
23 vintaging, I believe, was quite narrow here. In regard
24 to that, have you taken into consideration the precedent
25 that was set by the Federal Government action in disallowing

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

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

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

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

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

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

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

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

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

8 SENATORY HUBER: Thank you, Mr. Swanson.

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

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

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

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

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

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

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

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

13 SENATOR RADER: Representative Chatterton.

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

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

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

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

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

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

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

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

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

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

apply too much to our analysis of this contract.

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

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

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

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

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

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

15 SENATOR RADER: Senator Colletta.

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

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

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

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

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

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

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

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

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

23 SENATOR HUBER: Please do that.

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

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

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

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

13 SENATOR HUBER: That is my concern.

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

1 value to the State.

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

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

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

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

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

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

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

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

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

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

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

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

1 proceedings in case questions do come up later?

2 DR. SWANSON: Yes, sir.

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

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

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

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

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

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

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

- 3
- 4
- 5
- 6
- 7
- 8
- 9
- 10
- 11
- 12
- 13
- 14
- 15
- 16
- 17
- 18
- 19
- 20
- 21
- 22
- 23
- 24
- 25

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

127

AGO 546152

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

consider that aspect very vital.

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

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

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

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

As an aside, I think we should also mention

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

25 Now, as to the other provisions, the recall

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

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

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

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

22 Mr. Gruening.

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

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

3 REP. GRUENING: Could you identify it specifically?

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

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

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

18 MR. KILGORE: No, we have not.

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

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

1 REP. GRUENING: But the major part of that would be that
2 two hundred million cubic feet per day that you referred
3 to that's used there?

4 MR. KILGORE: Yes, a significant part of that does go for
5 generating electricity in the Anchorage area.

6 REP. GRUENING: And the total royalty share at peak capacity
7 is about two hundred-fifty to three hundred million
8 cubic feet per day?

9 MR. KILGORE: I said very roughly three hundred million cubic
10 feet a day. That's an eighth of 2.4 million cubic feet
11 a day, a very rough number.

12 REP. GRUENING: Did you run across a date at which at least
13 the present known reserves at Cook Inlet are exhausted?

14 MR. KILGORE: No, I haven't. The gas reserves data are
15 available. The American Gas Association has estimates
16 of reserves in the area.

17 REP. GRUENING: Do you recall whether that study of January
18 '77 covers that point?

19 MR. KILGORE: No, I don't recall. As I recall, it was
20 basically an analysis of potential gas demands along the
21 route of the pipeline.

22 REP. GRUENING: But it didn't take in total the gas demand
23 in the State?

24 MR. KILGORE: I believe not.

25 REP. GRUENING: Are you familiar with the provision that

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

4 MR. KILGORE: Yes.

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

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

20 SENATOR RADER: Representative Parr.

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

24 MR. KILGORE: Yes.

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

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

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

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

21 MR. KILGORE: Yes.

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

23 MR. KIGORE: Certainly.

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

1 at least at the present for use in the State of the gas.
2 At least it seemed to be highly doubtful as far as you
3 were concerned.

4 MR. KILGORE: What I said was, it's very uncertain, it's
5 elusive, and we suspect that the volumes would not be too
6 large.

7 REP. PARR: Does that mean what you're saying is that you
8 don't anticipate, at least in the foreseeable future,
9 a sufficient demand; is that what you're saying; or are
10 you simply saying you can't tell? I'm not sure.

11 MR. KILGORE: What we're saying, it's very difficult to tell.
12 If you want a judgment, I suspect it's lower volumes
13 rather than higher volumes.

14 REP. PARR: Has your company ever done any kind of a study
15 as to the lowest economic threshold at which petrochemical
16 plants and so forth will become feasible, of the kind
17 that might be built, let's say, in Alaska using the
18 royalty gas?

19 MR. KILGORE: No, we have not made formal studies of that.
20 We know some of the problems of the economics involved
21 and so forth, but we have not done a formal -- this is
22 from broad knowledge chemicals and so on. It is not from
23 a detailed study of the potentials for petrochemical
24 uses in Alaska.

25 REP. PARR: Could we assume that the use of natural gas in

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

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

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

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

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

14 REP. PARR: Thank you, sir.

15 SENATOR RADER: Representative Hayes.

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

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

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

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

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

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

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

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

1 REP. HAYES: Twenty years.

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

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

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

8 SENATOR RADER: Senator Sumner.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

18 SENATOR SUMNER: Thank you very much.

19 SENATOR RADER: Senator Butrovich.

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

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

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

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

way of population in Alaska?

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

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

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

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

MR. KILGORE: Yes, sir.

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

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

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

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

20 MR. KILGORE: I would agree with that.

21 SENATOR RADER: Senator Huber.

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

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

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

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

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

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

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

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

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

15 MR. KILGORE: That's correct.

16 SENATOR HUBER: Thank you, Mr. Chairman.

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

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

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

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

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

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

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

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

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

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

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

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

10 REP. CHATTERTON: To the financing.

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

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

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

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

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

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

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

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

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

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

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

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

20 MR. KILGORE: No, sir.

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

1 at these hearings thus far?

2 MR. KILGORE: Yes, Senator.

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

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

6 MR. KILGORE: Yes.

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

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

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

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

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

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

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

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

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

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

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

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

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

So, Mr. Moody, with that, would you please read into the record first, sir, your background qualifications, and then I assume you will make a statement and open yourself for questions.

165

1 MR. MOODY: Thank you, Mr. Chairman, to both Chairmen, and
2 to the Members of the Committee, I wish to express my
3 appreciation for the opportunity of being here. I have
4 been most impressed over the course of the past five
5 days with the attention and the concern which each of
6 you expressed. I wish that the Congress of the United
7 States would take as seriously some of the problems they
8 have as you obviously take seriously this problem before
9 you.

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

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

25 Following my resignation I represented the

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

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

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

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

20 MRS. SANDERS: Yes.

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

23 (Whereupon Exhibit 19 was duly marked.)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

it is as we touch upon each one of them.

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

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

But Section 6.1, the last clause makes it clear that there is one condition that cuts across all of the pricing alternatives, and it is that so long as the pipeline buyers are subject to the jurisdiction of the Federal Power Commission, so long as their rates are subject to the jurisdiction of the Federal Power 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
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

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

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

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

Or, finally, if neither of those two things 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^h 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."

147

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
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

three days' time. I recognize your concern.

REP. CHATTERTON: Thank you.

SENATOR RADER: Representative Hayes.

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

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

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

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

REP. HAYES: The second problem is that once you get it into the system, once it starts flowing out for sale, they may decide that it's in the best interests to the country -- once it starts flowing out it's awfully hard to turn it back around again. That's another possibility of losing it. So it would appear that signing the contracts would put us in a more hazardous situation, could be more jeopardy on the possibility in 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
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

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

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

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

SENATOR HUBER: In that question, would you go along with me one more? Would you have any feeling in the area where you are living right now, Washington, D.C., if 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
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 be our number one priority.

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

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

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

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

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

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

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

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

25 Here are some of the letters we have received

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

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

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

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

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

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

25 "The recent report of the Berger Commission's

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

6 MR. PENNEY: Yes, sir.

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

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

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

5 SENATOR RADER: Any further questions? Senator Sumner.

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

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

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

7 SENATOR RADER: Any further questions?

8 MR. PENNEY: Thank you very much.

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

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

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

7 Do we have any other ---

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

10 SENATOR RADER: Senator, I don't know that we can do that.
11 Representative Gruening's office, I know, sent out some
12 and my office sent out some in two different groups that
13 had some overlap. I'd invite you to come to my office.
14 We've got the letter from the Legislative Affairs people,
15 and, Elke, maybe you know more about those lists than
16 anyone. Would you explain to us what ---

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

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

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

on that side.

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

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

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

REP. GRUENING: That's fine.

(Whereupon Exhibits 22 and 23 were duly marked.)

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

SENATOR RADER: Fine.

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

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

were run by the joint committees, and we might even get a proof from the paper to attach so they know the dates.

SENATOR RADER: How many newspaper ads were run and in what newspapers?

REP. GRUENING: Daily News Miner, the Anchorage Times and the Daily News.

SENATOR RADER: One ad or several ads?

REP. GRUENING: Two days in each paper.

SENATOR RADER: If we can find a copy of that, that will be supplied to the reporter as Exhibit No. 24.

(Whereupon Exhibit 24 was duly marked.)

SENATOR RADER: Do we have any other requests for exhibits to be attached? We have one final exhibit, No. 25, which will be supplied by the Department of Natural Resources, and with that I take it that concludes our joint hearings; is that correct?

(Whereupon Exhibit 25 was duly marked.)

REP. GRUENING: Do we have the relevant statutes attached in there?

SENATOR RADER: No, we do not. Exhibit 26, would your office supply what you consider to be the relevant statutes?

REP. GRUENING: Sure.

SENATOR RADER: Exhibit 26 will be the relevant statutes, to be supplied by Representative Gruening's office to the reporter.

1 (Whereupon Exhibit 26 was duly marked.)

2 SENATOR RADER: Ms. Easley.

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

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

10 (Whereupon Exhibit 27 was duly marked.)

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

13 REP. GRUENING: John?

14 SENATOR RADER: Yes.

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

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

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

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

11 REP. GRUENING: What time?

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

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

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

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

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

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

25 SENATOR RADER: They will submit written testimony or whatever

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

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

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

14 REP. GRUENING: Whenever.

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

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

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

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

10 We will adjourn until 10:30 then Monday.

11 (Whereupon the hearing adjourned at

12 6:05 p.m.)
13
14
15
16
17
18
19
20
21
22
23
24
25

JOINT PUBLIC HEARINGS
of the
ALASKA STATE LEGISLATURE
on

SCR 3, 4, 5 and HCR 11, 12, 13

"THE PROPOSED SALE OF ROYALTY GAS"

January 31, 1977 - February 7, 1977

Juneau, Alaska

VOLUME I - APPENDIX
CONSULTANT PRESENTATIONS

Michael J. Scott, Assistant Professor of Economics p. A-1
ISER, University of Alaska (2/3/77)

1 after a ten minute recess and we will be prompt on ten
2 minutes.

3 (Whereupon the hearing was recessed at
4 2:50 p.m. and reconvened at 3:00 p.m.)

5 SENATOR RADER: The committee will come back to order. We
6 have asked Dr. Tussing and his associate to appear out
7 of order or they rather asked that they might appear out
8 of order, Mr. Scott, because of commitments that they
9 have tomorrow.

10 Dr. Tussing, we will follow whatever order of
11 presentation you and Mr. Scott think would be most ap-
12 propriate. Do you wish to make a presentation first and
13 then questions? Would that be the way of proceeding?

14 DR. TUSSING: Well, I think the way to proceed would be to
15 let Dr. Scott go first and then to ask questions of him
16 and I might have some comments on his answers. Dr. Scott
17 has done an analysis of the Task Force Report and the
18 documentation by the Department of Revenue for the Task
19 Force Report. It is a technical analysis.

20 I intend to range more broadly on national and
21 international political aspects of the contract. I am
22 willing to take responsibility for everything that Dr.
23 Scott is going to say because I have read his analysis.
24 He can't take responsibility for what I am going to say
25 because I don't have a prepared statement and I was not

1 quite sure what topics I was going to handle before I
2 got here. So don't blame him for anything nasty or
3 unpopular that comes from this side of the table.

4 SENATOR RADER: I'd like to have both you and Dr. Scott, you
5 are appearing here as expert witnesses and, therefore, a
6 statement of your background and your qualifications
7 would be appropriate in the record.

8 DR. SCOTT: My name is Dr. Michael J. Scott. I am an assistant
9 professor of Economics at the Institute of Social and
10 Economic Research, University of Alaska. I am a professional
11 economist with a Ph.D. in Economics from the University
12 of Washington. I am associated with the Institute's
13 Man-in-the-Arctic-Program, which is an econometric modelling
14 effort of Alaskan economy, and I have specialties in
15 natural resources, public expenditure modelling and
16 Alaskan cost of living.

17 I was requested by the committee to evaluate the
18 report, "A Comparative Evaluation, Prudhoe Bay Natural
19 Gas Pipeline Systems", prepared by the Gas Pipeline Task
20 Force, November 1976, to check its technical accuracy as
21 a supporting document to the sale of natural gas to El
22 Paso, Tenneco, and Southern for the expressed purpose
23 of securing an all-Alaska gas pipeline.

24 I was asked to do this since I had previously,
25 in late November, evaluated for the Legislative Affairs

1 Special Subcommittee on Oil and Gas Taxation, a study by
2 Dr. David Knudson of the Department of Revenue, which
3 was titled "A Comparative Economic Study of Three Competing
4 Alaskan Prudhoe Bay Natural Gas Transmission Systems",
5 and possibly also since I was involved in the ISER
6 studies on the subject of three gas transportation systems
7 beginning in November 1975.

8 My comments, accordingly, will be directed to the
9 internal logic of the section of the Gas Pipeline Task
10 Force report entitled Economic Factors. I regret that
11 I am unable to discuss the options for in-state use of
12 gas. At the time ISER was doing its studies (that is
13 April 1975 through June 1976), we were asked to look at
14 only export options. We did this for the Department of
15 Interior and the Federal Power Commission staff. Then,
16 too, our analysis mainly took place before Alcan's proposal
17 was before us, and there may have been delays in con-
18 struction which we could not anticipate. We had thought,
19 at the time we were doing our studies, that any of the
20 gas transportation systems could have been started in
21 1977. This, of course, has proved not to be the case so
22 far. There have been some changes in the state fiscal
23 structure, so any studies we have done since the time we
24 did them, have been overtaken by events related to the
25 permanent fund. And so our analysis, while generally

1 valid, has been overtaken to some degree so I don't want
2 to be held to specific numbers that we have generated.

3 The economic factors mentioned in the state report
4 are the cost of service, net benefits to the United States
5 as a whole, fiscal impacts, impacts on the private economy
6 and cost of living. The report makes several points with
7 respect to cost of service, based mainly on a study which
8 I mentioned previously I had evaluated earlier, the Department
9 of Revenue study by Dr. Knudson. A large number of
10 variables affect any cost-of-service calculation. Mentioned
11 in the study are throughput, that is the amount of gas
12 that would be forthcoming per day; total capital cost,
13 I might add -- including overruns, if any; the rate of
14 return to equity required by the company; inflation which
15 could be generally categorized as the general decline in
16 the purchasing power of money and then real price increases
17 during construction; interest rates available. And I
18 might also add the duration of the project, which affects
19 the financing risk, and which I expect Dr. Tussing will
20 mention.

21 The Department of Revenue technical report mainly
22 shows that the cost of service considerations which they
23 mentioned are favorable to the Arctic Gas line are
24 extremely sensitive to changes in many of the variables
25 which determine it, particularly volume of throughput and

1 the capital cost. While Dr. Knudson does not treat the
2 three proposals symmetrically, he does show that with
3 Arctic Gas at eight-eighths of his proposed volume, that
4 is the total throughput of, I believe, it was 2.5 billion
5 cubic feet per day and with twenty percent cost overruns
6 he is able to move the cost of service from One Dollar
7 Eighty-One Cents per thousand cubic feet to around Two
8 Dollars per thousand, while at seven-eighths of the
9 volume or if the state gas were not available or if
10 the throughput from the pipeline was not as expected,
11 2.5 billion, that moves the cost of service from --
12 I'm sorry. With seven-eighths proposed volume and ten
13 percent cost overrun moves it to Two Dollars and Seven
14 Cents, seven cents more; seven-eighths volume and twenty
15 percent cost overrun yields Two Dollars and Seventeen
16 Cents per thousand cubic feet. So that with only
17 nominal cost overrun or changes in the volume of production
18 which are within the realm of possibility, you can move
19 cost of service all the way from One Dollar Eighty-One
20 Cents per thousand up to Two Dollars and Seventeen Cents
21 per thousand. That is holding everything else constant.

22 The Department of Revenue seems to imply by this --
23 from this to mean that Arctic is somehow less preferable;
24 I think a more correct conclusion is that the cost of
25 service is an extremely slippery entity. While the

1 calculations are worth doing as illustrations, we can't
2 know how the cost of service will be influenced by the
3 various parameters at this time, so I don't feel that
4 the argument that for any of the lines ought to heavily
5 lean on the cost of service. The relative costs of
6 service mentioned in the Task Force report may well
7 hold, that is that Arctic would have the least cost of
8 service, I believe it is El Paso next and Alcan the
9 highest. Whatever the relative costs are there are
10 large differences between the two studies they mentioned
11 in the Knudson report and the Pipeline Coordinator's
12 office.

13 The net national economic benefit, however, they
14 do not have depending on the cost of service. They have
15 it depending more -- they have it depending on the
16 amount that is paid for the gas which is Two Dollars and
17 Eighty Cents, less the cost of construction, allowances
18 for interest on funds committed during construction,
19 working capital, operations and maintenance expenses,
20 taxes paid to foreign governments. I presume only that
21 allocable to the American earnings on Arctic.

22 At any rate, the analysis, again, is sensitive
23 to the assumption used, particularly to the price of
24 gas and the timing and staging of the projects. It is
25 interesting to note that to get net national benefits

1 to come our superior for El Paso to the Arctic and Alcan
2 proposals they require the following three assumptions,
3 full production of gas, that is eight-eighths of the 2.5
4 billion cubic feet for the Trans-Alaska with 1983
5 production. Full production for Alcan, but later than
6 El Paso, a year later in fact and Arctic Gas assumed
7 to have a ten percent cost overrun and seven-eighths
8 production.

9 Therefore, I'm not sure that the game was played
10 exactly fairly with the proposals. However, I think
11 it might be fairer to use the real schedules, whatever
12 those happen to be at the moment, they seem to change
13 from time to time, and the same throughput and the same
14 cost overrun considerations.

15 In any case, I think that since Alaska could
16 influence the benefits by its actions vis-a-vis any of
17 the lines, and since the calculation is sensitive to
18 the assumptions, we ought to be extremely cautious how
19 it is used.

20 With respect to fiscal impacts, the results of
21 this section depend on an earlier study by the State
22 Department of Labor, Research and Analysis Section.
23 Labor shows that the level of employment rises sharply
24 in each case through about 1981, then levels off. This
25 is supposed to include direct employment on the project,

1 induced employment in the state economy brought about by
2 the increase in the direct workforce. I did not have
3 access to the report at the time I was preparing my
4 comments here, so I can't compare their model to ours,
5 the Man-in-the-Arctic Program, the econometric model.
6 Their usual procedure, however, has been to use the HRPI,
7 that is Human Resources Planning Institute labor market
8 model, which does not take into account the impact on
9 employment of state spending of additional revenues
10 received by the state as a result of the gas projects.

11 Our work in this area, which does take this
12 into account through the state government sector, shows
13 that employment impacts are somewhat larger for El Paso
14 than they show, I believe they show around nine thousand
15 and we show around twelve thousand in the year 1990, a
16 little more than for Arctic, and for what it's worth,
17 about the same as the Alcan project.

18 So we have minor differences about the construction
19 period, but in the main we agree about the ranking and
20 approximate relative impacts on employment and on
21 population, I might add.

22 I have no real arguments with what the Department
23 did with revenues and expenditures. I would note, how-
24 ever, three things. Spending on local services and
25 state services probably influences migration and population,

1 especially in the El Paso case, where you have much
2 larger expenditures possible. And in any case, El Paso
3 proposes to use local communities more heavily than the
4 other two lines so that you would probably have higher
5 spending on local services.

6 All three routes show substantial front-end
7 state deficits which will have to be financed by reduced
8 services, higher taxes on someone, or both.

9 All three routes show substantial construction
10 employment effects between probably 1978 and 1984. This
11 may coincide with the timing of other major oil and
12 gas developments, for example, the Gulf of Alaska off-
13 shore, and I can foresee that some of these routes may
14 well be competing for transportation links and dock
15 space, particularly in the Gulf of Alaska.

16 I think that we can safely agree that if the LNG
17 plant proves taxable by the state under its property
18 tax that the rankings that are shown in the report are, in
19 fact, correct.

20 With respect to impacts on the private economy,
21 we have no fundamental disagreements with this section.
22 The section is based on work done by ISER and by state
23 experts.

24 With respect to employment, there is an importance
25 of acknowledging there that the fact that the jobs are

1 available does not say "to whom". In order to really
2 tell what the likely impact will be on state resident
3 employment we would need to know the type of jobs
4 available, including the requisite skills, the number
5 and type of skills available in Alaska to fill those
6 jobs and the type and effectiveness of "Alaska Hire"
7 policies.

8 With respect to real income, no matter -- with
9 respect to our work in this area, which is mentioned
10 in the report, it seems like no matter what we do with
11 respect to the relative throughputs of the lines, if
12 the revenues of the state are spent in ways that induce
13 migration, we found that it is impossible over the long
14 run to increase the real per capita personal income of
15 "Alaskans" and I say Alaskans advisably because that would
16 include migrants as well as those people who are already
17 in the state. It may well be that you could have a
18 decline in real personal income even though everyone
19 were made better off, in the sense that people who
20 already live in the state could have increased incomes
21 from building the pipelines, and those people who
22 migrate to the state may enjoy increases in real income
23 in spite of the fact that the average dropped. But we
24 don't know what the answer is there yet. We should know
25 in a couple of years. We are doing some work in the

1 area right now about distribution of income and economic
2 modelling in Alaska.

3 Results from our community survey in Fairbanks
4 show that economic benefits, however, were much more
5 widely spread than anyone had expected prior to the
6 Alyeska pipeline being built. So that might be something
7 you want to take into consideration.

8 With respect to cost of living, the analysis in
9 the report seems reasonable and straightforward and I
10 don't think we have any quarrels with that.

11 I would be happy to entertain any questions at
12 this time.

13 SENATOR RADER: Let me advise the committee that Commissioner
14 Martin, as you recall when he terminated his testimony
15 Monday, asked for permission to come back after the
16 conclusion of all the testimony and to supply us with
17 any information that he felt was pertinent and I under-
18 stand that he has an observer here. So I assume that
19 those parts of your report, Doctor, which take issue
20 with the Task Force and the other information will be
21 presented somewhat to the committee at least for some
22 rebuttal and I wanted to advise the committee members of
23 that prior to their going on with Dr. Scott's questioning.
24 But this would be an appropriate time I take it, Dr.
25 Tussing and Dr. Scott for questioning on Dr. Scott's
presentation?

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

A-11

AGO 546281

VII

ADMIN.

AGO 546282

JOINT PUBLIC HEARINGS
of the
ALASKA STATE LEGISLATURE

on

SCR 3, 4, 5 and HCR 11, 12, 13

"THE PROPOSED SALE OF ROYALTY GAS"

January 31, 1977 - February 7, 1977

Juneau, Alaska

VOLUME II

INTRODUCTION AND ADMINISTRATION PRESENTATION

List of Special Committee Membership	p. i
Introduction by Co-chairmen	p. 1
Administration Presentation - Introductory (Jan 31)	p. 8
by: Guy Martin, Commissioner of Natural Resources .. Avrum Gross, Attorney General	
with: Fred Boness, Assistant Attorney General Jack Byrd, Legal Consultant	
Administration Presentation - Conclusion (Feb 7)	p. B-1
by: Guy Martin, Commissioner of Natural Resources Fred Boness, Assistant Attorney General	
Administration Review of Judge Litt Decision (Feb 1)	p. C-1
by: Guy Martin, Commissioner of Natural Resources	



Alaska State Legislature

POUCH Y, STATE CAPITOL
JUNEAU, ALASKA 99811
907 465-3800

SENATE SPECIAL COMMITTEE TO CONSIDER THE SALE OF ROYALTY GAS

John Rader, Chairman
Mike Colletta
Chancy Croft
John Huber
Clem Tillion

HOUSE SPECIAL COMMITTEE ON THE SALE OF ROYALTY GAS

Clark Gruening, Chairman
Chat Chatterton
Joe Hayes
Joe McKinnon
Charlie Parr

SCR 3, 4, 5 Second Referral - Senate Resources
Third Referral - Senate Finance

HCR 11, 12, 13 Second Referral - House Finance

1 from Anchorage, and Charlie Parr from Fairbanks, and I'm
2 Clark Gruening, the chairman of the House Special Com-
3 mittee to consider this gas sale.

4 SENATOR RADER: We had hoped that we would have a place at
5 the table for every legislator who was interested and I --
6 in the Senate I asked for persons to let me know and only
7 Senator Kerttula let me know. I do see some legislators
8 in the audience that I would like to recognize. I see
9 Representative Haugen, I see Senator Sumner, Representative
10 Haugen stand up perhaps, Sumner, Representative Bill
11 Miles, Senator Willis, Senator Bradley, and if there is
12 anyone else here, and Representative Miller, Senator
13 Hackney.

14 We will not take questions from the floor except
15 for legislators. Any legislator who has a question though,
16 whether he is seated at the table or not, will be permitted
17 to ask questions of the witness if he desires. But,
18 because we do want a full transcript of this, I'd ask the
19 legislator to perhaps come forward and if there is an
20 empty seat here, take it for such period of time as he
21 is asking questions. I do want to extend that privilege
22 to all of you who are here if you have any questions. We
23 will not permit questions though from non-legislators.
24 If you have a question, you are going to have to get some
25 legislator to ask it for you or else it probably won't be

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

asked.

The -- we would like to have everyone sign in that is here. We want to keep a record of attendance, if we can, and who you represent. If you wish to testify, please leave your name with the person at the desk or with any of our staff members here. Elke Kallab, Elke would you stand up. Elke -- if you do wish to testify and are not the list, leave your name with Elke or search her out. If you give it to me, it may get lost. If you give it to Elke, why I'm sure it won't be.

We found out -- our original schedule was for two days here and one day at the Baranof. We have found out that this is available for three days so all of our meetings here are scheduled for today, tomorrow and Wednesday. I'm hopeful that both the House and the Senate will conclude their sessions so that we will be able to have an eleven o'clock session here starting tomorrow, going to twelve with an hour for lunch, coming back at one and going until four thirty or five or exhaustion wipes us out, whichever first occurs. But, of course, our meetings in the mornings and during the days will be subject to the House and Senate meetings on the hill and these committee meetings will of course be subject -- it has a lower priority than do those meetings. I expect, however, that we will be able to convene though tomorrow at eleven o'clock. Those

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

1 of you who are wishing -- yes. Those of you who want
2 transcripts, would you leave your name with the court
3 reporter. Prior to building you a transcript, we'll
4 try to give you a price on it so you'll have a chance
5 to back out. If you'll leave your name with her and
6 an address, we will try to work out some sort of a
7 situation here so that we can give you an estimate of
8 the price on the transcript and then she'll contact you
9 at the address you indicate and if you want to buy one,
10 you can. I don't think we are going to be able to
11 print up enough to handle everything at public expense,
12 we'll have to look into that. But, if you want a
13 transcript leave your name with the court reporter.

14 This room is over capacity, I'm sure. I'm going
15 to ask that you refrain from smoking. We'll try to take
16 a break at least every hour. I don't like to interrupt
17 the witness in the middle of his testimony or a question
18 a line of questioning that is being pursued, but subject
19 generally to the convenience of the proceedings at the
20 time, we'll try to take a break every hour to give you
21 a chance to take a smoke and stretch your legs.

22 We have a tentative agenda that we have developed.
23 It is only tentative. We'll take any witness out of
24 order. We're here to accommodate you for your travel
25 plans and your other commitments. We know that a lot of

1 you have things to do other than to be here. If you
2 wish to be taken out of order, let me know and I'll try
3 to accommodate you as soon as I understand what your
4 problem is.

5 It's a public meeting, of course, and everyone
6 is welcome to attend and everyone will be welcome to
7 testify. I suppose that if it went on for three weeks
8 there probably wouldn't be very many people here to listen
9 to you, but there will be someone here to listen.

10 I can't think of -- Representative Gruening, can
11 you think of any other remarks or ground rules we need
12 to establish?

13 REP. GRUENING: I'd like to introduce Representative Al
14 Osterback who is sitting on the Senate side but is
15 representing us in the House.

16 SENATOR RADER: Incidentally, from the Senate's point of
17 the side, we have both the Resources and Finance people
18 on our side. They have referrals of the resolutions
19 after the select committees and there may be some public
20 testimony taken by those committees at a later date.
21 That will be up to the chairmen of those committees to
22 determine whether or not they need it.

23 I have been contacted by a congressional delegation
24 and told them that I would read their testimony verbally
25 into the record and therefore I am going to do that,

1 although I think that in some instances we will receive
2 written testimony which will not be read unless it is
3 absolutely -- unless someone insists on it, some committee
4 member.

5 But, we have a wire from United States Senator
6 Mike Gravel.

7 (Whereupon Exhibit 1 was duly read into
8 the record.)

9 That exhibit will be exhibit number one. The
10 reporter will not retype exhibits which are read into
11 the minutes. We will make them exhibits and they will
12 be xeroxed when we make our copies to try to save on the
13 expense.

14 Exhibit number two, which the reporter need not
15 copy but which will be appended to the transcript is a
16 wire from United States Senator Ted Stevens.

17 (Whereupon Exhibit 2 was duly read into
18 the record.)

19 And that will be exhibit two. Representative Don
20 Young called me less than twenty minutes ago from
21 Washington, informed me that he had directed that his
22 testimony be hand carried from Washington and that it left
23 Washington Friday evening. I have been informed since
24 then that it was sent to Washington because of a telecopying
25 process -- sent to Anchorage and that the airplane cannot

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

1 leave Anchorage and that the reason that that testimony
2 is here is because of the Anchorage airport and not the
3 Juneau airport. I'm sure we will receive that testimony
4 in the course of the hearings and when we do, it will
5 likewise be read into the record.

6 REP. GRUENING: Senator?

7 SENATOR RADER: Representative Gruening.

8 REP. GRUENING: If I might be permitted a brief remark, it
9 seems to me that this -- these three contracts that are
10 before us now represent the single largest sale of our
11 natural resources since the Prudhoe Bay lease sale and I
12 hope -- I urge the legislators to hold sacred no sacred
13 cows in approaching the assumptions upon which this --
14 these three contracts are based. And, as the Senators
15 have pointed out, the principal reason that we are
16 considering these contracts today is to effect a political
17 decision in Washington, not to raise revenue for the State.
18 So, I would urge everyone to focus on at least what I
19 believe to be the principal question, what are we giving
20 up by entering this contract, if anything, and what are
21 we getting in return for the State -- for the people of
22 this state.

23 SENATOR RADER: Unless there are any further remarks, we'll
24 go back to our schedule here. I'll ask Commissioner Martin
25 if he would present his testimony and those of his

1 associates in whatever order he approves. Commissioner,
2 how would you like to handle questioning?

3 COMMISSIONER MARTIN: I'd like to ask Attorney General Gross
4 and Commissioner Gallagher to join me here and I'll
5 introduce the other individuals, Mr. Chairman.

6 SENATOR RADER: Would you want us to defer until the end
7 of your presentation for questions or ask questions as
8 we go along?

9 COMMISSIONER MARTIN: I think it would be most useful because,
10 as I'll explain, we have a fairly brief presentation, to
11 defer questions until the end, and then just have a
12 continuous question period after that.

13 SENATOR RADER: Does anyone on the committee object to that
14 procedure, any legislators object? That will be the way
15 we'll proceed then.

16 COMMISSIONER MARTIN: Is Mr. Gallagher here? I thought I saw
17 him earlier. Do you want to come up, Sterling?

18 Mr. Chairman, I have spoken, as you know, pre-
19 viously to a joint meeting of the two special committees
20 at least, and to both of the Chairmen of the two special
21 committees and, as I understand it, we have some options
22 for procedure, and I want to explain that before I begin.
23 We discussed either having a prolonged briefing by the
24 Administration in which as many as eight or ten individuals
25 could participate and give really very detailed information

1 with regard to every phase of this as opposed to a more
2 summarized presentation followed by questions. And my
3 understanding of the consensus of those -- the choice
4 between those two and which I checked with you earlier
5 this morning, was that a more summarized statement of
6 the administration's position, in view of the fact that
7 we have already submitted a tremendous amount of written
8 material to the committees, would be preferred. So, if
9 that's all right, I'll proceed in that vein.

10 Now, my attention today is to first read a state-
11 ment sent down by Governor Hammond, followed by a statement
12 by Attorney General Gross, who is a chairman of the
13 State's Gas Line Task Force, and then to -- then allow
14 the committee to simply ask questions of all the individ-
15 uals that are here. And, let me very quickly indicate
16 who is here and how I think we can be of assistance to
17 the committee's informational needs today. Governor
18 Hammond has asked me to be a principal spokesman on this
19 issue and to attempt to see that you get the answers that
20 you need, both here and otherwise, and I'll be pleased
21 to serve in that capacity. With me here today, in
22 addition to Attorney General Gross, who is the chairman
23 of the Task Force and who was also responsible for putting
24 together our FPC case, is Commissioner Gallagher, who
25 done a -- Commissioner of Revenue, who has done a great

1 deal of work on the economics associated with the various
2 line proposals and with the royalty gas contracts. Also
3 here, and I'll just ask these individuals to raise their
4 hands so you can identify them, is Mr. Bob LeResche, -- Dr.
5 Bob LeResche, who is the coordinator -- the Director of
6 Division of Policy & Planning in the Governor's office
7 and was basically the substantive coordinator of the
8 comparative route study done on the gas line issue. Also
9 here is E.Z. Gilbreth, who is the Director of the Division
10 of Mineral & Energy Management, the Department of Natural
11 Resources, who is responsible at least for representing
12 here today, the work that the State has done on royalty
13 gas demand and is also in charge of our effort on the
14 unitization of the Prudhoe Bay field. In summary, he is
15 in charge of our management function with regard to the
16 Prudhoe Bay field.

17 Also here is Mr. Hoyle Hamilton, who is Director
18 of the Division of Oil and Gas Conservation. Mr. Hamilton
19 is in charge of the field operation for the State,
20 pursuant to the State's conservation statute, and is the
21 individual who is coordinating our work on the reservoir
22 simulation study and other aspects of the performance
23 of the reservoir.

24 Also here is Assistant Attorney General Fred
25 Boness, who is the individual at the Department of Law

1 who coordinates legal oil and gas work, assisted me
2 staunchly throughout the negotiation of this contract
3 and is also the coordinator from Juneau of the State's
4 work in the FPC case. He's really our man on this issue.

5 And finally, Jack Byrd, who is sitting on the
6 end there. Jack is a -- I think safe to say a nationally
7 known consultant. He is an attorney, a nationally known
8 legal consultant in the area of natural gas. He is an
9 FPB attorney and has served as our gas contracting
10 consultant, particularly on matters of price and FPC
11 regulations throughout the negotiations.

12 There are other individuals involved who -- to
13 a lesser extent who can also be here to assist from time
14 to time but this is basically the team. I might say,
15 Mr. Chairman, that we really want to thank the committee
16 for making an effort to consolidate its hearings. We
17 have a number of individuals here who are going to be
18 difficult to get in one room on very many occasions and
19 we appreciate the fact that you allowed us the privilege
20 of making at least our factual presentation on this in
21 one -- in one instance. Mr. Byrd and Mr. Boness, par-
22 ticularly, will have demands on their time in the next
23 couple weeks will make it very difficult to get our
24 entire group together very often, but we'll try to
25 cooperate with the committee as far as we can to see

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

1 that we can get the people you need to be available.
2 With that, I would like to read a statement that was
3 sent down by Governor Hammond to the committee and then
4 ask Av Gross to give a statement of his own.

5 "Members of the Committee, members of my Adminis-
6 tration are here today to discuss a proposal of great
7 importance to the future of the State. Because your
8 review of this proposal should be as thorough as possible,
9 I would like to preface the more detailed comments of
10 others with my own statement. My objective is to lend
11 perspective regarding the issues involved, and to define
12 elements important to your ultimate decision.

13 Like the Native Claims Settlement Act, the Trans-
14 Alaska Oil Pipeline and 17 D(2) Lands, the issue of North
15 Slope natural gas transportation and use is a critical
16 decision for Alaska. Present national energy emergencies
17 and last year's passage of the Natural Gas Transportation
18 Act of 1976 leave little room to doubt that a national
19 decision on the gas transportation system is imminent.
20 The question is: what, if any, will, can and should --
21 what role, if any, will, can and should we play in that
22 decision to best protect our own interests within the
23 constraints imposed by overriding national interests?

24 After first analyzing various alternatives, my
25 Administration concluded that the best, most expeditious

1 transportation system from both the state and national
2 viewpoint was that which would take gas from Prudhoe
3 Bay to tidewater in Prince William Sound. This
4 legislature reflected a similar conclusion in a resolution
5 adopted two years ago. Polls indicate that almost --
6 indicated that almost eighty-five percent of the people
7 of Alaska stood solidly behind that choice. The
8 congressional delegation concurred. Such support was not
9 given lightly. Unlike the oil pipeline, the gas pipeline
10 route had been widely discussed through the state, both
11 in the media and through public meetings, before a decision
12 was made. That decision is one which can be supported on
13 principle as well as politics.

14 Having made the decision on which route to support,
15 we actively participated in Federal Power Commission
16 hearings; successfully advanced the unprecedented amendment
17 to protect later state uses of royalty gas, and took our
18 case to the people in the Lower 48 in an effort to offset
19 the considerable opposition. After all, nearly all major
20 distribution companies favored the Arctic Gas consortium.
21 Mid-western states, which had sought a Trans-Canada oil
22 pipeline, argued that the gas pipeline should go directly
23 to them. After participating in this process for some
24 time, and in light of legislative expression and congressional
25 consultation, I felt it necessary to do more to gain support

1 for our position from outside the state. That conclusion
2 led to the royalty gas contract you see before you now.

3 The major purpose of these contracts is to build
4 a national constituency in support of the Trans-Alaska
5 line while protecting and enhancing the in-state uti--
6 lization of Alaskan royalty gas wherever possible so long
7 as consistent with national needs. We believe the
8 proposed contracts protect the state's interests as fully
9 as possible under the circumstances. We are not, as
10 some suggest, simply trying to buy lobbyists in Washington.
11 That could have been done simply through hiring qualified
12 personnel. The royalty contract does far more. It gives
13 people throughout most other states an interest in seeing
14 that the Trans-Alaska route is approved. A decision on
15 this matter will ultimately be made by the President
16 and the Congress. Their overriding concern will be in
17 the national interest. Overriding national interest can
18 be demonstrated best if the largest number of people
19 possible directly benefit from approval of the Trans-
20 Alaska line.

21 Our actions in bringing forth these contracts
22 are what I believe the people of Alaska, the legislature
23 and the congressional delegation believed we should do.
24 I suspect that if my administration had not negotiated the
25 best contracts possible and advanced them under these

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

1 circumstances and then given them to you, we would surely
2 be asked by many of you where the royalty gas sale
3 proposals were rather than being questioned about
4 proceeding. As your legislative resolution indicated
5 to use "all resources at my command" to further a Trans-
6 Alaska gas pipeline route. Certainly, there are politics
7 involved in any such contractual agreements. However,
8 there is nothing at all wrong with political forces being
9 countered by political forces when the politics one uses
10 coincide with principle. So long as we believe the Trans-
11 Alaska route truly is in the state's and the nation's
12 best interests, we would be remiss should we not garner
13 what support we can so long as we do not do violence to
14 propriety or principle in the process.

15 My instructions for our negotiators were to seek
16 the best contract possible for the state to carry out the
17 policies articulated and to do so on a time schedule
18 which would allow the legislature the earliest possible
19 opportunity to review this alternative. After reviewing
20 the results of the negotiations, I concluded it to be in
21 the best interests of the state that this alternative be
22 advanced. That decision won the endoresement of a broad
23 spectrum of the Alaska public and the congressional
24 delegation and was, as well, accorded approval of the
25 Royalty Board as mandated by statute.

1 In negotiating the contracts, the State recovered
2 a good price; it protected the future in-state use of
3 gas; it gave the State the best opportunity to utilize
4 and protect its royalty gas pursuant to the amendment
5 we drafted and proposed to Congress for protection of our
6 royalty gas; and at the same time we've gained support
7 for the state's position on the gas pipeline debates.
8 Moreover, the contracts are consistent with the direction
9 the legislature gave to the administration when it not
10 only indicated its support for the Trans-Alaska route but
11 later appropriated money to aid in the negotiation of
12 contracts.

13 Some concerns have been raised concerning the
14 so-called "flexibility provision" in the contract. That
15 clause would permit the state through the governor to
16 change its position on the route issue at some subsequent
17 time. Some assert that no flexibility at all should be
18 possible and that the state should lock itself into an
19 all or none position in support of the Trans-Alaska route.
20 I think this is self-destructive, for I am sure that
21 nearly every person in the state would agree that if we
22 cannot have the El Paso route, the Alcan route is far more
23 desirable than the Arctic Gas route. And they would want
24 the State to be able to do what it can to gain the next
25 best choice should our first choice be impossible or unwise.

1 Other persons suggest that while flexibility is desirable,
2 any change of position should only be made with the
3 concurrence of the legislature. Normally I have great
4 sympathy with legislative participation in policy decisions
5 of the nature -- of this nature and my record bears it
6 out, but in this case you must recognize the realities of
7 the situation. Our support for the Trans-Alaska route
8 is strong and will not waiver unless and until it becomes
9 clear that that route cannot succeed. That point, if it
10 comes at all, will probably come at some time later in
11 the pipeline decision--perhaps in the closing debate in
12 Congress. Decisions will have to be made quickly if they
13 are to have any impact at all. I can assure you that if
14 I have to make a decision to shift our support from the
15 El Paso route to the Alcan route it will be only after a
16 clear consensus has emerged from our Congressional Delegation
17 that such a shift was necessary and after a similar
18 consensus had emerged through consultation with the State
19 legislative leadership. We would all recognize it to be
20 in the best interest, I think, if that -- in our best in-
21 terest, I think, if that moment arose. But, reconvening
22 the legislature and seeking a new full-scale debate on
23 the question would simply be unrealistic considering that
24 we might be dealing with decisions which would have to be
25 made in literally hours or days. If there were time, I

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

1 would honor a request by the legislative leadership to
2 call a special session, but I cannot support a requirement
3 for a mandatory session under any circumstances, for it
4 would tie our hands unnecessarily and perhaps jeopardize
5 the best interests of the state. I hope you will consider
6 these contracts very carefully. I have tried to have
7 them available for you at the onset of the session so that
8 you might move quickly on them, but I do not want in any
9 way to pressure you into a decision before you are
10 satisfied that the contracts are in the state's best
11 interests. At the same time, you know and I know the
12 timetable of the federal decision, and waiting an un-
13 reasonable period of time before giving your endorsement
14 to what we have done may indicate on a national level that
15 our support is vacillating or, for that matter, that our
16 support will not be translated into meaningful action in
17 enough time to have an impact. I am sure you are aware
18 of these factors just as I am, and thus will deal with the
19 contracts reasonably and expeditiously.

20 I hope this brief review clears the air on certain
21 aspects of the decision before you. Members of my
22 administration will be available to you today and later
23 to answer questions which led up to the contracts. I
24 have instructed them to stay here as long as they are
25 needed by the committee and to answer the questions you

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

1 have. Some of them will have additional statements to
2 make concerning the contracts. And, the Governor expresses
3 his thanks, Senator Rader.

4 At this time I would like to ask Attorney General
5 Gross to make a statement, the only other prepared
6 statement we'll be making today, which indicates the
7 work that was done by the Gas Line Task Force.

8 ATTORNEY GENERAL GROSS: Thank you, Commissioner Martin.

9 As the Governor has just indicated in his statement, one
10 of the major purposes for the contracts before you is
11 to build national support in favor of the Trans-Alaska
12 pipeline route. I think it is fair to say that approval
13 or disapproval of this contract by the legislature will
14 be interpreted in large part as approval or disapproval
15 of the Governor's decision to support the Trans-Alaska
16 line. Since that is the case, it seems to me incumbent
17 upon the administration to outline for you why we have
18 come to the conclusion that support for the all-Alaska
19 line is in the state's best interest. You have an enormous
20 amount of material before you that has already been
21 furnished by the administration to justify its decision,
22 but it is perhaps fitting as we begin these hearings
23 that I briefly outline how we have reached this point in
24 the decision-making process.

25 As one of the first acts of his administration,

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

1 Governor Hammond appointed me as chairman of the Gas
2 Pipeline Task Force. The purpose of that group was to
3 gather and analyze the available data on alternative
4 pipeline routes and then to recommend to the Governor
5 which route was in the state's best interest. The Task
6 Force was composed of commissioners from the departments
7 which would have involvement in the construction of a
8 gas pipeline, such as Community and Regional Affairs,
9 Revenue, Natural Resources, Highways and Commerce. Mr.
10 Champion, the Pipeline Coordinator, served on the
11 committee, as did Lowell Thomas, the Lieutenant Governor.

12 In candor, there were enormous pressures on the
13 task force. A review of the files indicated that little,
14 if any, prior substantive analysis had been done of the
15 alternate route proposals. Accordingly, we had to develop
16 the information on which our decisions were based from
17 scratch. The members of the task force had little prior
18 expertise in gas pipeline regulation matters or the kinds
19 of decisions which were relevant to choosing a particular
20 route. We had to gain that knowledge before we could
21 make any kind of an intelligent decision. Finally, we
22 were put under a lot of pressure by the schedule of
23 events having to do with the pipeline route decision.
24 The FPC hearings were about to begin and if the state was
25 to take any meaningful position, it was necessary that we

1 make a prompt decision on what position we would take in
2 those hearings.

3 We tried to arrive at a position fairly and
4 honestly. By that I mean we tried to evaluate the data
5 made available to us in an unbiased fashion. We did not
6 try to reach a politically popular result just for the
7 sake of that popularity. The Governor instructed us to
8 reach a position that we could rationally support, and
9 we knew we had to do that since if we were to promote
10 our case before the FPC and in the national forum, a
11 decision based purely on political considerations would
12 be quickly and obviously exposed for exactly what it
13 was. We may have made mistakes, Mr. Chairman, in our
14 deliberations, but I can assure you that they have not
15 been through lack of commitment or effort to do what
16 was best for the state.

17 Initially we had but two alternative route
18 proposals--the Arctic Gas route and the El Paso route.
19 In analyzing those choices, we used information provided
20 by the companies both to us and in their filings before
21 the Federal Power Commission. That information was
22 subjected to the scrutiny of various departments which
23 evaluated the information with a view toward testing its
24 authenticity. We commissioned an economic study on the
25 alternative routes. Evaluating all the evidence, the

1 task force concluded unanimously that from both economic
2 and environmental viewpoints, the El Paso route was
3 clearly the best for the state. We recommended it to
4 the Governor and he accepted our recommendation, committing
5 the state to supporting that choice.

6 The reasons for the choice are, I think, now
7 obvious, at least in retrospect. From an economic stand-
8 point, the El Paso route generated a great deal of in-
9 state employment during construction and created a number
10 of long-term job opportunities within the state. The
11 El Paso project meant a greater amount of capital in-
12 vestment in the state. It also provided opportunity for
13 in-state use of gas, a matter of critical importance.
14 The Arctic Gas route provided little lasting economic
15 base for the state. Environmentally the Arctic Gas route
16 intruded on the Arctic Wildlife Range, one of the last
17 undisturbed wilderness areas in Alaska, while the El Paso
18 route for the most part utilized an existing pipeline
19 corridor developed for the Alyeska route. Every single
20 major environmental group involved in this matter joined
21 us in our support of the El Paso route as opposed to
22 the Arctic Gas route. It was one of the few issues on
23 which those who promote rapid development in our state
24 and those who are strict conservationists agreed.

25 Finally, very real questions have been raised as

1 to whether the Arctic Gas route can even be built, at
2 least in the foreseeable future. Native land claims
3 problems in Canada are very real right now. And, as we
4 all know, from our personal experience, those claims can
5 have very real impact.

6 Now, approximately a year after our initial
7 decision and a good part of the way through the presen-
8 tation of the case before the Federal Power Commission,
9 a new route alternative developed. That was the route from
10 Prudhoe Bay to Fairbanks, and then down the Alcan Highway.
11 That is the route that is now known as the Alcan proposal,
12 and it has some real benefits for Alaska. For instance,
13 it permits in-state use of royalty gas (though it does not
14 bring the gas to tidewater), and it provides a greater
15 long-term economic base in the state than is provided by
16 the Arctic Gas route. Environmentally the Alcan route
17 uses existing pipeline corridors to Fairbanks and then
18 follows the highway to the Canadian border, with minimal
19 environmental impact. Environmental groups started to
20 split with the surfacing of this proposal. Some of them
21 now advocate the Alcan route.

22 The Governor asked at that time that the task
23 force re-evaluate our position in light of the Alcan
24 proposal, and we did so, using basically the same process
25 as we used to reach our original decision. The task

1 force concluded after substantial study, including two
2 additional comprehensive economic analyses, that while
3 the Alcan route was far better than the Arctic Gas route,
4 it still was not as beneficial to the state as the El
5 Paso route. In long-term employment, for instance, the
6 El Paso proposal will create nearly one thousand more
7 jobs in the state than the Alcan proposal. On a net
8 basis, the El Paso route will produce approximately Five
9 Hundred and Twenty-five Million Dollars in income for the
10 state treasury during the effective life of the line, as
11 opposed to approximately Three Hundred and Fifty-seven
12 Million Dollars for the Alcan route. Only the El Paso
13 route will take gas to tidewater where prospective use of
14 our royalty gas will probably be greatest. Moreover,
15 from a national viewpoint, our analyses indicate that the
16 El Paso route can give as much as One Billion Dollars
17 more net benefit to the nation, primarily through the
18 fact that more of the project is built with American
19 labor and materials, and is subject to only United States
20 taxation.

21 Environmentally the case between Alcan and El Paso
22 is very close. The task force favored El Paso since it
23 used existing corridor technology. Now, that is important,
24 since it means that we can use the wealth of material
25 that we have developed on rivers, tundra, and wildlife

1 as the Trans-Alaska pipeline was built. Moreover, we
2 would, in effect, channelize our pipeline development in
3 the state. But there are real benefits to Alcan as well.
4 It is a purely subjective judgment and I would not
5 seriously quarrel with any of you who felt that Alcan was
6 the better environmental choice, but, in my view, it is
7 not so much better as to countervail the substantial
8 economic benefits which flow to the state if the Trans-
9 Alaska pipeline route is selected.

10 As chairman of the task force, it was my basic
11 function to coordinate the efforts of the various depart-
12 ments involved. I do not pretend to be an expert on the
13 various studies which have been done, technical aspects
14 of construction or difficult questions involving environ-
15 mental matters. We have here today, however, people who
16 can answer those questions, and Commissioner Martin and
17 I can direct your questions to the people who can best
18 respond to them. We are available to help you in any way
19 we can in explaining what we have done and why. I think
20 we have made the right decision and I hope we can convince
21 you that we have made the right decision. Thank you.

22 COMMISSIONER MARTIN: Mr. Chairman, I'm -- having said a
23 great deal on these contracts in prepared statements and
24 the other night before Senator Gruening's committee, I'm
25 not going to make a prepared statement in addition to

1 that made by the Governor and Attorney General Gross, but
2 I'm prepared to answer what questions I can and direct
3 your others to any other individuals we have here who can
4 help. Thank you very much.

5 SENATOR RADER: Thank you, Commissioner, Attorney General.

6 Have we any questions from any members?

7 REP. GRUENING: Somebody has got to start here.

8 SENATOR RADER: Mr. Gruening?

9 REP. GRUENING: I think this goes to Mr. Gross. In the
10 comparative evaluation it stated -- November of '76,
11 there is a letter, December 2nd, 1976, to the Governor
12 in which on page three of that letter, on the bottom of
13 the third paragraph, Chairman Gross makes these remarks:
14 "I think Alaska would agree that if we reached a point
15 where support of the El Paso route as no longer feasible,
16 the state should throw its support behind the Alcan route.
17 The only real question is at what point." And then in the
18 next paragraph you suggest a number of points at which
19 that support might be switched, and one of them was the
20 decision of the Federal Power Commission Hearing Judge.
21 And that decision, as I understand it, will be made
22 tomorrow, and I don't know what the decision will be, but
23 let's assume that it is not favorable to the all-Alaska
24 Route. Is it your position now that that is not an
25 important stage at which we should consider the -- our

1 first choice or is it important as you see it?
2 ATTORNEY GENERAL GROSS: Well, it is certainly important,
3 Representative Gruening. I think that since I wrote this
4 letter we have had an opportunity to discuss with both
5 the Congressional Delegation and the people involved in
6 the effort in Washington, what the impact will be of
7 an adverse decision before the Federal Power Commission.
8 It is my impression, from discussing that with those
9 people, that the fight will still be very much an open
10 one at that stage, that the basic decision is going
11 to be made by the President and the Congress, and that
12 the issue will not be foretold by a Federal Power
13 Commission decision even if it were adverse. So I
14 would say at this point that an adverse decision would
15 not cause me, at least, to recommend to the Governor a
16 re-evaluation of our position.

17 Commissioner Martin has been more in charge of
18 the Washington aspects of this and I think he would be
19 more appropriate to answer that; but that would be my
20 own reflection on what I consider.

21 COMMISSIONER MARTIN: I'd only add, Mr. Chairman, that I think
22 the circumstances that exist now, after the passage of
23 the Alaska Natural Gas Transportation Act, should be noted
24 to be substantially different than that which would exist
25 under ordinary certification processes. As that bill is

1 structured the FPC administrative law judge's opinion
2 ultimately leading to an FPC decision becomes only a part
3 on an overall structure which will involve a number of
4 other federal agencies, the President and Congress prior
5 to the decision. Whereas, under the ordinary circumstances
6 the finding of the judge followed by the Commission would
7 be determinative. So, I think that the circumstances
8 change but I would want to add that we intend to look at
9 that decision and we anticipate, quite frankly, that it
10 will be lengthy, several hundred pages, and we anticipate
11 that it will have a number of subtle and sophisticated
12 points in it. So that I think that it would be very
13 difficult now to say before seeing it what the position
14 would be. But, standing alone I don't think that it
15 represents a -- necessarily a single factor to change the
16 state's position.

17 REP. GRUENING: In this new legislation, what role or what
18 importance would you play on the presidential -- the
19 President's decision?

20 COMMISSIONER MARTIN: Well, all of these are somewhat subjective
21 judgments. My own feeling would be that the way the
22 decision will be made, and I guess I say this from the
23 perspective of my experience somewhat from the oil line
24 as well as this present dispute, Mr. Chairman, is this,
25 that my guess is that the President will take advantage

1 of the fact finding period set up in the bill utilizing
2 the federal agencies as well as the FPC. He will then
3 move toward a position on it without probably taking a
4 final position and then work with members of Congress to
5 see if the issue can somehow be brokered or somehow
6 resolved between the two branches prior to the time that
7 it goes.

8 So my guess is that the President is going to be
9 very important but that he will not send a recommendation
10 to Congress without having a fairly good idea of how it
11 will be returned. His role is unquestionably crucial.

12 REP. GRUENING: What I'm trying to determine, Commissioner,
13 is at what point, interpreting the Governor's remarks
14 today that you read, at what point would he make a re-
15 consideration? If I understood it correctly, he said in
16 Congress. In other words, the President's decision wasn't
17 as important to him -- or I'm trying to understand at
18 just what point you think these considerations that
19 Chairman Gross pointed out earlier are important.

20 COMMISSIONER MARTIN: I don't think that you can identify a
21 single instance but I can give you some examples that
22 would be the sort of thing that would be important. For
23 instance, if we get an early indication that the -- if
24 the President simply does what I suggest, he may not, and
25 that is, takes a position simply within the next sixty or

1 ninety days, stakes out a position and says "I'm going
2 to support the Arctic route" or "I'm going to support the
3 El Paso route", we will know something then that will be
4 definitive. We don't know whether he will do that.

5 Similarly there could be an action taken in
6 Canada, a definitive action which would give us an idea
7 whether Canada has any capability at all to approve any
8 pipeline through its country or whether it will act so as
9 to facilitate it. And I really think that you're not going
10 to get an answer as to a definitive point in time and
11 this is what we think is one of the strengths of the
12 contracts, that it puts us in a position where we can be
13 somewhat flexible in response to that but at the same time
14 have our basic position well established and well supported

15 SENATOR RADER: Senator Croft?

16 SENATOR CROFT: Could I ask -- I'd like to get back to Attorney
17 General Gross' letter of December 2nd. You said in the
18 last sentence -- the last paragraph of that, "I feel there
19 is every possibility that the Trans-Alaska project will
20 eventually be selected for the transportation of North
21 Slope gas." Do you expect Judge Litt tomorrow to in effect
22 recommend the El Paso route?

23 ATTORNEY GENERAL GROSS: No.

24 SENATOR CROFT: What has happened to date to make you think
25 there is every possibility that that route will be

1 selected?

2 ATTORNEY GENERAL GROSS: I think the indications I have,
3 Senator Croft, primarily revolve about the Canadian
4 situation. I think that the Canadian situation is going
5 to be a great deal more formidable than the administrative
6 law judge contemplates and that the land claims issue --
7 the national situation in Canada at the present time are
8 going to create a climate in which a Trans-Canadian route
9 of any kind is going to be difficult. And I think that
10 will be a highly determinative force on a national level.

11 SENATOR CROFT: Mr. --

12 SENATOR RADER: Senator?

13 SENATOR CROFT: Unless somebody else has another question. I
14 was going to ask in that regard that the Anchorage Times
15 of Saturday had reference to a treaty that had been
16 recently concluded with Canada and somebody had said that
17 that treaty had no material effect on the pipeline debate.
18 Do you believe that's correct and exactly what does that
19 treaty do?

20 ATTORNEY GENERAL GROSS: I do believe that is correct but I
21 think Commissioner Martin can better explain it if that
22 is all right.

23 COMMISSIONER MARTIN: Well, I think that it has some effect.
24 I don't think that it is going to be determinative in any
25 way. That's -- the treaty that was signed and now

1 subsequently has to be ratified in each country, is
2 basically a formalization of the ad referendum agreement
3 that was made earlier and that agreement really doesn't
4 resolve any of the difficult questions that confront
5 Canada on this issue. It tends to be more of an agreement
6 to agree than anything else. I can have Assistant Attorney
7 General Boness describe the terms of that treaty, I'm
8 sure you are already familiar with them, but I don't think
9 that treaty in any way is an agreement for a Trans-
10 Canadian pipeline, either Alcan or Arctic.

11 SENATOR CROFT: The reason I ask is because I had heard that
12 there was going to be a move on the part of our congressional
13 delegation to fight this because it did have implications.
14 You would expect then no fight out of our congressional
15 delegation as a result of it?

16 COMMISSIONER MARTIN: I would think that they might oppose it
17 but my own indication is that they share the view that I
18 just expressed regarding the treaty, that it essentially
19 establishes more normalized working relations between the
20 United States and Canada on sort of a broad range of
21 issues, but it does virtually nothing to materially advance
22 either an Alcan or Arctic route.

23 SENATOR CROFT: Mr. Chairman, would you expect that the
24 administration in conjunction with the Congressional
25 Delegation and the purchasers of the North Slope gas would

1 then oppose that treaty in Congress?

2 COMMISSIONER MARTIN: I really wouldn't take a position on
3 that. Our position throughout has been not to obstruct
4 relationships with Canada nor to highlight differences
5 between Alaska or the U.S. and Canada on this issue. I
6 think the bigger issue really is simply the Canadian
7 self-interest and the internal Canadian problems in terms
8 of approving it. But, without examining in detail, my
9 preliminary guess would be no, that we would not make
10 major efforts to oppose it, if any.

11 SENATOR RADER: Any other questions? Mr. Parr?

12 REP. PARR: Yes. I believe my question would be for
13 Commissioner Martin. In reading the Governor's statement,
14 Mr. Martin, the purpose of this is to build a constituency
15 in the Lower 48. Now, the Governor in dealing with the
16 reason for not getting legislative concurrence in his
17 switch said that a decision to shift, and these are
18 almost his exact words, would have to be reached quickly
19 and perhaps in hours or days and therefore it wouldn't
20 be possible to get the legislature back into it. I
21 would like to know what credibility you think we would
22 have if on July 3rd we are supporting the El Paso route
23 and July 4th we are supporting the Alcan, not only what
24 credibility we'd have but what credibility our presumed
25 allies would have?

1 COMMISSIONER MARTIN: Mr. Parr, as I see it there are really
2 two situations that might exist to change the state's
3 position on this issue. One could occur any time and one
4 could occur, as I see it, only relatively early in the
5 debate. The one that could occur relatively early would
6 involve the substantive merits of the routes themselves
7 and that is the emergence of facts, whether those facts
8 are deregulation of gas or other factors, which would
9 just simply change the substantive judgment of Alaskans
10 on which routes are in its best interest.

11 The second factor which I think could occur at
12 any point, would be the development of facts which
13 indicate that our first choice, El Paso, simply cannot
14 succeed and that we would lose to Arctic, a third choice,
15 unless we changed our support to a second.

16 Now, in terms of your question about credibility,
17 I think that most of the early development with regard
18 to new substantive aspects will happen probably during
19 the time -- or a good part of it will happen during the
20 time that the legislature is considering this issue and
21 should be very much a part of our debate.

22 With regard to the second factor, I think that
23 anytime we switch, based on the fact that El Paso can
24 no longer prevail, we are simply -- we are not impairing
25 credibility because we are not changing our mind about

1 which is the best route. We are simply saying that the
2 best route can't succeed and we're changing our allegiance
3 of support to the one that is the next best in our
4 interest. So, I think that either the State or the
5 companies could make that argument.

6 REP. PARR: Then you would say that the people down in
7 Tennessee or wherever who were supposedly writing their
8 Congressman in support of the El Paso route would under-
9 stand that they were being asked to switch the next day
10 as to writing their Congressman to support the Alcan
11 route?

12 COMMISSIONER MARTIN: I don't think that they would know, Mr.
13 Parr. I think that it is a very difficult situation.
14 I mean, there is no question in my mind that you have --
15 that your point is valid to some extent. The logical
16 extension of it, however, is that we lock ourselves into
17 a single avenue of support at this time and give ourselves
18 no avenue to get out of it if circumstances do change.

19 REP. PARR: Thank you.

20 ATTORNEY GENERAL GROSS: Representative Parr, I think -- is
21 it any more -- is it any different than in any political
22 process where a position is reached where a compromise
23 must be made which some person may not wish independently
24 but, forced to it is, nonetheless, required to make a
25 compromise? It happens in the Legislature, it happens in

1 the Congress, it happens all the time and I don't think
2 it is a question of credibility. It is a question of
3 you seeking the best thing you can get for your constituents.
4 View it to the extent you can and I don't think it is a
5 question that will be not credible, it's simply dealing
6 with reality.

7 COMMISSIONER MARTIN: Representative Parr, I'd like to add
8 one other thing when you asked about your constituency
9 in Tennessee. Under those circumstances they are not
10 going to lose the gas if the position changes. I mean
11 those same people who have been writing the letters are
12 going to be getting the gas but getting it through a
13 system which can succeed rather than through one that may
14 be a hopeless -- you know, a loser and can't succeed at
15 some later time. So those individuals will still have
16 the gas supply.

17 REP. PARR: May I reply?

18 SENATOR RADER: You still have the floor.

19 REP. PARR: Well, in reply to Mr. Gross, I see his point and
20 after all we all know that politics is the art of
21 compromise, right? But, that is a little bit different
22 from what I was talking about, I think. We were talking
23 about persuading a bunch of ordinary people who are just
24 who are not politicians but to support our cause by
25 persuading their politicians, right? And I think that is

1 quite a bit different from the fact that we in the
2 legislature and in the Governor's office and everywhere
3 else all have to accept compromise as a political fact
4 of life. I think there is quite a little difference
5 there.

6 ATTORNEY GENERAL GROSS: I think Commissioner Martin's point
7 is well taken. If the compromise will still protect the
8 interests of those individuals, I think they would support
9 it.

10 REP. PARR: Mr. Chairman, well, of course and if that's the
11 case, what we ought to do is make it pretty clear, "look,
12 we want you to support whatever the State of Alaska wants
13 supported, so you can get the gas. not that we want you
14 to support El Paso so you can get the gas." Right? We
15 were telling them that El Paso is the best route, okay?

16 ATTORNEY GENERAL GROSS: Right.

17 REP. PARR: And they are supposed to honestly believe that
18 and try and persuade their congressmen, not just because
19 they are going to get the gas because that is purely a
20 selfish motive and if that is the way we are going to
21 play it, we ought to know it. But I felt we were going
22 to persuade them that El Paso was the best route and
23 then we come along and say, "well, no soap, boys, now it's
24 Alcan we have to go for." That's all I have Mr. Chairman.

25 SENATOR RADER: Mr. Chatterton?

1 REP. CHATTERTON: Mr. Chairman, Mr. Commissioner, on November 22,
2 1976, why the Alaska Royalty Oil and Gas Development
3 Advisory Board met and did indeed approve your determi-
4 nation to waive the competitive bid process and sub-
5 sequent to that why you as required by statute set forth
6 some findings and conclusions. And I realize fully,
7 Commissioner, that you were operating within a time
8 frame, that you had to come up with something prior to
9 the early portion of the first session of the Tenth
10 Legislature. But, you in effect say that one of the
11 rationales for not having any competitive bidding as far
12 as intrastate use of gas is that no specific proposals
13 for such purchases were forthcoming. Now, and in your
14 judgment, how far on down through the future calendar
15 time do you think that situation would remain in effect?

16 COMMISSIONER MARTIN: My experience thus far with the royalty
17 oil and gas, Representative Chatterton, would indicate
18 that rather than a highly competitive situation arising,
19 what will happen is that a series of possible users of
20 royalty oil or gas will develop. Now these may be small
21 utilities, Golden Valley or some other electric cooperative,
22 they may be municipal -- municipalities that go toward
23 some gas system or a system that uses oil as a fuel for
24 electrical generation or other purposes, or there may be
25 large users that develop from major petrochemical or other

1 projects, and it may be that as those uses develop or
2 we define uses that are beneficial to the state, that
3 we can structure competitive sales to reach particular
4 objectives but that they will be largely predicated on
5 individual development or uses that may be competitive.
6 For instance, in the case of Golden Valley Electric,
7 it is very unlikely that we would expose Golden Valley
8 Electric to a highly competitive sale which might be at
9 the expense of consumers along with somebody else who
10 had come in to compete with Golden Valley Electric. Now,
11 we have not made any final determination on this but I
12 think we'll see that situation confronted. So, I don't
13 foreclose the possibility of competitive sales but I
14 think it will arise in the context of a lot of individual
15 proposed uses that will have to face a competitive sale
16 on one of those proposals.

17 REP. CHATTERTON: My follow-up question, Mr. Chairman. Is
18 it further and under your finding speaking to interstate
19 sale of gas -- you say, "under present legal and regulatory
20 circumstances a competitive sale based on price competition
21 is not feasible because the price at which natural gas
22 may be sold in interstate commerce is controlled by the
23 Federal Power Commission." And, I ask you, Commissioner,
24 how far into the future can you guarantee the citizens
25 of Alaska that "present legal and regulatory circumstances"

1 will make it -- will keep the situation so that you
2 cannot ask for competitive bids for interstate sale?

3 COMMISSIONER MARTIN: Well, I don't think I can give you a
4 figure of guarantee and I doubt that you would force me
5 to come up with it in a short period of time. Under the
6 new administration I'm sure you are aware that the
7 President has indicated his desire to move toward de-
8 regulation. Exactly how reliable that makes an absolute
9 promise for deregulation is anyone's guess and I think
10 it is something that might well be granted with our
11 congressional delegation. I do think that the situation
12 is unpredictable. The odds are now substantially higher
13 in favor of deregulation occurring than they were before
14 President Carter made that statement.

15 In terms of this contract, we would be again
16 benefiting by prices realized from the Prudhoe Bay
17 field if we went to a deregulated situation. I know
18 that later in this week there is going to be additional
19 testimony on the price provision that deals with de-
20 regulation and I'm hopeful that perhaps at sometime we
21 can come back and have a discussion which I think will
22 be complex and an interesting discussion on what that
23 means. And, I think that there will be -- that we are
24 largely protected under a deregulated, or regulated
25 situation to get the highest price from that field. I

1 will not tell you that there may not be circumstances
2 that can arise that are unforeseeable at this time which
3 may not make some differences and I want to discuss that
4 with the committee. But, basically speaking, I think
5 that this contract ties itself to the highest price,
6 whether or not deregulation occurs.

7 REP. CHATTERTON: Thank you, Mr. Commissioner, thank you.

8 SENATOR RADER: Any further questions? Senator Croft?

9 SENATOR CROFT: I'm curious in regard to the use of political
10 influence exactly where you expect that political
11 influence to fall? Whom are we trying to effect?

12 ATTORNEY GENERAL GROSS: Political influence, I think the
13 Governor's words, I think, are more apropos. I think
14 he called it "building a national constituency". I
15 think what he is trying to do, Senator Croft, is to give
16 people in other states as well as Alaska, an interest in
17 seeing the Trans-Alaska pipeline route approved. Now in
18 as they are influenced, as they desire that route, hope-
19 fully their congressional representatives will also desire
20 that route. Hopefully there will be more of a national
21 constituency as would influence the President in his
22 decision. That is the type of thing we are talking about.

23 SENATOR CROFT: You don't anticipate these contracts having
24 any effect on the FPC then?

25 ATTORNEY GENERAL GROSS: I think that frankly the contracts

1 have come too late to influence the FPC decision except
2 as it indicates a commitment of the gas. But in terms
3 of building a constituency for the pipeline, no. I think
4 the FPC decision is probably already written.

5 COMMISSIONER MARTIN: Each of the buyers, Senator, did
6 intervene in the FPC in favor of the Trans-Alaska route
7 but I think beyond that it is certainly not a political
8 situation with the FPC from here on out. They'll be
9 participating in the standard legal procedures of the
10 FPC and doing so on behalf of the Trans-Alaska route.

11 SENATOR CROFT: As an educated guess, is it fair to assume
12 that you anticipate that Judge Litt tomorrow will basically
13 rule in favor -- or recommend in favor of the Arctic
14 route and that the FPC in its full commission hearing,
15 which decision they have to make prior -- or on or before
16 May 1st will likely follow his recommendations?

17 COMMISSIONER MARTIN: Well, the former question with regard
18 to Judge Litt's decision is difficult to guess. The only
19 way that you can guess is the way in which the Judge has
20 asked his questions and made his statements during the
21 hearing. In my own view that has tended to follow a strong
22 bias toward the Arctic route and some dissatisfaction
23 with both of the other alternatives. So, I -- my honest
24 personal expectation is he will rule in a fairly compli-
25 cated decision probably, in favor of the Arctic route

1 and the decision will be somewhat complex beyond that.

2 In terms of the FPC following his decision, I
3 think that's just too speculative to really guess. I
4 believe there is one and possibly two seats vacant on
5 the FPC. The way those seats are filled will have a
6 tremendous impact on that and I think that the information
7 that is produced outside of the FPC proceeding from here
8 on out will also have an impact on it, and that is one
9 case in which I think the State will want to participate.
10 As you may know, during that period of time the ex parte
11 rule is waived for some purposes and a great deal of
12 information will be made available to FPC commissioners
13 in addition to that which is made available for the record
14 itself. So, I just think it is too unpredictable to know.

15 SENATOR CROFT: Do you think then that these contracts may
16 have an effect on the FPC?

17 COMMISSIONER MARTIN: I think they'll have a substantive
18 effect and I think it will be important that the people
19 that we have working for us will be able to produce new
20 information and hopefully develop better information on
21 the routes but I don't think they will have a political --
22 To answer your questions in terms of politics, I doubt if
23 it will have a political effect. I think, Senator, it is
24 very important to say a couple things here to at least
25 give my own personal opinion with regard to this idea

1 about politics being at the heart of it. I don't share
2 that view. First of all, someone said earlier, I think
3 it was Clark, that what is important is what you get and
4 what you give up. In terms of what you get, I think we
5 spend too much of our time really dealing with thinking
6 the only thing we get is political support. As I see it,
7 there are really four major things, some of them having sub-
8 parts that we get. One is, we get a good price for this
9 gas and we get it, I think, according to a term that gives
10 us the best protection we can get aside from getting a
11 premium. We may at a later time be able to get a premium
12 and I'm -- I've said that throughout this entire consideration.
13 It's a matter of whether or not you want to withhold this
14 action waiting for that time to possibly arise. It is not
15 here now and we can't get it now, but we get a good price.

16 Secondly, we get a contract which very closely
17 follows the theory that Mr. Moody advanced last year and
18 that could be followed to protect our royalty gas. We get
19 in-state protection of gas by a total take back provision,
20 which I think most people agree is extraordinary in its
21 coverage of future in-state uses and to protect. That may
22 or may not be something we can accomplish later.

23 Third, we get, I think, a reasonable exercise of
24 the rights that we gain through the amendment that passed
25 the Gas Transportation Act and last years Congress. There

1 has been some disagreement over whether or not this is
2 the way and the time in which that should be exercised.
3 I personally believe it is a reasonable way and a reason-
4 able time to exercise it, and I think the Congressional
5 Delegation agrees with that.

6 And, fourth, and only fourth do we get the
7 support for the pipeline that we are talking about and
8 even there, that support while it has a political aspect,
9 that is it builds a constituency in a certain area and
10 it puts people on our side working for it. It also has
11 a substantive aspect, Senator Croft, in that these
12 companies, Tenneco and Southern, are companies with great
13 resources in terms of their substantive capability,
14 whether it is LNG or offshore operations and the way in
15 which they merge into the El Paso system in a logical
16 distribution pattern. They bring a great deal more to
17 it than politics. So, I think that while it is unques-
18 tionable that there will be political or other -- you
19 know, something to be characterized as political support.
20 There is much more to the contract than that that is of
21 benefit to the state.

22 SENATOR CROFT: Mr. Chairman, could I reply to that? The
23 phrase "political support" did not originate with me.

24 COMMISSIONER MARTIN: I understand.

25 SENATOR CROFT: I don't know whether it did with you or the

1 Attorney General but on page twelve of the Governor's
2 speech dated November 12th, he says, "Gaining political
3 support at this critical stage of the pipeline proceedings
4 is the major reason for acting now on royalty gas, but
5 there are other reasons also." And then on page fifteen
6 he says, "The primary objective of this sale is to gain
7 additional support for the pipeline route the State
8 supports."

9 COMMISSIONER MARTIN: I understand that and I think it is
10 fair to characterize it as a primary reason, or the primary
11 reason, but I'm trying to make it a point ---

12 SENATOR CROFT: The primary reason is political support?

13 COMMISSIONER MARTIN: That -- in my view, it is not. I think
14 in my view there are many reasons and they are all of
15 somewhat equal character. I think the Governor said that,
16 and that is his view, that he thinks it is a primary
17 reason.

18 ATTORNEY GENERAL GROSS: I think you may be getting into a
19 semantic difficulty here. I think what you read,
20 Senator Croft, said the reason for selling the gas
21 now is to generate political support, and I think that's
22 unquestionably accurate and the Governor stressed it.
23 That is the reason we are doing it now as opposed to
24 doing it a year from now, that a year from now it will
25 have no impact in gaining us any support for our position

1 in the Trans-Alaska pipeline dispute. I think Commissioner
2 Martin is stressing that the contract itself whenever
3 made, also has certain highly desirable features to it,
4 which he has stressed. And I think that is absolutely
5 accurate too.

6 SENATOR CROFT: Could I ask one more question and then Mr.
7 Chatterton has one. To what extent does either the
8 Federal Power Commission or the United States Congress
9 have authority or the possibility of allocating this gas
10 wherever it goes anyway? Couldn't they simply say, "we
11 approve this route and we determine that 2.5 billion
12 cubic feet a day are to be sold east of the Mississippi
13 River"? And doesn't -- I mean, doesn't Congress have the
14 power to allocate that gas rather than them having to
15 say, "We're going to approve a route because then a
16 supplier may buy it through some contract"?

17 COMMISSIONER MARTIN: Well, Senator, I think you know partially
18 what the answer to that is. That is the stuff with
19 which interstate commerce clause battles are made between
20 states and the federal government. Under some circumstances
21 I would say, yes. Under the -- as you know, oil is
22 allocated and I don't suppose that there is any over-
23 riding reason that they couldn't do that. The circumstances
24 would have to exist to do so.

25 Let me just point out on the other side, though,

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

1 that we were successful in drafting a proposal and
2 our delegation was even more successful in gaining the
3 passage of the amendment which gave Alaska the right to
4 utilize its gas in-state. So that I think all you can do
5 is judge that subjectively as a political possibility.
6 In other words, a legislative congressional possibility.
7 Right now, I think, that given the gas shortage in the
8 Lower 48, how we react, responsibly or not to that in
9 Alaska, has a great deal to do with that. How other gas
10 producing states react has something to do with that.

11 In my view, the passage of the amendment was a
12 hopeful sign and it may be one that we can capitalize on
13 and protect future in-state uses. But -- the question
14 is simply, can they do it? I would say, sure.

15 SENATOR CROFT: I have some additional questions but I notice
16 Mr. Chatterton wants the floor.

17 SENATOR RADER: First of all, anybody who has not yet asked a
18 question, who would like to, we'll open it up to everyone
19 before we get to -- Mr. Chatterton, then.

20 REP. HAYES: Mr. Chairman?

21 SENATOR RADER: Mr. Hayes?

22 REP. HAYES: Commissioner Martin, just one item of clarification.
23 The statement regarding the primary purpose of the
24 contract which had to do with political considerations,
25 that was the Governor's position and not yours?

1 COMMISSIONER MARTIN: Yes, sir.

2 REP. HAYES: I read it in the transcript of your Royalty Oil
3 and Gas Development Advisory Board of November 22nd,
4 where I got the impression that it was your opinion.

5 COMMISSIONER MARTIN: My view is that -- just to clarify it,
6 Mr. Hayes, is that all of these purposes are extremely
7 important and that is one of them. Whether it is not
8 the most important or not, or the primary purpose, is that
9 I think it is subjective judgment. I think each of them
10 are important, in a combination they make up a very good
11 argument.

12 SENATOR RADER: Mr. Chatterton?

13 REP. CHATTERTON: Thank you, Mr. Chairman. I'm sorry, Mr.
14 Commissioner, but I would like to recall your memory and
15 see if you still stay. Going back to those findings
16 that I referred to that you made following the November
17 board meeting, why you do say that the "primary objective
18 of the proposed" -- "presently proposed sales to improve
19 and strengthen the position of the state with respect to
20 the decision process for the system to transport North
21 Slope natural gas" and I gather --

22 COMMISSIONER MARTIN: Well, Mr. Chatterton, I'd stand by that
23 statement.

24 REP. CHATTERTON: Yes, I think that is what you said here.

25 ATTORNEY GENERAL GROSS: Mr. Chatterton, as one who has been

1 involved in this from the Gas Pipeline Task Force point
2 of view, I think when you say "political influence", what
3 you are really saying is that it is a roundabout way of
4 saying any influence. This is a political decision which
5 is going to be made in the larger sense. A political
6 decision as to policy consideration clashing to produce
7 a decision as to where this pipeline route is going to
8 be built. If the state is going to have any influence
9 in this, it is going to have to have political influence
10 in this. That's -- we either have the choice of doing
11 nothing and watching it happen, or we have the choice of
12 becoming actively involved and trying to influence the
13 decision. The Governor made the latter choice.

14 SENATOR RADER: Senator Poland, then Senator Bradley.

15 REP. BRADLEY: Representative.

16 SENATOR RADER: Representative Bradley.

17 REP. BRADLEY: You don't know what an insult that is.

18 SENATOR RADER: I didn't mean to insult you, Representative.
19 Senator Poland?

20 SENATOR POLAND: As long as we are on this political issue,
21 one of the things that has bothered me about the switch
22 provision in there is what incentives do these three
23 companies particularly have when they're going -- as I read
24 the contract, they're going to get the gas no matter what
25 route.

1 COMMISSIONER MARTIN: You have made a common error, Senator
2 Poland, I believe in reading the contracts, because they
3 will not get the gas no matter which route it is. I
4 have talked to a number of legislators who have made the
5 same error reading the contracts.

6 The gas will only be given -- if they are support-
7 ing the position that the state supports and if that
8 position prevails so that if the state never changes its
9 position from El Paso and Alcan is certificated, none --
10 these contracts will simply be void.

11 If the state changes its position to a second
12 route, let's say Alcan, and one of the companies refuses
13 to switch at the time the state does so and then Alcan
14 prevails, or the other route prevails, they similarly
15 lose the gas. So, the only circumstances under which they
16 get gas is if they are supporting the state position and
17 if that position prevails. Under all other circumstances
18 the contracts would be void, so they have an undeniable
19 incentive to be with the state on the prevailing position.

20 SENATOR POLAND: Excuse me, Commissioner, I didn't express
21 myself well because I understood that the state had to
22 switch its position for their contracts still to be in
23 power. But, if the state does -- I mean, they have no
24 incentive to particularly work to hold the state on the
25 all-Alaska position.

1 COMMISSIONER MARTIN: I would think they would have the
2 incentive of wanting to prevail since that is the
3 position we are going to take and the position we believe
4 would prevail.

5 SENATOR POLAND: Mr. Chairman, I have one other question that
6 I would like to ask the Commissioner.

7 SENATOR RADER: You still have the floor.

8 SENATOR POLAND: The state has the right to take back whatever
9 gas it needs for in-state use, including the exchange of
10 Prudhoe Bay gas for other gas elsewhere in Alaska. If
11 the exchange gas is used in Alaska and including lique-
12 faction of the gas provided the liquid gas is used in
13 Alaska, now, does this mean that we cannot sell gas to a
14 third party for liquefaction and export?

15 COMMISSIONER MARTIN: Let me ask. Yes, that is right. I
16 wanted to make sure that I had followed your question.

17 SENATOR POLAND: Then if we want to use those things we have
18 to go into that business ourselves?

19 COMMISSIONER MARTIN: I want to be sure I understand your
20 question, Senator Poland. Would you run that by one more
21 time? I'm not sure I understood it.

22 SENATOR POLAND: Does this mean that we can't use -- we can't
23 sell to a third party for liquefaction and export?

24 COMMISSIONER MARTIN: That is right, we could not do that.

25 In my view that is right but we could sell for liquefaction

1 and use. The statement we make is protected from all
2 in-state uses except liquefaction for export. What you
3 are suggesting is a way that we might essentially cheat
4 that provision. What we have sold in these contracts,
5 I have made it clear in all my statements, is the -- the
6 one thing we have sold is gas that is surplus to state
7 needs and the sole judge of state needs is the state
8 itself through its statutory process. But, anything that's
9 surplus the state needs by our own choice is committed
10 under those contracts and what you're suggesting is a
11 way to -- essentially to surrogate that bargain, if the
12 bargain is to sell gas that's surplus.

13 SENATOR POLAND: In other words, you don't consider that the
14 state needs the liquids?

15 COMMISSIONER MARTIN: This has -- I assume -- I didn't under-
16 stand your question to have anything to do with gas
17 liquids, Senator Poland. I can discuss that -- I didn't
18 think -- were you asking about gas liquids?

19 SENATOR POLAND: No, I asked on this other and then I'm also
20 interested in -- what about the liquids? Because your
21 answer --

22 COMMISSIONER MARTIN: Well, the liquids have been the subject,
23 I think, of some misunderstanding. Under the terms of
24 this contract Alaska has a full right to the liquids from
25 this gas. Let me give it to you in practical terms. It

1 first has a right -- and this has nothing to do with the
2 notice provisions under the contract, it has a right to
3 take those liquids and do whatever it wishes with them,
4 including exporting them or any use in Alaska and to take
5 them at any point where those liquids are taken from the
6 gas, whether it's in Alaska or outside.

7 In addition to that, it has the right to take the
8 liquid -- the gas off itself and take the liquids from
9 the gas and to use it in Alaska. The only limitation is
10 not in the contract but it is a practical economic
11 limitation as to whether or not those liquids will actually
12 be taken out in Alaska or whether or not the state can
13 justify the building of a plant to take out the liquids
14 itself for only the royalty share. Now, it's been
15 suggested and I think by several people, that one of the
16 things the state did not do in this contract is to use
17 the contract to coerce in some way or to negotiate for
18 the fact that the liquids of all of the gas would be
19 taken out in Alaska. That is accurate, we did not. But
20 I can assure you that we would not have been able to get
21 this contract if that were our objective. Now, if the
22 legislature believes or other believe that that should
23 be our objective, to force the eight-eighths on us -- every-
24 one to take out their liquids in Alaska, we can take a
25 run at doing that but that is not one of the objectives

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

1 of the contracts. Other than that, we have a full right
2 to our liquids anywhere they come out or we want to take
3 them.

4 SENATOR RADER: Representative Bradley?

5 REP. BRADLEY: Commissioner Martin, is the State of Alaska
6 engaged -- and this is somewhat in following the four or
7 five or six or eight questions regarding political clout,
8 is the State of Alaska embarking on some sort of un-
9 precedented new morality or new ethics or something that
10 is unusual that's ever been done -- that's never been
11 done by any other states. I mean it doesn't -- I'm --
12 this is somewhat rhetorical. It doesn't appear to me
13 that way but some people have commented on bad morality
14 and some people have -- and of course when people mention
15 politics, I guess in a lot of cases they're talking about
16 it as being bad. I don't feel that way and I don't think
17 some people do but -- are we entering into some sort of
18 new era of sin regarding our resource development?

19 COMMISSIONER MARTIN: Well, I have never heard the point
20 raised by anyone until raised by one -- raised by
21 Lieutenant Governor Boucher at the Royalty Board and
22 raised just in the last week. Those are the two occasions
23 on which I heard the issue raised in the whole last year
24 or so that this issue has been discussed and quite frankly
25 has been very openly known.

1 My own view of that is, no, we are not entering
2 into any new period and we don't intend to. I don't
3 think there is a specific precedent for a state doing
4 what we have done. Let me try to answer the question
5 this way in terms of what was involved. First of all,
6 other states don't fool around with -- you know, even
7 the kind of contract we have, which is I think a
8 reasonably complex answer to a problem that is itself
9 complex, they just simply spend money and they pay people
10 money to go down and lobby people in Washington and
11 lobby people elsewhere to do what they want.

12 Secondly, I think it is very important to remember
13 that we are not coercing the national will using our
14 resources. If we were in a position of saying, "we want
15 the Trans-Alaska pipeline and we are not going to let
16 our gas leave this state to go to the people in the
17 Lower 48 under any circumstances except the certification
18 of this route", I would think then we would be in a
19 coercive and somewhat morally questionable position.
20 What we're saying is we're expressing a preference for
21 the route we want and we're making a contract that would
22 award gas only to companies that help us get that route.
23 If the route fails the contract -- the only implication
24 of that is that the route fails. The implication of it
25 is not that the people in the Lower 48 who may need it,

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

1 are deprived of some portion of our surplus gas, so we're
2 not coercing.

3 And finally let me just say that there is only
4 certain tests of what may or may not be politically or
5 ethically acceptable actions and I think that a year of
6 public debate on which that question simply was not
7 raised, followed by what I would say is ongoing consul-
8 tations with our Congressional Delegation with regard to
9 their perception of the way this would be heard in
10 Washington. This indicated to me that they consider it
11 to be a highly proper and in fact, a desirable course of
12 action and not one, which at least to them, has indicated
13 moral questions.

14 SENATOR RADER: We have gone a little bit more than an hour.
15 We will take a ten minute break and we'll strictly limit
16 it to ten minutes. We will bang it back to order in ten
17 minutes sharp. We're adjourning -- or recessing.

18 (Whereupon the hearing was recessed at
19 3:30 p.m. and reconvened at 3:40 p.m.)

20 SENATOR RADER: Representative Rhode has to leave the hearing
21 and asked to be permitted to ask a question. Mr. Rhode?

22 REP. RHODE: Thank you, Mr. Chairman. I have just one question
23 and I'll be satisfied with a short answer. Under the
24 present law, as I understand it, we have the privilege
25 of taking our one-eighths share of the gas out of this

1 line at any place and anytime. Now, if this contract is
2 not approved -- or I should say, if this contract is
3 approved and the Congress repeals that privilege, where
4 do you stand with this contract?

5 COMMISSIONER MARTIN: Representative Rhode, the Congressional
6 amendment indicates that we have that right and it orders
7 the Federal Power Commission to approve any contract that
8 does that. If we have approved this contract and if the
9 amendment is repealed prior to the time we get that FPC
10 approval, it's our legal belief that we are not protected,
11 that we would then have to rely on FPC approval without
12 the amendment. That is still possible but the chances
13 of it being approved at that point are substantially less.

14 SENATOR RADER: Mr. Gruening had an exhibit, I believe.

15 REP. GRUENING: I have an exhibit but I would like to ask
16 some questions based on facts that appear in this. The
17 exhibit numbered exhibit three is based on Tenneco's
18 interstate natural gas pipeline market areas and it has
19 some figures on the states that are served and the amount
20 of gas that they provided these states. And based on
21 that the staff for the House Special Committee has come
22 up with some figures that show that Tenneco's share of
23 its twenty-five states that they serve is about ten per-
24 cent. In other words, they provide about ten percent of
25 the natural gas to these twenty-five states in 1975.

1 Tenneco's share of royalty gas under these
2 contracts, based on those same figures, would be less
3 than three-tenths of a percent. Now, that is fifty
4 percent of our royalty gas. You put that in juxtaposition
5 with the fact that there is twenty trillion cubic feet
6 consumed in the United States in 1975, what impact is
7 this going to have on building a constituency? It
8 appears to me -- doesn't it -- it appears to me and does
9 it appear to you, Commissioner, that the amount of royalty
10 gas we're committing really is infinitesimal when you are
11 trying to deal with the energy gas shortage problem that
12 we have?

13 COMMISSIONER MARTIN: I think you can only answer that in
14 terms of the -- you know, rather than looking at the
15 numbers and I do agree with your analysis. I'd like to
16 see the figures but I understand what you are saying,
17 three trillion cubic feet. And, in fact the entire
18 Prudhoe Bay, which is let's say twenty-six to thirty-one
19 trillion cubic feet, about one years supply in the United
20 States. People forget that. We're very limited by the
21 importance of any amount, getting our royalty amount.
22 But the true measure of it is the level of interest and
23 the level of support it genders and it seems to me that
24 in terms of the effort that it has generated and the
25 support that it has generated and the interest it has

1 generated, we're making it go pretty far, but we can't
2 be right, we can't make it go any farther than the basic
3 amount and that is somewhat limited. That is about all
4 I can say.

5 REP. GRUENING: Commissioner, unless the -- you know, the
6 emotionalism of the crisis that is presently in the
7 Lower 48, you know, upsets Congress to the degree that
8 they don't look at these facts, won't Congress really
9 look at the total energy picture and determine that if
10 they are going to solve the gas problem, it is not going
11 to be through, you know, picking a pipeline route, but
12 reallocating the gas on a major basis as legislation is
13 already introduced to do?

14 COMMISSIONER MARTIN: I mean it is a subjective judgment.
15 I think that that is a possibility but right now we have
16 a gas line procedural act that sets up an exactly
17 opposite procedure to reach a decision on the route. So,
18 that if you have to bet on what is the most expectable
19 thing to happen, I would put my trust in the fact to
20 carry out the terms of the gas line procedural act and
21 try to reach a decision on the route. Now, whether or not
22 allocation comes with that, I don't know. It's -- it's in-
23 tangible.

24 REP. GRUENING: What I'm trying to get at though is what are
25 we actually receiving by selling the gas now? In other

1 words, I understand your concern and I think the contract
2 really has addressed itself to a lot of the points in
3 terms of price, but even the best attorneys can't see
4 six, seven, ten years in the future. So, if we're
5 getting very marginal influence -- in other words, if
6 Congress looks at it and says, "this isn't going to
7 make it -- a lot of difference, this commitment one way
8 or another" and this constituency really won't exist.

9 I'm trying to determine whether we really are
10 building a constituency.

11 COMMISSIONER MARTIN: Clark, I've never tried to change what
12 I think was the basic position on what we get in terms
13 of support for the route. It is a subjective judgment.
14 It could be analyzed, as you have done it, by trying to
15 figure out the amount of gas as it compares to something
16 else or it can be done by talking about whether Tenneco's
17 a good or bad company or any other number of ways. I
18 can only judge it myself in terms of what it appears
19 to be doing and what it appears that it would do in
20 that decision. And I've tried to apply the judgment of
21 many people doing it. To me, the fact that our Congres-
22 sional Delegation has to make that fight thinks that it
23 is one of the most important things that we can do and
24 they believe that it is crucially important to win the
25 debate is a very important factor and goes beyond what

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

1 we can find on paper to demonstrate that it is not an
2 important factor. So what we get, it seems to me, is
3 more than just the figures on the paper but what people
4 think they can make out of that. Right now that appears
5 to be important.

6 REP. GRUENING: Will the companies' own decision on which
7 route to support have an effect? I relate back to
8 Senator Poland's earlier question in that what is the
9 incentive of these companies to lobby for the first
10 choice, El Paso, when in fact they know that the state
11 would accept a certification of the Alcan line. I mean
12 I don't think logically or reasonably we'd reject that
13 certification if it was the only one and why not -- what's
14 -- I mean, won't they be in the drivers seat in deter-
15 mining which one they want --

16 COMMISSIONER MARTIN: Well, we would accept it. We would
17 accept it but the question is whether or not we will be
18 supporting it at the time. That is what we're left with.
19 It may well be that we conclude throughout the procedure
20 that El Paso's in our best interest and that the companies
21 stay with us throughout and that that route simply loses.

22 I made an error earlier and I want to correct it.
23 I said that the contracts would terminate. The contracts
24 may be terminated rather than they would terminate. It's
25 policy that we would terminate it and I said it that way

1 because if it's policy then that would be the case.
2 But under any circumstances, they're under incentive to
3 support the state position because they must be with that
4 position when it prevails.

5 ATTORNEY GENERAL GROSS: If I might add to that, the Congres-
6 sional Delegation, Representative Gruening, can shift
7 its support to an Alcan route without the Governor shifting
8 his support. That the result that even if an Alcan
9 route prevailed in Congress, these companies would not
10 receive the royalty gas.

11 SENATOR RADER: Any further questions?

12 REP. GRUENING: Not at this time.

13 UNIDENTIFIED VOICE: Would you explain that again, please?

14 ATTORNEY GENERAL GROSS: Sure. The Congressional Delegation
15 could in the end end up voting for somebody supporting
16 an Alcan route. If the Governor did not formally shift
17 the state support under the contract to the Alcan route,
18 these companies would not receive any gas because they
19 would not be -- they would not be in support of the route
20 that the state would be supporting and that route would
21 not be successful. So long as the state stayed with
22 support of the El Paso route.

23 SENATOR RADER: Representative --

24 COMMISSIONER MARTIN: I think --

25 SENATOR RADER: Excuse me, sir.

1 COMMISSIONER MARTIN: I was just going to say that I think
2 that is an entirely appropriate question to ask the
3 buyers and I'm sure you will, in terms of how they're
4 basing their activities and their judgment. There is no
5 question in my mind that based on the activity that has
6 already been undertaken and based on the preference of
7 the buyers and based on what would be done -- you know,
8 even during the time that the legislature is working on
9 this, that a case for support of the El Paso route is
10 being put together. It has been put together basically
11 without any difference of opinion from many people in the
12 state for some time.

13 I think questions about how difficult it is to
14 change are appropriate but nevertheless we think we may
15 reach that time.

16 REP. GRUENING: I have just a comment on -- the hypothetical
17 that the delegation would be for one line and the Governor
18 the other is pretty improbable. If I understand what you
19 said earlier is that if the delegation -- whatever they
20 say goes as far as you're concerned, they're --

21 COMMISSIONER MARTIN: No.

22 REP. GRUENING: No?

23 COMMISSIONER MARTIN: What the Governor said is pretty clear.
24 He said that we may reach a time at which it is appropriate
25 to change. If it looks like El Paso can't prevail and

1 we'll lose to Arctic without -- unless we switch our
2 support to Alcan. He'd base his decision to change on
3 the consensus of the delegation and legislative leader-
4 ship and gave his pledge in his statement, as I under-
5 stand it, to call a special session after consultation
6 with the legislative leadership if time permits.

7 ATTORNEY GENERAL GROSS: I suppose as a scenario you are
8 suggesting that the companies behind the scenes could be
9 working in support of an Alcan route, which they hope
10 would ultimately prevail, under the assumption that
11 eventually the state would have to come over to that
12 when they saw that the El Paso route would collapse.
13 I think the state would probably take it amiss if it
14 found that the people who were receiving the gas under
15 the contract who had been committed to supporting a
16 Trans-Alaska route were actually working under the scenes
17 to support an Alcan route. I think that would probably
18 affect the state's decision as to what it did and I
19 don't think the companies would in any sense do that.
20 I don't think that they would act in such a fashion.

21 REP. GRUENING: I can't believe the state in a myth would
22 then forego the opportunity -- In other words, you are
23 saying that it would -- if it found that, it would not --
24 it would reject the contract, if it found that they
25 weren't living up to snuff, in your view?

1 ATTORNEY GENERAL GROSS: Well, I suppose what you are asking
2 is would the state approve it after the fact. I mean
3 if the Alcan proposal was then approved by Congress,
4 would the state switch its support so it could give the
5 royalty gas to these people. If that is what you are
6 asking I can't imagine why that decision would be made
7 just for that. I don't know.

8 SENATOR RADER: Representative Chatterton, I'm going to tend
9 to go to persons who have not previously asked a
10 question, however, Representative Chatterton did want
11 to have a follow-up on something that occurred before
12 the recess and then I'm going to start recognizing
13 persons who have not yet spoken. Representative
14 Chatterton?

15 REP. CHATTERTON: Thank you, Mr. Chairman. Commissioner,
16 I sense that there is a consensus of agreement amongst
17 this group with your statement that the primary objective
18 of these gas sales contracts are to strengthen our end
19 in the decision making process that you get an all-
20 Alaska line. Just before we broke for coffee I very
21 admirably -- I think I heard you speak to the point
22 that you would in no way want to coerce any decision as
23 far as Alaska gas is concerned to the South 48. Now,
24 as I say, I think that is admirable and I share that
25 position with you. Now my question to you, Mr. Commissioner,

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

1 is very simply this: That if subsequent testimony before
2 here develops that the city gate price in Columbus,
3 Ohio, would be lower by some route other than the all-
4 Alaska line, would you still favor these contracts?

5 COMMISSIONER MARTIN: Well, I don't know.

6 ATTORNEY GENERAL GROSS: Can I respond to that, Representative
7 Chatterton?

8 REP. CHATTERTON: Please.

9 ATTORNEY GENERAL GROSS: For one thing, I think that the
10 price in Ohio probably is going to be lower by another
11 route than the all-Alaska line. I think that the
12 evidence which has developed indicates that the delivered
13 price of the gas down below will probably be the cheapest
14 by the Arctic Gas route, next by the Alcan route and
15 finally by the El Paso route. So, the decision already
16 has been made to make -- to support that and that is
17 for a number of reasons. Some environmental, having to
18 do with environmental considerations other than purely
19 economic ones, the other having to do with political
20 problems with building the lines themselves. Now the
21 Arctic Gas, for instance, the model for Arctic Gas is
22 constructed under the assumption of certain provisions
23 for construction -- Arctic construction, using snow
24 roads. Our people in the state government believe that
25 that is a totally unfeasible way of constructing the

1 line and that as a practical matter if Arctic Gas is
2 certificated they will end up spending a great deal more
3 building the line than they anticipate spending at this
4 time, that their cost overruns will be substantially
5 greater and that therefore their cost of delivery will
6 be substantially more.

7 Similarly, the political problems in Canada may
8 mean that the lines may not be able to be constructed
9 until many years in the future, beyond the point at
10 which the gas under the El Paso proposal could be
11 traveling southward. So, price is one consideration.
12 An additional factor is the point that construction of
13 an all-Alaska line will be using American labor and
14 materials, it will be constructed wholly within the
15 United States and the net economic benefit of that for
16 the country is higher than using a gas Arctic proposal.
17 So, there are other economic benefits to the country
18 than just the price of delivered gas.

19 REP. CHATTERTON: Thank you.

20 SENATOR RADER: Representative Meekins?

21 REP. MEEKINS: Commissioner Martin, following up on what
22 Senator Poland asked you about, the liquefaction, invoking
23 the take back provision in order to commit our royalty
24 gas to a third party for liquefaction and export, you
25 indicated, as I understand it, that that would not be

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

1 possible in this contract. Is that correct?

2 COMMISSIONER MARTIN: That is right.

3 REP. MEEKINS: What about taking back our royalty gas for
4 purposes of using -- to then recommit it to a third
5 party in order to give an incentive for the location of
6 a petrochemical industry?

7 COMMISSIONER MARTIN: We could not take it back if they
8 subsequently exported it but we could certainly take it
9 back to be used in such a facility.

10 REP. MEEKINS: But we could not -- for instance, if that
11 exactly was our purpose, to increase the incentive if
12 necessary, for a location of a petrochemical industry
13 at tidewater for export to the Lower 48 or elsewhere,
14 we could not do that under this contract?

15 COMMISSIONER MARTIN: That is right and that's a very -- I
16 think a very important question. It is one of the
17 alternative courses that I think ought to be very carefully
18 considered by the legislature. I tried to point this out
19 before. What we have committed in this contract and it's
20 a fairly -- in other words, I said this last year to this
21 committee. You really have to sell something in order to
22 get anything back. Now, the only thing that we have
23 committed is whatever gas is surplused to any state needs
24 in the future and is going to be exported. So that the
25 only -- the only really meaningful arrangement that will

1 be difficult to enter into with regard to that surplus
2 gas in the future is one where someone comes to us and
3 says "we will build you a petrochemical plant in five
4 years if you will let us export your surplus gas for five
5 years and then use it." That we would not be able to do
6 but what we would be able to do is to take it back and
7 commit it to that plant in five years, as soon as they
8 are ready to build.

9 Incidentally, we have looked at -- in the oil
10 situation we have looked at a couple contracts and we are
11 still actively looking at them, where they propose to
12 do this kind of thing. In other words, to take an export
13 for a period of time and then tie it back to a -- what I'd
14 say a possible refinery at some later time. And, at
15 least thus far we haven't found anything that looks like
16 a good deal for the state.

17 REP. MEEKINS: Thank you.

18 SENATOR RADER: Representative Rudd?

19 REP. RUDD: Mr. Martin, I would like to follow up on
20 Representative Rhode's question having to do with the
21 possibility that Congress would repeal the Alaska
22 exemption.

23 SENATOR RADER: Representative, would you speak a little
24 louder, please?

25 REP. RUDD: I'd like to follow up Representative Rhode's

1 question on the possibility that Congress will repeal the
2 Alaska exemption. If that happens, does it depend on
3 Congress as to whether or not they make it retroactive
4 or would our contracts, if we had entered into them,
5 then be void?

6 COMMISSIONER MARTIN: Well, let me be very clear. We don't
7 believe as a legal matter that simply entering into the
8 contract now gives us any special protection. We believe
9 we not only have to enter into the contract but we have
10 to advance it to the FPC using that provision in order
11 to gain protection. Congress could do basically anything
12 it wants and there is no reason -- at the time that it
13 repealed it, it would act retroactively. My feeling
14 would be that if it wanted to repeal it, it would vary.
15 It would not be likely that they would be in a mood to
16 make it retroactive to pick up this contract.

17 REP. RUDD: But you feel even if they don't make it retro-
18 active that our contracts are in danger at that point?

19 COMMISSIONER MARTIN: Well, I discussed this the other night
20 with the House Special Committee. It's again a subjective
21 judgment, what the risk of repeal of that provision is.
22 I made the statement that Congressmen have said they are
23 going to try to repeal it. I have no question but what
24 some attempt will be made. Whether or not it will be
25 successful is a purely subjective judgment and I've tried

1 to poll our delegation on that on a continuing basis
2 and they have no strong feeling for it other than the
3 fact that they believe that an attempt will be made and
4 that there is some risk of repeal.

5 REP. RUDD: And may I ask you, how much weight did this
6 possibility of repeal carry in your negotiations in the
7 contract? In other words, how much weight did you give
8 to the idea that you wanted to get something started
9 before --

10 COMMISSIONER MARTIN: It carried -- it carried very little
11 in my personal opinion, Representative Rudd. What it
12 did do, not the threat of repeal, but what the provision
13 did was change somewhat my position on the issue of the
14 contracts themselves. This is one reason I stress other
15 values of the contract other than the political aspects.
16 Last year I testified before Senator Rader's committee
17 and others that I was quite skeptical about the meaning
18 of any of these contracts because I thought that they
19 had almost no chance of ever being realized because it
20 was doubtful the FPC would ever approve of a take back
21 provision absent some Congressional assistance.

22 But once Section 13(b) was enacted, it increased
23 substantially, in fact it increased almost to the extent
24 of making it virtually certain, that we could get approval
25 of such a provision if we could put one together, get

1 it advanced and approved and put it before the FPC while
2 the provision was in place. But, it came along late
3 enough that it really didn't change the nature of the
4 negotiations a great deal. We were working on the
5 contracts and quite frankly if we had finished the
6 contracts and Congress had not acted to put that provision
7 in as they did in the closing hours, I would -- we might
8 be advancing the contracts to the legislature right now
9 but I would be saying to you quite honestly that they
10 would have a very low chance of being approved in the
11 FPC. Now I can say to you I think they have a very good
12 chance of being approved in the FPC.

13 REP. RUDD: May I ask just one more?

14 SENATOR RADER: Certainly.

15 REP. RUDD: Do you think that there is an element of time
16 that is involved here, that we must move rapidly?

17 COMMISSIONER MARTIN: Judgment with respect to time again is
18 subjective but I personally think there are two things
19 to be said. One, I think that we have a responsible
20 attempt together to try to utilize the benefits of that
21 provision. I think that the way we have done it is
22 responsible and I think we're capable of selling it.
23 Obviously our delegation agrees because they think they
24 can live with the results of this contract and preserve
25 the amendment. Whether or not we can wait and bank on the

1 fact that the amendment will stay in place and go to some
2 other kind of arrangement is simply a calculated risk that
3 everyone will just have to take.

4 SENATOR RADER: Senator Huber?

5 SENATOR HUBER: Thank you, Mr. Chairman. I think my question
6 is mostly for Guy.

7 SENATOR RADER: Senator, you are going to have to speak up.
8 I am certain they can't hear you.

9 SENATOR HUBER: All right, Senator, I'll speak up. I think
10 my question is mostly for Guy. We have -- in the gas
11 contracts themselves there is a provision that says
12 pretty close like this, that there is no front end money
13 but that whatever the highest price paid by anybody that
14 is allowable by the FPC or if in case the FPC isn't
15 controlling it, whatever the highest price is that is
16 paid to any of the producers in the field will be what
17 the price is to the Alaska royalty share. Is that roughly
18 correct?

19 COMMISSIONER MARTIN: I think so. Let me defer to our two
20 price experts. They're with me on that.

21 SENATOR HUBER: Well, in effect that says that if anybody else
22 who has a share that is proportionate to ours, let's say
23 that ARCO has twice twelve and one-half, they probably
24 have got a little more than that, or twenty-four percent,
25 and they get Fifty Million Dollars of head end money.

1 Proportionately if any head end money is allowed by any-
2 body, shouldn't we have had a provision that also bounces
3 back and says that we'll get the highest price per cubic
4 foot, no head end money unless anybody else gets head end
5 money, if anybody else gets head end money, we'll get a
6 proportionate amount in accordance with our percentage.
7 Wouldn't that protect the State of Alaska a lot better
8 on price?

9 COMMISSIONER MARTIN: No, we don't have such a provision and
10 it could be something that could be negotiated for,
11 Senator.

12 SENATOR HUBER: Is it still negotiable?

13 COMMISSIONER MARTIN: Well, not under the present circumstances.

14 I would say that it would have to be capable of being
15 passed through in the rate base. I will tell you this,
16 that if that could not be passed through either in the
17 ARCO situation or in ours, these contracts would not be
18 possible. In other words, the company -- we may be able
19 to negotiate some other kind of a deal but I don't believe
20 we could have negotiated these contracts -- included that
21 provision unless it could have been passed through
22 totally.

23 SENATOR HUBER: Well, Mr. Chairman, I --

24 COMMISSIONER MARTIN: And it is not legal to pass it through
25 now.

1 SENATOR HUBER: I could foresee the possibility under de-
2 regulation that they may allow front end payments and
3 in which case other people would quickly negotiate
4 them, being they don't have them, and we would be left
5 out in the cold at the lower price. And it don't look like
6 the contracts protect us sufficiently in that area.

7 COMMISSIONER MARTIN: I don't think the terms of the contracts
8 as they are presently drafted would include that. That
9 is right, sir.

10 SENATOR RADER: Senator Croft?

11 SENATOR CROFT: Commissioner, before we leave the subject,
12 you made the statement that no front end payment could
13 be built into the rate base. Is that -- is that statement
14 actually correct? Aren't there circumstances in which it
15 can be built into the rate base?

16 COMMISSIONER MARTIN: The -- yes.

17 SENATOR CROFT: And in that regard we have not gotten the
18 highest possible price for our gas, isn't that correct?

19 COMMISSIONER MARTIN: Jack, do you want to answer that?

20 MR. BYRD: Under the present FPC rules --

21 SENATOR RADER: Mr. Byrd, why don't you sit down and identify
22 yourself for the record? You'll be the first new voice
23 here and --

24 MR. BYRD: Thank you, Senator. I'm Jack Byrd from Kansas.
25 Under the present FPC rules if front end money is advanced

1 and included by the pipeline to advance freight rates,
2 then you -- whoever sells the gas takes a penalty on the
3 price.

4 SENATOR CROFT: That is right, but what as to companies that
5 are not regulated by the FPC?

6 MR. BYRD: On intrastate purchasers?

7 SENATOR CROFT: Right.

8 MR. BYRD: They could still do it.

9 SENATOR CROFT: So there could have been intrastate purchasers
10 not subject to FPC regulations who would have bought this
11 gas and could have paid us front end money --

12 MR. BYRD: Still can, under the contract.

13 SENATOR CROFT: And there are utilities in California that
14 could do that?

15 MR. BYRD: Well, no, not in California.

16 SENATOR CROFT: Where are they?

17 MR. BYRD: The only intrastate purchaser you would have
18 would be in Alaska and you could still sell -- withdraw
19 gas to an intrastate purchaser in Alaska and demand front
20 end money, if you want.

21 COMMISSIONER MARTIN: And you could not do that and sell to --
22 as you suggested, we disagree that you could do that to
23 anyone in California because the transportation would be
24 regulated, Senator, and the same provisions would apply.

25 SENATOR CROFT: The transportation, but would the distribution

1 with the utility itself, if it bought the gas not for re-
2 sale to somebody else, would that sale itself be regulated
3 as well as the transportation tariff?

4 MR. BYRD: The only provision I know of in which you can do
5 that now would be under order 533, the transportation
6 provision. The direct sale to an industrial customer for
7 a high priority use, not for resale, a distribution company
8 cannot do that.

9 SENATOR CROFT: But somebody that used it themselves could
10 pay front end money?

11 MR. BYRD: Right. They could pay a premium price, they are
12 exempt from regulation under the FPC.

13 SENATOR CROFT: Thank you.

14 SENATOR RADER: Representative Hayes -- excuse me, were you
15 through with your --

16 MR. BYRD: One other point, the transportation of any such
17 moving of gas from Alaska to California would have to be
18 certified by the FPC. They would have no control over
19 the price paid if it was not for resale and it was used
20 for a high priority industrial use.

21 SENATOR CROFT: A higher price than what we have in these
22 contracts could be paid in that situation?

23 MR. BYRD: Yes. But we have a provision in here that if any
24 of our working interest owners sells theirs under that
25 kind of a rule, these -- then our prices go up.

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

1 SENATOR CROFT: Yes, but whether they do or not, we could
2 have sold our gas conceivably -- legally sold our gas for
3 a higher price than what we have in these contracts.

4 COMMISSIONER MARTIN: Only by pursuing a completely different
5 objective. We don't deny that, Senator. I mean, the
6 fact is that we could have chosen a number of different
7 objectives including not selling and waiting to do it
8 later after deregulation. So, we think there are a number
9 of possibilities in not carrying out these objectives
10 we're doing it.

11 SENATOR CROFT: I understand that. But if I could, just so
12 that we understand the policy questions that are involved,
13 this sale does involve a sale of our gas at not the highest
14 possible price?

15 COMMISSIONER MARTIN: That is a great overstatement, Senator
16 Croft.

17 SENATOR CROFT: But isn't it correct?

18 COMMISSIONER MARTIN: No. It's correct but in the context
19 of a number of other things. It's correct in the context
20 of selling the gas for other purposes in this, but selling
21 it for the purposes that we have attempted to carry out
22 here, we believe that we have gotten the highest price.
23 If we sold it for other purposes in which we subjected
24 all other considerations to price, I think it is possible
25 we could have gotten a higher price, yes.

1 SENATOR CROFT: As I understand it, if we sell it primarily
2 for political purposes, we got the highest possible
3 price.

4 SENATOR RADER: Representative --

5 COMMISSIONER MARTIN: You are still wrong, Senator. I mean
6 I think he is wrong factually, Senator. Maybe we ought
7 to respond. Let me ask Mr. Boness to do it. He is
8 characterizing my answers.

9 MR. BONESS: Senator Croft, the FPC regulates two things. It
10 regulates transportation and it regulates the sale. In
11 a direct sale -- do not have to have -- a direct sale is
12 not regulated. In that sense you seem to be suggesting
13 that the FPC -- the higher price could be paid or front
14 end money could be paid. However, the FPC has the power
15 to prevent that kind of sale from taking effect by virtue
16 of its control over the transportation aspects of the
17 pipeline. The Transco case was a case which involved
18 essentially that set of facts, where a sale took place,
19 the shipment of the gas was to be over an interstate
20 pipeline to be sold -- to be delivered, I believe, between
21 Texas and New Jersey. The Federal Power Commission said
22 they don't like the terms under which that sale takes
23 place, therefore we are not going to approve the trans-
24 portation. They had no authority over the sale itself
25 but they did have authority over the transportation.

1 Whenever you are talking about moving the gas outside of
2 Alaska, you're not within the realm of 13(b), and the
3 Federal Power Commission would have authority over whether
4 or not to approve the sale. They couldn't regulate the
5 price but they could absolutely preclude the sale.

6 MR. BYRD: Plus the fact that under the contract, if Atlantic
7 Richfield or one of our -- one of the lessees up here
8 sold royalty -- or sold their gas under 533 and got a
9 higher price, then our gas from those leases would
10 escalate up to that price.

11 COMMISSIONER MARTIN: Jack, but Senator Croft's question
12 was going to our gas.

13 SENATOR CROFT: My question is, regardless of what they do
14 with ours -- with theirs, what could we have done with
15 ours?

16 COMMISSIONER MARTIN: Yes, I understand.

17 SENATOR CROFT: And as I understand the answer, it is we
18 could have gotten a higher price but Commissioner Martin
19 feels there were other factors that weigh into the
20 decision that means that it was not in our interest to
21 do it, and secondly, it might have been unlikely that
22 we would have gotten a higher price. It is legally
23 possible.

24 COMMISSIONER MARTIN: That's -- yes.

25 SENATOR RADER: Mr. Hayes?

1 REP. HAYES: Thank you. I was wanting to pursue that line
2 of questioning that Senator Croft was just pursuing,
3 regarding just how much we might be paying for -- by
4 giving up alternative sales that might have some front
5 end money involved for this political clout that we're
6 going to get from the three gas companies that are
7 purchasing our royalty gas. But it is probably not a
8 figure that you can put any -- that you can put an exact
9 number on, however, I think testimony indicates that
10 under certain circumstances that we are giving up some --
11 something of value. Whatever that is, I don't know, but
12 we are pursuing this on the basis -- that there is no
13 front end money possible on the basis that the payment
14 of front end money for interstate sale would not allow
15 the incorporation of the front end money in the price
16 scheduling. But, isn't it possible that -- I'll ask
17 this to Commissioner Martin, isn't it possible or con-
18 ceivable that a purchaser for interstate sale purposes
19 might be willing to give up to the State of Alaska a
20 portion of his anticipated profit in the way of front
21 end money, regardless of whether he's ever passed it on?
22 And in that event there is a possibility of getting the
23 premium price.

24 COMMISSIONER MARTIN: Representative Hayes, yes. I think
25 it is conceivable that we could have structured a

1 situation where maybe even in a -- you know, maybe a
2 competitive situation or maybe a situation where we
3 simply just solicited people to do that, that we could
4 have gotten some amount. In other words if the question
5 is how much would some interstate buyer eat of their
6 proceeds, I think the answer -- our determination
7 basically is that it would be generally quite a small
8 amount and secondly that it was certainly not possible
9 with these buyers. And quite frankly, it was not con-
10 sistent with at least the purpose of the contract which
11 had to do with getting the best and strongest support
12 for the pipeline route.

13 I might just say that our process in attempting
14 to do that was to try to work with the available buyers
15 we have and then to consult pretty much continuously
16 with the delegation of others to try to see who could
17 give us the greatest amount of help. So that trading
18 all those things off, I don't think we got a realistic
19 expectation of getting a small enough front end.

20 SENATOR RADER: Any members who have not yet asked questions,
21 first?

22 SENATOR HUBER: I'd like to pursue this same thing.

23 SENATOR RADER: Well, Mr. Carpenter has not yet had a
24 question. Mr. Carpenter, unless you want to waive --

25 REP. CARPENTER: I'll yield. I'll yield to the Senator.

1 SENATOR HUBER: Well, I think we was to a point, Mr. Chairman,
2 and I'd like to pursue the same thing being I started
3 this.

4 SENATOR RADER: Proceed.

5 SENATOR HUBER: We have picked our purchasers that we have
6 contracts with that are now going for approval from a
7 certain group of purchasers. These are pipeline trans-
8 porters, not users, for instance. A user has different
9 rules applied to him. If we had sold six percent to
10 Pacific Gas and Electric and six percent to Wentworth
11 Brothers for making into methanol and certain other
12 things and certain other people -- for users there is
13 different set of rules applied. Would you care to discuss
14 that and have you shown in your deliberations consideration
15 for these other type of contractors -- or these other
16 type of purchasers?

17 COMMISSIONER MARTIN: Only to this extent, Senator, that we
18 dealt to some extent with everyone who came to us with
19 an offer to deal with us. We made some tough decisions
20 as to who we would work with. To finally go through, and
21 we consulted broadly to try to get the ones that could
22 do the most good. These are the ones that ended up in
23 our final judgment being that. Now, we're willing to
24 stand with that. We did not consider Wentworth Brothers
25 nor did Wentworth Brothers approach us with the idea of

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

1 buying under these terms and adding their support to
2 the pipeline that we favor, nor the other one you mentioned.

3 SENATOR HUBER: I'm trying to get back to the basic considera-
4 tion of whether we're getting the highest price, which
5 this contract says we are. What it really says is that
6 we're getting the highest price from a certain class
7 of buyer only, those who are in the pipeline transporta-
8 tion distribution business, and cannot enter into -- by
9 FPC rule, cannot enter into another phase of the business.
10 Isn't that right?

11 MR. BYRD: Whoever bought it would have to have the certi-
12 fication of the FPC to get it transported, and if you'd
13 sell it to Pacific Gas and Electric for boiler fuel
14 you'd never get a certificate.

15 SENATOR HUBER: Well, I didn't say for boiler fuel, you
16 said that.

17 MR. BYRD: I don't know what they would do with it. It would
18 have to be for a high priority industrial use and not
19 for resale.

20 SENATOR RADER: Mr. Carpenter.

21 REP. CARPENTER: I'm departing from the present line of
22 questioning.

23 SENATOR RADER: Did somebody wish to pursue this line of
24 questioning, or were you through?

25 SENATOR HUBER: Mr. Carpenter yielded to me, Mr. Chairman,

1 and I thank him very much. So we can continue.
2 SENATOR RADER: I think Mr. Meekins wanted to pursue the
3 same line of questioning. You have the floor, Mr. Meekins.
4 REP. MEEKINS: Thank you, Mr. Chairman. Just to clarify
5 that then, there are trade-offs here involved, and there
6 are some things we give up in order to have this contract.
7 One of those, I understand, is a small premium (in your
8 view), a fairly small premium, if that premium comes
9 out of profits of the companies because it can't be
10 passed through into the rate base; is that correct?
11 COMMISSIONER MARTIN: Under future circumstances, the size
12 of it is unknown.
13 REP. MEEKINS: If there was deregulation?
14 COMMISSIONER MARTIN: These questions, you know, stand in
15 the present time frame. It may well be under deregulation
16 there are different terms in the future, we could
17 restructure it and do something else. That has to be
18 balanced against how important it is, how important the
19 gas line decision is to the use of the amendment in
20 Congress and so on. So our view is that for now this
21 is a good alternative. It may be that under changing
22 circumstances that the premium could be larger, or the
23 price could be unregulated.
24 REP. MEEKINS: Right. That's a possibility; we don't know
25 it as yet ---

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

1 COMMISSIONER MARTIN: That's right.

2 REP. MEEKINS: -- whether that's going to be the case. But
3 in any case, that small premium, in your view a small
4 premium, is one of the trade-offs, and I'm not quite
5 sure if the higher price by sale to users or not -- I
6 seem to get contradictory information -- on the one
7 hand, it seems that the FPC would not approve transpor-
8 tation of such a sale, and on the other hand it seems
9 like they would. I'm not sure what ---

10 COMMISSIONER MARTIN: I think Mr. Byrd's answer is the proper
11 one, for certain high priority users they would have a
12 chance of getting approval of the transportation. For
13 most users, and certainly any large scale ones that are
14 not priority, they would have virtually none.

15 REP. MEEKINS: So what you're saying is it is conceivable
16 to some scale to get a higher price if that sale was
17 to a high priority use and, therefore, it would be
18 approved.

19 COMMISSIONER MARTIN: Yes, it's possible, and it may have
20 been possible to accomplish, but we had no indication
21 that it was and no offer.

22 REP. MEEKINS: Thank you.

23 SENATOR RADER: Any further questions along this line?
24 Senator Croft.

25 SENATOR CROFT: When was the decision that prohibited

1 building advance payments into the rate base?

2 MR. BYRD: It became effective November 5.

3 SENATOR CROFT: Of '76?

4 MR. BYRD: '76.

5 SENATOR CROFT: So that it is true that if this sale had
6 been entered into possibly a year ago we could have
7 gotten a higher price?

8 MR. BYRD: No. That November 5 date affected only advance
9 payment or interest free loans that were made prior
10 to an order that came out abolishing it, but it was
11 the end of 1975. But there were a lot of advances,
12 advance payment contracts, that still had not been
13 executed, or advancements had not been made. Those
14 were not abolished. Then the order coming out effective
15 November 5, in 770-A they say that if the producer
16 draws those down and the purchaser puts them in rate
17 base, then the producer has to decrease his price, pay
18 the carrying charges on it.

19 SENATOR CROFT: Then is it correct that if these contracts
20 had been entered into in 1975 we could have gotten a
21 higher price?

22 MR. BYRD: It would have been legal to extract ---

23 SENATOR CROFT: Front end money.

24 MR. BYRD: -- an advance payment.

25 SENATOR RADER: Any further questions on this line of

1 questions?

2 SENATOR HUBER: Just one, Mr. Chairman.

3 SENATOR RADER: Senator Huber.

4 SENATOR HUBER: Then in a deregulated system, and we look
5 like we're headed toward deregulation now, some of the
6 gas that will be in the deregulated system will be gas
7 that has had front end money paid on it from Prudhoe Bay
8 gas that's had front end money paid on it, and is also
9 paying a certain rate to the field gas, which is
10 apparently what we're getting, and if we had just held
11 our gas until deregulation we could sell it for any
12 price we wanted to make up for that, couldn't we?

13 COMMISSIONER MARTIN: Yes, assuming, Senator, that deregu-
14 lation occurs, that we can structure the kind of contract
15 that allows us to take back, and that that contract is
16 approved, then you can be in a similar circumstance and
17 you get more money and sort of have, you know, guns and
18 butter at the same time. But you have to make all those
19 assumptions to get there, and I think some of them are
20 at least speculative.

21 SENATOR HUBER: These early sales, the amount that goes in
22 is a very large amount of the sale price too, isn't it?

23 COMMISSIONER MARTIN: I'm sorry?

24 SENATOR HUBER: These early sales that were made that were
25 approved, the front end money really amounts to a large

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

amount.

COMMISSIONER MARTIN: There were some large advance payments, that's right.

SENATOR HUBER: Thank you.

SENATOR RADER: Representative Gruening.

REP. GRUENING: Commissioner, if, given the fact we have an active Congress allowing us to take back our gas for in-State use and if we assume that the primary goal was not to affect a political decision on the line, how long could the State wait safely to decide what to do under contract or how it wanted to sell its gas?

COMMISSIONER MARTIN: Mr. Chairman, there's only a subjective answer to that question. It could be years or it could be terminated during the next year. It seems to me that what we have now is a good alternative to take advantage of, and it may be that we want to pass that one up and try to structure another one.

REP. GRUENING: If I understand what you were saying earlier, we don't gain any rights by entering the contract in terms of this amendment. I mean, the amendment is there.

COMMISSIONER MARTIN: We only gain rights by having the contract approved by the FPC at a time that the amendment is in place. So our question is, how long will we have the amendment in place, and I made it very clear the other night that I'm not trying to create an atmosphere

1 of fear that it will be repealed. I honestly don't know
2 if it will be repealed. I'm almost certain an attempt
3 will be made to repeal it, and what we have is an
4 opportunity now to take advantage of it while it's in
5 place.

6 REP. GRUENING: Do you read that amendment as allowing the
7 FPC to do anything other than approve the take back
8 provisions in the contract?

9 COMMISSIONER MARTIN: Yes, I think they might be able to
10 approve -- well, let me ask to be certain of that. I think
11 they would be able to approve something of a sale. They
12 could approve a direct application, couldn't they?

13 MR. BONESS: They could approve.

14 COMMISSIONER MARTIN: I guess the answer is, there are other
15 formulations that they can approve.

16 REP. GRUENING: Well, like price. But I'm talking about the
17 take back.

18 COMMISSIONER MARTIN: No, I'm talking about the take back.
19 I mean, I think that there would be other ways to
20 approach them other than a sale configuration, but
21 I'm not certain what those would be at this time. I'm
22 not saying there aren't other avenues that you could
23 approach the FPC with using 13-B. The question is
24 really, how long you'll have the ability to use 13-B and
25 whether or not this is a satisfactory way or not to

1 exercise the privileges. If this one were approved,
2 putting aside all other things, it would give the State
3 unprecedented protection for its royalty gas never before
4 enjoyed by any state; there's no question about that.
5 Whether or not we could do it in a better or more success-
6 ful way, I don't know. It's pretty hard for me to
7 imagine a more comprehensive coverage of future in-State
8 use than this one. I can think of a few ways to do it,
9 but not very many.

10 REP. GRUENING: Despite that do you think there's a danger
11 that the FPC may not approve?

12 COMMISSIONER MARTIN: No, I think that 13-B pretty much
13 mandates FPC approval.

14 REP. GRUENING: Where the slippage might occur is in their
15 approval of the price, the pricing arrangements under
16 the contract; is that what you're referring to?

17 COMMISSIONER MARTIN: I'm sorry if I'm not making myself
18 clear, Mr. Gruening.

19 REP. GRUENING: No, I understood what you said before, but
20 if that last statement of mine about the pricing isn't
21 correct ---

22 COMMISSIONER MARTIN: Would you repeat it? I'm sorry, I
23 didn't understand.

24 REP. GRUENING: I do understand correctly that as you see,
25 the FPC would have to approve the take back provisions

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

in this contract, these contracts, under the Congressional Act.

COMMISSIONER MARTIN: Right.

REP. GRUENING: Is there a problem then with the pricing provisions of the Act in terms of the FPC approving them?

COMMISSIONER MARTIN: I don't see any, Mr. Chairman.

MR. BONESS: Again, the amendment addresses the problems related to transportation aspects of the FPC's jurisdiction. Even though the State is not subject to FPC jurisdiction for purposes of sale, the FPC could have prevented the State from getting, either effect to the take off provision in the contract or entry into the contract because it didn't like the prices the State was getting; the State had extracted a price higher than the price which the FPC approved. They could have prevented the transportation aspects of it. The amendment, Section 13-B, prohibits the FPC from doing that with respect to transporting the gas for intrastate uses. There is no problem with respect to the FPC regulating a sale which is the price provision, and under the amendment we're free with respect to both taking off and the price. Absent the amendment, we have to convince the FPC to authorize the transportation of the gas for use in the State.

REP. GRUENING: Reading the amendment, do I understand

1 correctly, the FPC could disapprove pricing arrangements?

2 MR. BONESS: No.

3 REP. GRUENING: Under the contract, they cannot?

4 MR. BONESS: Not under that amendment. They have to give
5 effect to the transportation and they have no other
6 basis for disapproving of it.

7 REP. GRUENING: Maybe I should follow this up because the
8 last part of that amendment says that the FPC shall only
9 review the justness and reasonableness of the rate charge
10 for such transportation.

11 MR. BONESS: Yes, I apologize. I should have picked up on
12 that was what you were concerned about. What it addresses
13 is the notion of the transportation charges for moving
14 the gas, say, as far as Fairbanks or as far as Valdez.
15 Obviously, intrastate transportation of gas is going
16 to affect the overall tariff for everybody else, and the
17 FPC is given authority to review that rate and make sure
18 that it's just and reasonable. That is really for the
19 State's protection and also for the protection of all
20 the other shippers on the line, to make sure that costs
21 are allocated between interstate and intrastate shipping
22 in a just and reasonable fashion.

23 COMMISSIONER MARTIN: Rather than going to the price paid
24 for the gas itself.

25 MR. BONESS: But it's like the price of a ticket for moving

1 on the line, is what we're talking about, not the price
2 of the sale of the gas.

3 REP. GRUENING: But do you see any danger, other than the
4 fact we're losing, maybe losing options on dealing with
5 which route we want, in delaying then a decision on
6 how we want to sell the gas? Put aside the question,
7 just for a moment, of which route we're trying to affect;
8 is there any danger in delay, because I understand it
9 you don't buy the theory that without the amendment
10 that there's much advantage in getting the FPC to approve
11 a contract?

12 COMMISSIONER MARTIN: Well, I don't reject it, but I don't
13 think that -- you know, Dr. Moody thinks that's a
14 controlling theory, and I don't think it is. I think
15 there are still problems, but I think it's a valid
16 theory, it's something that could be tried. You only
17 made one exclusion. You said that if we exclude the
18 purpose of helping the line.

19 REP. GRUENING: Yes. I know that's a major exclusion, but ---

20 COMMISSIONER MARTIN: Even if you exclude that, then there
21 would be a great value in attempting to take advantage
22 of 13-B before it's lost. There would also be an
23 advantage, some advantage, I would think, in this
24 contract over others in terms of price. I'm not saying
25 we couldn't do better, depending where our objectives are,

1 but there are advantages in each of those four categories
2 I indicated you would be giving up. There are also
3 improvements that you might seek in another direction
4 if you take out one of the objectives. If you take
5 out the political assistance objective, you might be
6 able to substitute another one.

7 SENATOR RADER: Mr. Carpenter now.

8 REP. CARPENTER: Thank you, Mr. Chairman.

9 SENATOR RADER: You've been very patient.

10 REP. CARPENTER: After all this time, I really wish that
11 my question were an exciting one, but it's not. It
12 relates to a technical provision in the sales agreement,
13 in Article Five, which addresses quality. In Section One
14 we mention that the gas to be delivered by the seller
15 to the buyer at the delivery points shall conform to
16 the quality specifications, etc. But in the preceding
17 paragraph, Article Four, Section Four, we say the
18 seller shall retain the right to receive all liquids
19 removed from the gas prior to its delivery to the
20 pipeline, etc. My question is this: if the liquids are
21 removed as provided in that section in Article Four,
22 I understand that the quality specifications will drop
23 because the btu content will change. Doesn't Section One
24 of Article Five negate Section Four of Article Four?

25 COMMISSIONER MARTIN: Representative Carpenter, I've heard

1 that concern expressed before, and we've looked at it.
2 Mr. Boness, I think, can answer that question.

3 MR. BONESS: Yes. 5.1 deals with the delivery point, which
4 is a point on the North Slope prior to the time the
5 gas will be put in the pipeline, and our gas will be
6 at the same quality, wherever our delivery point to,
7 as the gas the producer is moving along that stream and,
8 therefore, we don't have to do anything special to it.
9 Once the gas is put on the pipeline to move south we
10 will have the opportunity to take that gas off and
11 change it without being in violation of 5.1, because
12 5.1 addresses only the question of the quality of gas
13 at the delivery point.

14 REP. GRUENING: I see.

15 COMMISSIONER MARTIN: We looked at that carefully, and when
16 I heard it the first time it sounded like it was a good
17 argument. But it looks like it only applies to that one
18 point.

19 REP GRUENING: I see.

20 SENATOR RADER: I have one question, myself. Do you have
21 staff that will be able to analyze the decision of the
22 Trial Judge if it comes out today or tomorrow and be
23 able to report back to us, at least in a summary sense,
24 the day after tomorrow perhaps, as to whether or not
25 that decision does, in fact, substantially affect the

1 posture of the situation?

2 COMMISSIONER MARTIN: You are looking at the group that will
3 probably try to do that, and Mr. Byrd, and Mr. Boness
4 and others will probably try to do that, and we'll try
5 our very best to get a report back.

6 SENATOR RADER: So we'll expect to hear from you perhaps
7 Wednesday then on that item?

8 COMMISSIONER MARTIN: If we get the decision in a form that
9 we can analyze I think we can do that, sir.

10 ATTORNEY GENERAL GROSS: Senator Rader, we do have Washington,
11 D.C. counsel that are, of course, participating for us
12 in the hearing, and I anticipate that they should have a
13 report to us probably by tomorrow night as to at least
14 a summary of what's happening, and we'll share it with
15 the committee.

16 SENATOR RADER: You will share it?

17 ATTORNEY GENERAL GROSS: Yes.

18 SENATOR RADER: There were some other questions. Mr. Swanson,
19 did you have a question?

20 REP. SWANSON: I never said a word.

21 SENATOR RADER: Anybody who has not? Senator Hohman and
22 then Senator Sumner.

23 SENATOR HOHMAN: I was calling your attention to Senator
24 Sumner.

25 SENATOR RADER: Senator Sumner.

1 SENATOR SUMNER: Mr. Chairman, I'd like to ask the Commissioner,
2 I get the impression from Senator Croft that maybe
3 Senator Croft is still under the impression that the
4 State could have got a higher price for its gas. I'd
5 really like to put that to rest. Do you think there is
6 any real probability, under any circumstances, that
7 reflect reality at all, that the State should have
8 negotiated for a higher price in this contract or in
9 other contracts?

10 COMMISSIONER MARTIN: Generally, no; but only if it had picked
11 a completely different objective related to only price
12 itself.

13 SENATOR SUMNER: Mr. Chairman, I'm not so concerned about
14 picking a different objective if it's real. Is it real
15 to expect that the State could have gotten more money?

16 COMMISSIONER MARTIN: I think it's, yes -- real isn't exactly
17 it -- I think it would have been unlikely that we would
18 have gotten more money.

19 SENATOR SUMNER: On a scale of one to ten, where would you
20 say?

21 COMMISSIONER MARTIN: I couldn't give you that, I don't know.

22 SENATOR SUMNER: Well, it creates some serious doubts.

23 COMMISSIONER MARTIN: I would be pleased to do this, Senator
24 Croft and Senator Sumner -- you know, I understand your
25 question, and I'll look back at the transcript to get

1 the intent of it rather than trading back characteriza-
2 tions of one another's answers. I would be pleased to
3 look at that and give you something at least indicating
4 what I think the alternatives were for getting a higher
5 price and the probabilities. Would that be acceptable
6 to the Chair?

7 SENATOR RADER: It would be, although I'm sure the committee
8 would like to share in that dialogue. Do you mean
9 tomorrow, perhaps?

10 COMMISSIONER MARTIN: Tomorrow or Wednesday. I mean, we'll
11 look at it and give you back an answer that's more
12 definitive.

13 SENATOR RADER: Senator Croft, does that sound all right to
14 you?

15 SENATOR CROFT: Maybe in the meantime you could tell me, as
16 well, whether you initiated any contact with anybody
17 that might have paid a higher price and asked them to
18 bid as well.

19 COMMISSIONER MARTIN: No, I don't think that we did, because
20 we weren't pursuing that as the principal objective.

21 SENATOR SUMNER: Mr. Chairman, let me continue for just one
22 minute then.

23 SENATOR RADER: Senator Sumner.

24 SENATOR SUMNER: Do you think at this time it's worthwhile
25 to postpone this contract in view of the merits of the

1 contract and what you're aware of at the present time
2 that it can buy in the form of developing an expanded
3 constituency for support in the South 48?

4 COMMISSIONER MARTIN: No, I don't.

5 SENATOR SUMNER: And on a scale of one to ten, how sure are
6 you of that position regarding that? I'm really interested
7 in knowing where your impact is.

8 COMMISSIONER MARTIN: I don't know where on a scale of one
9 to ten, but I'm quite sure that that's right, I think,
10 this objective as opposed to that one, is more important
11 to pursue at the present time.

12 SENATOR SUMNER: Then would it follow that you believe that
13 to the benefit of most Alaskans that the sale, that the
14 contracts you've drawn here relating to the sales of
15 royalty gas, is the best under most reasonable circum-
16 stances?

17 COMMISSIONER MARTIN: Yes.

18 SENATOR SUMNER: Thank you, Mr. Chairman.

19 SENATOR RADER: Senator Huber.

20 SENATOR HUBER: One short one to get in perspective again,
21 one short little question came up. The class of people
22 that we dealt with here, the three companies that we have
23 sold to, are they, under FPC type language, are these
24 the type of customers that are called common purchasers--
25 the regulations that apply to common purchasers?

1 MR. BYRD: They're natural gas companies that are under the
2 jurisdiction of the Federal Power Commission.

3 SENATOR HUBER: For instance, I am aware that all three of
4 these companies do not sell any gas to anyone, they
5 purchase the gas here and sell the gas to other gas
6 companies that sell the gas, at exactly the same price
7 they purchase it at, plus their transportation charges.
8 Isn't that correct?

9 MR. BYRD: I don't know whether any of them are burner tip
10 distributors or not.

11 SENATOR HUBER: The only thing I wanted to know so I can
12 analyze it, are all three of these classed as common
13 purchasers by the FPC?

14 MR. BYRD: I don't know what you mean by common purchasers.
15 They're all natural gas companies under the regulation
16 of the Federal Power Commission. They buy gas and
17 transport it for resale.

18 SENATOR HUBER: Could you try to find the answer?

19 COMMISSIONER MARTIN: Could you say what you mean by common
20 purchasers? What statutes would you reference?

21 SENATOR HUBER: FPC requires that pipeline companies be
22 both common carriers and common purchasers. That's not
23 true in oil pipelines but it is true in gas pipelines.
24 I don't know about the next term, whether it's a
25 correct one or not. Rather than analyzing it against

1 specific purchasers, maybe somebody who sells to customers
2 in Northwest Michigan, for instance, and then in turn
3 purchases from Tenneco or something.

4 MR. BYRD: I'm not familiar, Senator, with the terms "common
5 purchaser" and "common carrier". There are natural
6 gas companies and there are distribution companies.
7 Distribution companies normally buy gas at the city gate
8 from the natural gas companies, which these three
9 companies are, and then they distribute it to the burner
10 tip and sell it. They're under the jurisdiction of
11 the State Commission. I don't know of any place in
12 the Natural Gas Act where it refers to common purchasers
13 or common carriers. They are not common carriers.
14 They're natural gas companies and pipeline companies that
15 are moving gas interstate for resale. They do move the
16 gas interstate that's not for resale, it's sold directly
17 to an end user, and they do do that. But that still
18 doesn't make them common purchasers or common carriers.

19 SENATOR HUBER: So you can't list whether these three
20 class as common purchasers or some other term?

21 MR. BYRD: As we use common purchasers in oil proration in
22 the Lower 48, because you have to purchase commonly or
23 equally from all the producers, but that doesn't apply
24 to natural gas pipelines. There's no use of the term
25 "common carrier" or "common purchaser" in the Natural

1 Gas Act that I'm familiar with.

2 SENATOR RADER: Any further questions? Mr. Parr.

3 REP. McKINNON: I had a couple questions, Senator.

4 SENATOR RADER: Oh, excuse me, Mr. McKinnon, did you have
5 a question?

6 REP. McKINNON: No.

7 SENATOR RADER: Mr. Parr.

8 REP. PARR: Going back to what we were talking about a while
9 ago, other possible sales and so forth, who is buying
10 the other seven-eighths, the producers' gas?

11 COMMISSIONER MARTIN: At the present time, Mr. Parr, I don't
12 have the precise percentages. There is one contract
13 which is valid, that's the Columbia contract we discussed
14 at length the other night, which is approximately thirty
15 percent. I'll be honest, I haven't been able to nail
16 down the figure, but that's roughly accurate. And we
17 believe that there's a small contract, and I can't recall,
18 but it's less than one percent.

19 REP. PARR: Who is that?

20 COMMISSIONER MARTIN: Texas Eastern, we think. So far as
21 we know, it's less than one percent. Those are the two
22 that are still outstanding. The Columbia contract is the
23 one we discussed at length at the hearing the other night.

24 REP. PARR: I realize, of course, that we're talking now
25 about contracts which we know have been signed and are a

1 matter of public record and so forth. Do we have any
2 information as to where this gas is going that is not
3 a matter of public record, officially signed contracts,
4 etc.? I would assume some of your high-powered experts
5 would probably know.

6 COMMISSIONER MARTIN: Mr. Parr, I asked them -- in fact,
7 after we had our conversation the other night in the
8 committee, I attempted to find out. I wanted to know
9 essentially if there was industry scuttlebutt or, you
10 know, just information that was around that there were
11 contracts. My best information, and it's limited by
12 what is on the record, is that there are no others
13 and there are no shadow contracts as far as I know that
14 commit the gas, that people are waiting for the certifi-
15 cation decision or for price information to firm up
16 before those contracts are made. I've heard various
17 rumors, but I know of no information with regard to
18 other contracts.

19 REP. PARR: Mr. Chairman, I have just one other question.

20 SENATOR RADER: You still have the floor, Mr. Parr.

21 REP. PARR: Would it be your assumption that either one of
22 the three companies that are involved in this is one
23 of the three companies that is probably getting a good,
24 large share of the producers' gas as well?

25 COMMISSIONER MARTIN: The company, our purchasers?

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

REP. PARR: These three.

COMMISSIONER MARTIN: No. In fact, my information is that none of them have made any commitments, informally or otherwise, any other contracts for any other part of it.

REP. PARR: Were there any of the other companies who were interested in getting our royalty gas whom we even know or have reason to assume were getting producer gas? Now, the only one you know for sure is Columbia. Did, for example, Columbia try to get in on the royalty gas deal as well?

COMMISSIONER MARTIN: No, they did not come to us. Northwest attempted to get into the royalty gas and, so far as I know, is attempting to buy producer gas, without success.

REP. PARR: I guess that leads up to my final question, Mr. Martin, and that is that I presume there were a lot of companies back in '75 that put up a lot of money and made all sorts of deals of lending money, and various other ways, in order to get this gas on the North Slope, and the FPC, I guess, or the courts, or somebody put the kibash on this; right? These people were interested in getting large amounts and so forth. What is it that these companies such as Tenneco and Southern and El Paso actually have to gain by getting such minute amounts? I get the impression, or apparently at least as far as we know, that they have not tried to get the producer gas.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

One would assume that ---

COMMISSIONER MARTIN: No, I didn't say that, Mr. Chairman.

I thought you asked if they had it. I think they're all making substantial efforts to buy as much gas as they possibly can, as are a number of others.

REP. PARR: Is the amount of gas that is available from the royalty gas really significant? I mean, it's one-eighth less whatever we keep, right?

COMMISSIONER MARTIN: Representative Parr, again I'd just very briefly say, I think part of that is going to have to be judged by how important people think it is. I urge you to direct that question also to the producers and to the Delegation. They think it's important; three trillion cubic feet of gas, or whatever percentage they get, they believe it to be important, and I think it's a mistake to assume that that amount of gas is minuscule or unimportant. It is an important supply of gas, given the fact that we're talking about very limited gas supplies. The thing that holds this contract together, obviously, is that they believe that we will not be using great amounts of our royalty gas, and we believe that we will be using it all. Those beliefs are in conflict and we think that we have the ability to take it back if we want it. If they didn't have confidence they would get a substantial portion of it

1 they wouldn't invest their time and effort in the contract.

2 REP. PARR: Mr. Chairman.

3 SENATOR RADER: Certainly.

4 REP. PARR: I guess the thing that kind of bothers me is
5 that in the initial commitments by the producers, at
6 least the information I've seen, no one of these three
7 companies was listed as getting it. There were a number
8 of other companies listed. Now, these other companies
9 would also have an interest in the route taken.
10 Presumably, they were buying an awful lot more gas.
11 I don't know how they compare in size to the three
12 companies we're dealing with, but they must be pretty
13 large, and presumably would have the money and the
14 expertise for a lot of political clout. It just sort
15 of disturbs me -- we keep acting as if this one-eighth
16 is going to be the tail wagging the dog.

17 COMMISSIONER MARTIN: Mr. Parr, if I can suggest, there are
18 some very important differences. For instance, we had
19 a prolonged discussion the other night about the Columbia
20 contract. There's quite a great difference between the
21 Columbia commitment and ours. The fact, I think Mr.
22 Gruening used the words, "Let's don't play the constituency
23 game," -- well, we think it could conceivably be very
24 important. The difference between the Columbia contract
25 and this one is this: Columbia is going to get that gas

1 whatever way the route goes. They're going to get the
2 gas whether it goes El Paso, or Alcan, or Arctic. In
3 fact, they're on record with the FPC as saying that,
4 that they think they'll get the gas just as well through
5 any route. Our contract is different in that ours is
6 the only contract, and may remain the only contract,
7 where our buyers only get it if they back the successful
8 route that's also backed by the State. So where we are
9 different from them is that we have gained support in
10 addition to simply committing our gas, generally speaking.

11 REP. PARR: Do you think the statement you just made about
12 Columbia is true of the other major companies that were
13 trying to buy the producer gas?

14 COMMISSIONER MARTIN: I would guess it would be, yes.

15 REP. PARR: In any event, it doesn't make any difference
16 which route is chosen, they get the gas?

17 COMMISSIONER MARTIN: I don't know of any of those contracts
18 that limit it.

19 REP. PARR: Thank you.

20 SENATOR RADER: Senator Croft and then Representative
21 Chatterton.

22 SENATOR CROFT: I just want to pursue what Representative
23 Parr was talking about. There is nothing that prohibits
24 Tenneco from negotiating with the other owners of gas at
25 Prudhoe Bay to purchase gas; is that right?

1 COMMISSIONER MARTIN: No.

2 SENATOR CROFT: And as far as you know, more than fifty
3 percent of the gas at Prudhoe Bay is uncommitted?

4 COMMISSIONER MARTIN: That's accurate.

5 SENATOR CROFT: And for Tenneco to decide that it no longer
6 wants to support the Alaska route, the only penalty under
7 the contract is it doesn't get the Alaska gas. So,
8 quite conceivably, since it's not prohibited from
9 negotiating with other owners of gas, it could enter
10 into an agreement, perfectly legal under the contract,
11 with somebody that would furnish them more gas than
12 the State, and the condition of that would be to support
13 some other route in Congress.

14 COMMISSIONER MARTIN: That would be possible, but unlikely.

15 SENATOR CROFT: But it's not prohibited by the contract?

16 COMMISSIONER MARTIN: No.

17 SENATOR CROFT: Thank you.

18 SENATOR RADER: Mr. Chatterton.

19 REP. CHATTERTON: Thank you, Mr. Chairman. Commissioner,
20 I've been told, rightly or wrongly, that some of the
21 routes proposed need as an economic threshold a daily
22 through-put on the magnitude of two billion to 2.4
23 billion cubic feet per day, and over probably a twenty-year
24 period, in order to be economically viable. Is what
25 I've been told roughly right, in your opinion?

1 COMMISSIONER MARTIN: That's right.

2 REP. CHATTERTON: At what point in time, Mr. Commissioner,
3 are you willing to guarantee to anyone that is willing
4 to build a transmission line that you will make available
5 from the Prudhoe Bay pool 2.4 billion cubic feet a day
6 of pipeline gas, available for them without jeopardizing
7 ultimate recovery?

8 COMMISSIONER MARTIN: The point at which that could be
9 guaranteed (if you want to stay with that word) is
10 probably several years away, Mr. Chatterton. And I want
11 to make it clear that that will be a guiding pivotal
12 decision. That decision will be determined, as opposed
13 to the decision with regard to the route. We intend to
14 carry out the conservation statute of the State, and it's
15 my feeling that the way it will go, roughly, is that
16 an initial off-take rate will probably be approved based
17 on a reservoir simulation study. A subsequent decision
18 will be based on early field history, and decisions past
19 that time will be based on the field performance to date.

20 REP. CHATTERTON: A follow-up question. Do you have any
21 feeling whatsoever that any good business-minded company
22 would commit funds for rolling of steel for pipelines,
23 or for permits, or you name it, until they were completely
24 assured of a study supply of gas and with no possibility,
25 in other words, beyond all reasonable doubt, that they

1 would steadily have that supply of gas, it would not be
2 cut off for conservation purposes?

3 COMMISSIONER MARTIN: If I can get myself there for just a
4 second -- your question is just about as complicated
5 and confusing as some of my answers, Representative
6 Chatterton.

7 REP. CHATTERTON: I learned from you, Commissioner.

8 COMMISSIONER MARTIN: So, I'm willing to take the rap for
9 that. Let me say this: I think that, you know, putting
10 it your way, maybe no one would do it. But I think, as
11 a practical matter, what is likely to happen is that a
12 number of reservoir simulation studies and the early
13 field history will be extremely indicative of the way
14 in which that field is going to perform, and those who
15 are interested, who are certificated and interested
16 in building a pipeline, are going to have to make a hard
17 decision in regard to the reliability of that information.
18 But, my own opinion is they are not going to get a
19 guarantee because no one can guarantee how a field will
20 perform, and our conservation statute is rather clear in
21 terms of which demands to make that field operate
22 properly. So I think that there is a possibility, yes,
23 the people will invest based on what they believe, based
24 on sound information will be the deliverability figures
25 through that route. As you may know, this was a point

1 of substantial controversy between the State and the
2 Administrative Law Judge of the FPC, in which he
3 demanded with, quite frankly, some anger that we guarantee
4 him a figure. And I spent eight hours on the stand
5 one day basically answering the questions for him that
6 I just answered to you, saying that I couldn't and
7 wouldn't give him a guarantee, at which point he con-
8 cluded that we were obstructing the line because I
9 wouldn't give him a once and for all figure.

10 REP. CHATTERTON: Thank you, Commissioner.

11 SENATOR RADER: Mr. Meekins.

12 REP. MEEKINS: Thank you, Mr. Chairman. I'm trying to
13 approach this through the cost benefit analysis that
14 Representative Gruening indicated, that we should look
15 at it in terms of what we're giving up and what we're
16 getting. I want to come back to the question about
17 location of a petrochemical industry at tidewater. As
18 I've been approaching this, it seems to me one of the
19 benefits of a line reaching all the way to tidewater is
20 to increase the competitiveness of petrochemical products
21 in Lower 48 markets and other markets because they
22 wouldn't have to include in their costs the costs of
23 overland transport and trans-shipment. So what I'm
24 wondering is, does the contracts' prohibition against
25 taking back the royalty gas and using it for an incentive

1 to locate reduce the possibility or the likelihood of
2 a petrochemical industry locating in Alaska.

3 COMMISSIONER MARTIN: I really don't know if it reduces it
4 or not. I think it limits our flexibility in regard to
5 what we can offer, and maybe in that sense it does
6 reduce it, Representative Meekins. How much is something
7 I don't know. Let me say this: we've looked at that
8 question seriously as we can in trying to consider
9 various options before Royalty Board, and thus far at
10 least there has been a pretty low level of confidence
11 in the kind of deal where someone comes to you and says,
12 "Let us export for blank-number of years, during which
13 time we'll do a feasibility study or attempt to take some
14 type of action, and at the end of that period if it looks
15 good, build a refinery or a petrochemical plant."
16 So I think it may well reduce the options, but it
17 reduces one that thus far has not been particularly
18 attractive.

19 REP. MEEKINS: Do you know if any of the companies that are
20 in the contract that are getting the commitment of our
21 royalty gas are also in the business of petrochemical
22 products?

23 COMMISSIONER MARTIN: Yes, I'm certain there are subsidiaries
24 of Tenneco. I prefer for them to answer themselves.
25 There are probably subsidiaries in some cases.

1 REP. MEEKINS: Thank you.
2 SENATOR RADER: Any further questions?
3 REP. HAYES: I have one question, Mr. Chairman.
4 SENATOR RADER: Mr. Hayes.
5 REP. HAYES: Was the gas company mentioned that owns thirty
6 to forty percent -- what's the name -- Columbia Gas?
7 I've heard that they were so interested in getting that
8 quantity of gas, or in tying it up from SOHIO that they
9 went so far as to make a loan, an interest free loan of
10 several hundred million dollars as an incentive, or
11 whatever their purpose was. Anyway I understand it
12 was tied in with the right to buy that gas, and my
13 question is, when we were looking for purchasers for our
14 royalty gas did we contact them and, if so, what was
15 their reaction?
16 COMMISSIONER MARTIN: I can't say. I don't think we did
17 contact Columbia Natural Gas, Mr. Hayes. They were
18 unquestionably aware of the proceeding, and I made a
19 number of public statements indicating that we wanted
20 to hear proposals from anyone interested in engaging
21 in this type of contract with a take back provision and
22 supporting the Trans-Alaska route.
23 MR. BYRD: I might make one comment. There's been a lot of
24 talk about the front end loan and interest free loans.
25 You want to keep in mind that those are made to producers

TAKU REPORTERS
DEPOSITIONS - HEARINGS - GENERAL REPORTING
JUNEAU, ALASKA 99901

1 for development and exploration, and I question whether
2 or not they would ever be made to a royalty owner that
3 doesn't really spend money for development of the acreage.
4 All of them that I'm familiar with have gone to producers,
5 and they have a commitment to develop, and then when
6 the gas is developed the advancer has the priority to
7 buy. I've never known of one to go to a royalty owner.

8 SENATOR HUBER: Mr. Chairman.

9 SENATOR RADER: Senator Huber.

10 SENATOR HUBER: Shouldn't that answer have been predicated
11 also that this is maybe the only state that's able to
12 take its gas in kind instead of otherwise?

13 MR. BYRD: Texas and New Mexico are taking theirs.

14 COMMISSIONER MARTIN: We're not the only state.

15 SENATOR HUBER: Well, we're virtually, aren't we?

16 COMMISSIONER MARTIN: Just a couple other little ones like
17 Texas.

18 SENATOR HUBER: Like Texas? Is that relatively recent though?

19 MR. BYRD: They've had the right for several years but they
20 haven't exercised it.

21 SENATOR HUBER: They haven't exercised it though, have they?

22 MR. BYRD: They are now, and so is New Mexico.

23 SENATOR HUBER: They're doing it now, but they haven't
24 been up until very recently.

25 MR. BYRD: That's right.

1 SENATOR HUBER: Mr. Chairman, I was taken by the remark
2 that a producer could expect this, but a royalty owner
3 couldn't, especially under the condition that the royalty
4 owner takes his gas in kind. If you will excuse me,
5 sir, it appeared to me, the separation, to be completely
6 ridiculous.

7 SENATOR RADER: Mr. Gruening.

8 REP. GRUENING: I just want a clarification of that last
9 statement. Isn't the reason Columbia Gas would pay a
10 cash bonus is to get a certain amount of gas committed,
11 it could care less what the producer does with it.
12 I mean, isn't the primary motivation of the gas company
13 to get the gas, and that's why they pay the bonus?

14 MR. BONESS: Representative Gruening, after the discussion on
15 Thursday night I attempted to find out additional
16 information about the Columbia sale. The Columbia sale
17 was entered into in 1971 ---

18 SENATOR RADER: Mr. Boness, would you speak up a little
19 bit more?

20 MR. BONESS: The Columbia sale was initially entered into
21 between SOHIO and Columbia in 1971. It involved actually
22 six separate documents -- well, at that time it involved,
23 I believe, four separate documents, two of which were
24 amended in 1974. I don't have all of those documents,
25 but those that I did have available I made available

1 to the committee's staff.

2 It's a very complicated arrangement, and the
3 basic purpose of it was to make money available for
4 development of the reservoirs and to insure that gas
5 would be produced at some time. When it was entered into
6 in 1971 the thought was the oil pipeline would be built
7 at an early date and gas would be moving many years ago.

8 In '74 when it was realized that the gas wasn't
9 going to move, some amendments were made to insure that
10 the gas would eventually move. The purpose behind the
11 advance payment orders, just in terms of the FPC policy,
12 was to encourage exploration for gas. That's the reason
13 (Mr. Byrd pointed out) it goes to producers and not
14 royalty owners. Royalty owners don't explore for gas,
15 producers do. It was to encourage the exploration of
16 gas and a commitment to that gas to the interstate market.
17 It was made at a time when oil companies were saying
18 the reason they couldn't explore was they didn't have
19 enough money to go out and explore.

20 Eventually, when the FPC reviewed that decision
21 pursuant to a court order, it concluded that particularly
22 with respect to Alaska the gas was going to be committed
23 in the interstate market in any event and, therefore,
24 advance payments with respect to Alaska were inappropriate.

25 In response to an earlier question by Senator

1 Croft, whether had the State entered into this advance
2 payment, into this contract, we could have gotten front
3 end money at an earlier time, the answer is only if we
4 had entered it between 1973 -- there were two orders
5 dealing with advance payment -- I believe August, but
6 I'd have to check the month. There were two orders,
7 and when the FPC issued its decision of December 31, 1976,
8 it ordered a show cause order with respect to those that
9 were entered into prior to 1973.

10 That included, I believe, four different companies,
11 El Paso, Columbia, -- I'm afraid I can't mention the
12 other two. Only the contractor Columbia dealt with
13 North Slope gas. All of the advance payment contracts
14 which had been entered into, and they had been for
15 virtually all of the gas, were ordered to refund the money.
16 So all of those contracts were refunded and, of course,
17 the gas companies were not allowed to put in the rate
18 base the terminated contract. The Columbia one, the
19 show cause order was issued, they filed the response in
20 March, and nothing has happened since then.

21 The Columbia contract, as a practical matter,
22 could be terminated. Columbia has out, I believe, a
23 Hundred and Seventy-Five Million Dollars in advance
24 payments. Their net cash flow, I believe, is around
25 a Hundred and Three Million Dollars, according to the

1 transcript, and obviously if a company has out a Hundred
2 and Seventy-Five Million Dollars and can't put it in
3 its rate base, it's going to be in a very difficult
4 situation. Columbia witnesses testifying in the FPC
5 proceeding testified that probably they would have to
6 terminate the contract if they were ordered to refund
7 the money.

8 REP. GRUENING: That question really went to the willingness
9 of the gas company to pay it in order to get the gas.
10 I can understand why the FPC wouldn't want it maybe
11 paid if it weren't going to be used for exploration and
12 development, but as far as the gas company went, their
13 prime motive was to get the gas.

14 SENATOR HUBER: Mr. Chairman, may I get back with Fred?

15 SEANTOR RADER: Were you through, Mr. Gruening?

16 REP. GRUENING: Yes.

17 SENATOR RADER: Senator Huber.

18 SENATOR HUBER: Mr. Boness, right exactly where you left off,
19 in the case of deregulation, which looks like it's
20 imminent right now in Congress, or appears to be at
21 least, wouldn't it be, if we approved these contracts,
22 only our commitment with these three contractors that
23 would prevent us from receiving a price that would allow
24 us to recover proportionately what other people got
25 in front end payments, by getting a higher price for our

1 royalty gas, because in effect others have got front end
2 payments -- or did some of them, at least Columbia did.
3 Wouldn't it be our contracts in case of the deregulation
4 that would stand in the way of us doing that?

5 MR. BONESS: Do you mean the Columbia contract? That's the
6 only one where advance payment happened.

7 SENATOR HUBER: No. For instance, right now Columbia has
8 a contract that had front end, and apparently they'll
9 get the highest field price that's allowed by the FPC
10 to be paid for that. Isn't it true that for the State of
11 Alaska to get that same higher price, including the front
12 end money, our contracts will be standing in the way of
13 that provided the gas is deregulated?

14 MR. BONESS: Let me start with the regulated situation.
15 In the regulated situation there is a penalty that takes
16 into account the fact that in the price, if everybody
17 else was getting the highest price, Columbia would be
18 paying something less because they'd already had some
19 money.

20 In the deregulated situation it depends on what
21 the contract between Columbia and SOHIO provides. I'm
22 not completely familiar with that contract, but I suspect
23 that Columbia will not be paying the same price for the
24 gas it receives that some other pipeline company will be
25 paying from somebody that had not advanced front end

1 money. In other words, I believe the Columbia contract
2 more than likely takes into account the fact that, if
3 deregulation occurs, some money has been paid already
4 and, therefore -- say, Texas Eastern may be able to pay
5 Arco a higher price than Columbia will be paying SOHIO.

6 SENATOR HUBER: You'd believe that we would be protected
7 by this highest field price clause where they wouldn't be?

8 MR. BONESS: Yes, sir.

9 SENATOR HUBER: Thank you, Fred.

10 SENATOR RADER: Any further questions of these witnesses?

11 SENATOR CROFT: Mr. Chairman.

12 SENATOR RADER: Senator Croft.

13 SENATOR CROFT: So that I can get in context some of the
14 questions that Representative Meekins has been asking,
15 is it true -- and I guess maybe Mr. Byrd would be the
16 one that might know this best, or Fred -- is it true
17 that once the route is certified that there is going to
18 be a tariff, in effect, approved for that basic facility?
19 Whatever the plan that's submitted at that time, that's
20 going to set that; is that basically correct?

21 MR. BONESS: Once the route is selected by the President
22 and approved by the Congress, it will go back to the FPC
23 and they will establish a tariff at that time.

24 SENATOR CROFT: Based on that particular facility?

25 MR. BONESS: That's right.

1 SENATOR CROFT: And any additions, changes, in that facility,
2 any spurs off that facility, would then have to stand
3 on their own weight in terms of economic viability; is
4 that correct?

5 MR. BONESS: Well, any spur off the line would have to be
6 certified first by the FPC in the new Section Seven
7 proceeding.

8 SENATOR CROFT: And when you tried to certify that spur,
9 would the FPC then go back and re-establish the tariff
10 for the whole line with that spur as an addition, or would
11 it keep the tariff on the existing line and set a new
12 tariff for that spur?

13 MR. BONESS: I believe it would set a new tariff for the spur.
14 The tariff sets a price for transportation between point
15 "A" and point "B".

16 SENATOR CROFT: Right, and with regard to the El Paso line
17 as it's proposed now, the tariff would be between Prudhoe
18 Bay and Valdez, is that correct, and there would be
19 intermediate tariffs for points in between?

20 MR. BONESS: Yes.

21 SENATOR CROFT: But there wouldn't be any other tariffs
22 in Alaska established except along the route of that line?

23 MR. BONESS: There would also be a separate tariff for the LNG
24 facility.

25 SENATOR CROFT: Right. But suppose somebody wanted to take a

1 portion of that to the Delta area, to Anchorage, or
2 wherever, and you had to construct a small line in order
3 to do that? The tariff for that small line would have to
4 be such as to pay for that entire facility, is that
5 correct, the entire spur?

6 MR. BONESS: That spur would be regulated by the State
7 Pipeline Commission, not by the Federal Power Commission.

8 SENATOR CROFT: And it would have to be economically viable
9 by itself; you wouldn't go back and get the FPC to come
10 up with a new tariff for the Prudhoe Bay to Valdez line;
11 is that correct?

12 MR. BYRD: It depends on where the sale was made. If the
13 sale was made by the State to somebody at a point where
14 the spur was going on, then that would be intrastate
15 and the FPC would already have collected their proportionate
16 share to get it there, and from the point of sale off
17 the certificated FPC line to Anchorage, say, that would
18 be a State regulated project and it would have to stand
19 on its own feet.

20 SENATOR CROFT: So my question is, to what extent, in order
21 to make sure that we have the maximum potential for
22 developing and using the gas intrastate -- shouldn't we
23 insist that any spurs be built into the basic line and,
24 thus, reflected in the overall tariff to pay for that
25 line rather than waiting until a later date and having

1 those spurs which then have to be economically justified
2 by themselves alone?

3 MR. BYRD: I question if the FPC would certificate on this
4 main line a facility solely for the movement of intra-
5 state gas. The legislation that was passed prohibits
6 them from preventing a take off and preventing the
7 transportation through the facility to the point of
8 take off, but I think from that point on it would be
9 an intrastate project.

10 SENATOR CROFT: But suppose that we wanted to build a spur
11 to Anchorage because, for some reason, it was more
12 suitable to an LNG type of operation or to a petro-
13 chemical operation than Point Gravina is? Then that
14 spur would have to stand on its own, would it not?

15 MR. BYRD: Yes.

16 SENATOR CROFT: But that if we built that in at this point,
17 prior to certification if we insisted on the spur, it
18 could be built in the overall tariff.

19 MR. BYRD: But the interstate shipper wouldn't pay any part
20 of it.

21 SENATOR CROFT: Why not?

22 MR. BYRD: The FPC just wouldn't let them. The interstate
23 shippers are only going to pay their proportionate share
24 of the cost of the pipeline and whatever facilities are
25 built that go on into interstate commerce.

1 SENATOR CROFT: Yes, and suppose you had a petrochemical
2 complex that did send it on into interstate commerce at
3 Anchorage so that it would be a part of interstate's
4 interests?

5 MR. BYRD: You're thinking about a cryogenic plant at
6 Anchorage that would move liquid gas on to the 48 States.
7 I question whether the FPC or El Paso, either one, would.
8 Under our contracts we couldn't do that, we couldn't
9 take the gas out to liquefy it and move it to the 48
10 States. If we were going to use the gas in a petro-
11 chemical plant we could take it and move it to Anchorage
12 or some other point, but we would pay the tariff from
13 the North Slope to the point of the take off, and we'd
14 pay the intrastate transportation, or our purchaser
15 would, for moving it from the point off on the FPC
16 certificated line over to Anchorage, and that spur
17 wouldn't be FPC jurisdiction.

18 SENATOR CROFT: Was the question of any type of spurs to be
19 constructed by El Paso considered during the negotiations?
20 Were they requested to make any change with regard to
21 their line?

22 COMMISSIONER MARTIN: Not during negotiations, Mr. Croft, but
23 we have demanded on several occasions that they or other
24 companies add spurs, or come forward with a proposal
25 of spurs, for instance, in the case of Haines or some

1 other place, and they have refused steadfastly to do that.
2 SENATOR CROFT: As I understand it, they're going to be
3 back Tuesday or Wednesday. I have some additional
4 questions, the hour is getting late.
5 SENATOR RADER: Well, we can -- if it's in the nature of a
6 general examination, then maybe we ought to pursue
7 them the first thing in the morning. I do expect you
8 to be back though probably -- first of all you said you
9 would like to be able to sum up anything that might
10 develop and secondly, you hope to report to us on the
11 decision if it can be analyzed. What's your desire,
12 Commissioner?
13 COMMISSIONER MARTIN: We're fine. We're in good shape until
14 about Thursday of this week, Senator, and then we'll be
15 sending -- I think Jack will have to return and Fred
16 will be heading to Washington to work on the reply brief
17 in the FPC, so Wednesday will be fine.
18 SENATOR RADER: Would you prefer that instead of tomorrow?
19 COMMISSIONER MARTIN: We'll be glad to come back and spend
20 any amount of time. Tomorrow is also fine.
21 SENATOR RADER: Any other questions of these witnesses? If
22 not, we will tentatively start out with Tenneco, Southern
23 and El Paso tomorrow, hopefully at 11:00 o'clock, or
24 as soon thereafter as the House and Senate adjourn.
25 (Whereupon the hearing adjourned at 5:00 p.m.)

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

FEBRUARY 7, 1977

1
2 SENATOR RADER: The Joint Committee Hearings of the House
3 and Senate Royalty Gas Sale Committees will come to order.
4 We invited Commissioner Martin and such other persons
5 as he might deem appropriate to respond in any manner,
6 that they see fit, to questions that have been raised
7 that they think should be dealt with, or supplementary
8 information. Particularly did we want to get from you
9 an analysis of the opinion from the Trial Judge from
10 your point of view as to what it says and what it
11 doesn't say, and such other matters as you think may
12 be pertinent to the committee.

13 I think the best thing would be for you and
14 Mr. Boness, or either of you, directly to give us sort
15 of a rundown on where you think we are and then start
16 the questions, if that would be all right to do.

17 COMMISSIONER MARTIN: Yes, sir. Thank you, Senator Rader.

18 I should say that after talking to you last week I've
19 not come prepared to give you a full briefing and run-
20 down on the FPC Judge's opinion. In fact, my under-
21 standing of last week was that once the thing was
22 cancelled on Friday that we had moved beyond that, and
23 the decision has been well distributed up here now.
24 We can do that in rough form but, quite frankly, we
25 didn't come prepared to do that; we came prepared to try

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

B-1

AGO 546410

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

to respond to some of the questions that were raised and to take all your questions.

SENATOR RADER: I would appreciate your doing it just in rough form then as to your understanding generally, just for purposes of the committee. I know I haven't seen a copy of the decision, and I know that either you or Mr. Boness will have read it in full and analyzed it, and I would like to know what effect it has, if any, on these hearings, and on your position or on a position that we should take or might want to take.

COMMISSIONER MARTIN: Senator, let's take it on this way. I think we can say that Fred has read the opinion, at least largely. It's awfully long, and I have not gotten all the way through it. I have read certain parts of it, and I think we can give you a brief summary. Let's just start by having Fred run down some of the key points that are in the decision and then maybe we can talk about the meaning of them.

SENATOR RADER: Excuse me. I see Senator Kerttula. Senator, would you like to -- you're certainly welcome if you'd like to join us up here for the questioning.

SENATOR KERTTULA: Thank you, Senator Rader. If I have something I'll come up there. Thanks very much.

SENATOR RADER: Or you can stand and address the questions there, if you wish, from your seat. Yes, Mr. Nakak,

1 also. Would you care to join us?

2 MR. NAKAK: Not presently.

3 SENATOR RADER: Proceed, Commissioner.

4 COMMISSIONER MARTIN: I'll let Fred just give a brief run-
5 down of the things.

6 MR. BONESS: I would like to start by indicating just a
7 little bit about the procedure, what will happen now.
8 The opinion, as you know, was issued on February 1.
9 We have thirty days in which to file a brief of exceptions.
10 Basically what that means is that the Judge throughout the
11 opinion says, "I find Arctic Gas will be able to construct
12 from snow roads in the time frame they've projected,"
13 and numerous other findings of that nature.

14 The State doesn't believe that that can be done.
15 It will have a number of exceptions to findings of the
16 Judge. We will have thirty days in which to file the
17 brief, and the purpose of my going back to Washington,
18 D.C. is to work with our attorneys back in Washington
19 to prepare that brief, and all the other parties will
20 be doing the same. Once that brief is filed, the Judge's
21 decision, the whole record and those briefs will go to
22 the Commission.

23 They will issue a decision, a recommendation to
24 the President on May 1. The opinion itself is very long,
25 it's four hundred and thirty pages with about another

1 seventy pages of appendices, some of which are also
2 pertinent to the decision and must be read to understand
3 the decision itself. It's organized into a number of
4 sections, there's a Gas Supply Section, a Construction
5 and Logistics Section, an Environmental Section, a Tariff
6 Section, a Financing Section; and within each of those
7 sections the Judge addresses generally what Arctic Gas
8 says it can do, what he believes they can do, what
9 El Paso says they can do, what he believes they can do.
10 There is some discussion in each section of Alcan.
11 although, rather interestingly, the Judge at times just
12 seems to ignore the Alcan proposal altogether. He never
13 praises it, he occasionally criticizes it, but in general
14 he just doesn't treat the Alcan proposal in anywhere
15 near the same length as he treats the El Paso and Arctic
16 Gas proposals.

17 I have not read all of the decision. I'm half
18 way to three-quarters of the way through the decision.
19 There are a number of places where the State of Alaska
20 is mentioned in terms of the positions it has taken.
21 We will have things to respond. As you may know or may
22 have heard, the Judge asserts that the State is a person
23 under the Natural Gas Act and that our sales will have
24 to be certificated by the Federal Power Commission.

25 As I indicated on Thursday night to Representative

1 Gruening's committee a week ago, we are intervening in
2 other cases -- we have intervened in other cases which
3 address that issue and which may form the precedent for
4 what would be the eventual finding in the Alaska proceeding.
5 But, in any event, I would point out that the Judge's
6 position is contrary to the position taken by the Office
7 of General Counsel for the Federal Power Commission,
8 and it will be a legal issue which will ultimately be
9 resolved, I feel quite certain, by the courts.

10 I don't believe the Judge's assertion that
11 jurisdiction exists is really in any particular fashion
12 detrimental to the State's position. It is really based
13 more on an assertion that it just must be so rather than
14 on any serious legal analysis, in my opinion.

15 I believe I would prefer to leave it there rather
16 than going into the number of specific issues that the
17 Judge addresses unless it would be the committee's pleasure
18 that I attempt to do that.

19 SENATOR RADER: Of course, the inquiry here is, should we
20 or should we not pass the resolutions approving the sale.
21 Is there anything in the decision from the point of view
22 of the State that would impinge upon our decision as to
23 one way or another in that regard, in your view -- or
24 in your recommendation to us in that regard?

25 COMMISSIONER MARTIN: I would stick by the statement that we

1 made earlier, Mr. Chairman. This decision, once the
2 procedural bill passed last year, is made less important
3 than it would be under ordinary circumstances, and I'm
4 not going to change that position because of the way
5 the decision came out. On the other hand, the strength
6 of the decision, it seems to me, points out two things
7 very clearly. One is that the State has a tremendously
8 long way to go to support either of the two routes that
9 are in the State's interests; and the second thing it
10 points out, and I want to mention this in the statement
11 that I'm going to make to you today, is that this is
12 a terrifically Federally oriented decision and points
13 out, sort of in the most vivid terms, the kinds of
14 things that we may be running up against in attempting
15 to protect the future in-State use of our gas and running
16 up against in terms of Federal jurisdiction over our gas.

17 So those two things very much, in my view,
18 make what we're considering here more important -- in my
19 view, make it substantially more important that we take
20 action at an early time, and make it more important
21 that we do what we can to support the El Paso route.

22 SENATOR RADER: I really didn't mean to open the questions
23 at this stage. However, inasmuch as I have, do other
24 members of the committee have any questions particularly
25 concerning the decision, and then we would go into the

1 other. Senator Croft.

2 SENATOR CROFT: I do on that point. One of the reasons these
3 contracts were announced on November 12 was so that they
4 could become a part of the record, and both the staff
5 report which was issued in December, and Judge Litt's
6 decision which came out in February thus considered those
7 contracts. What did the staff report and what did Judge
8 Litt say about these contracts? What effect did the
9 contracts have on their decisions?

10 COMMISSIONER MARTIN: I think they had pretty much the effect
11 that I thought, and that was less effect on the FPC
12 proceeding than they'll have on any subsequent proceeding.
13 I stated that before publicly, and that was a point I
14 made basically in trying to take additional time before
15 they were introduced. I think that they didn't affect
16 the decision a great deal, nor did I expect it to.

17 SENATOR CROFT: What did Judge Litt say about the contracts?

18 COMMISSIONER MARTIN: I don't recall that he treated them
19 in length at all.

20 SENATOR RADER: Any further questions on the decision?

21 Representative Parr.

22 REP. PARR: Mr. Martin, you used the term "Federally oriented"
23 a minute ago. Do you mean that this was the same thing
24 as what sometimes is called "In the National interest"?

25 COMMISSIONER MARTIN: Well, I don't know what sort of semantics

1 you're after, Mr. Parr.

2 REP. PARR: I'm not looking for semantics, Mr. Martin.

3 You said "Federally oriented" and I don't understand
4 the term.

5 COMMISSIONER MARTIN: Let me try to explain that. It seems
6 to me that the best that the State of Alaska can hope
7 to come out of this is with some agreed understanding
8 between the Federal Government and the State with regard
9 to the State's ability to use the royalty gas of their
10 own. That understanding, in my view, would be to acknowl-
11 edge that because of Alaska's production of these resources
12 and distance from other markets, the needs we have in
13 the State, that we will have a somewhat free hand to
14 use our own resources.

15 At worst, on the other hand, the Federal Govern-
16 ment will assert total jurisdiction over not just the
17 gas that comes out of Prudhoe Bay, but the royalty gas
18 that comes out of Prudhoe Bay, and direct that that gas
19 be sent somewhere else other than Alaska.

20 Now, that's a whole spectrum of possibilities
21 with respect to the gas that we own. When I say Federally
22 oriented, in this context I'm referring to the fact that
23 Judge Litt took the position that they should have
24 virtually total control not over just the Prudhoe Bay
25 gas but our State owned gas as well.

1 REP. PARR: In other words, what you're saying is Judge Litt
2 said that the Federal Government would have the power
3 then to decide where the gas would be most needed, including
4 our royalty gas.

5 COMMISSIONER MARTIN: That's right.

6 REP. PARR: And then to send it there.

7 COMMISSIONER MARTIN: And went much further than that to
8 advocate the repeal of Section 13-B and immediate asser-
9 tion of Federal jurisdiction over our gas right from
10 the wellhead.

11 REP. PARR: Thank you.

12 SENATOR RADER: Any other questions? Representative Gruening.

13 REP. GRUENING: Commissioner and Mr. Boness, is there anything
14 in the decision that indicates why he thinks 13-B ought
15 to be repealed?

16 COMMISSIONER MARTIN: Yes. He discusses it, not at length,
17 but he basically makes the assertion that the Federal
18 Government again should control all of the gas in the
19 national interest rather than just the seven-eighths that
20 belong to the producers, and really indicates that the
21 Federal Gas Act, in his opinion, has applicability to all
22 of it and that then all of the Federal powers given to
23 the Federal Power Commission under its act would apply.

24 REP. GRUENING: You mentioned just earlier that the decision
25 behooved us to move faster on these contracts. I think

1 that was your comment. What is there in the decision
2 that compels us to do that?

3 COMMISSIONER MARTIN: Basically the fact that it pointed
4 up the terribly uphill battle that the State faces in
5 supporting either one of its two routes, and it seems
6 to me that it just emphasizes the need for whatever
7 additional assistance we can get from these contracts
8 or the support that comes as a result of them.

9 REP. GRUENING: You recall that in the task force evaluation
10 that there was mention of the fact that at some point
11 the State would consider switching its support to Alcan,
12 and now having been asked that question, and the decision
13 hadn't come out yet -- now that it's out is there any-
14 thing in that decision that would give the Administration
15 cause to reflect and to change their position?

16 COMMISSIONER MARTIN: I think we'll continue to consider it,
17 and we'll probably be discussing it this week, but my
18 present reading of the situation is that the decision
19 would not indicate a change is necessary.

20 REP. GRUENING: You will be discussing the possibility of
21 switching support next week?

22 COMMISSIONER MARTIN: Yes, but I don't think that there is
23 any strong possibility that we'll change.

24 REP. GRUENING: But that matter will come up?

25 COMMISSIONER MARTIN: I should say, that matter is under

1 just continual scrutiny and discussion because we want
2 to make sure that whatever is in the State's best
3 interests is protected. But I think it highly unlikely
4 that we'd want to change because of this decision.

5 In fact, our present directive is for Mr. Boness to go
6 to Washington and prepare a brief opposing the recommen-
7 dations made by Judge Litt.

8 SENATOR RADER: Any further questions on the decision?

9 Representative Miles.

10 REP. MILES: Regarding Judge Litt's advocacy of repeal of
11 the exemption, Commissioner, has anybody been in contact
12 with our Congressional Delegation to gain a feel of how
13 Congress feels since the Litt decision came down, and
14 are you familiar with ---

15 COMMISSIONER MARTIN: Well, I've been in contact with the
16 staff of our Delegation. I think I've been in contact
17 with all of the staff since that time, not only on that
18 question or precisely on that question. But I've dis-
19 cussed this issue, although not personally with any
20 of the Delegation. What I'm learning from them is that
21 it's really too early to assess what happened in Congress
22 as a result of that decision. I don't think they've
23 really digested it really anymore than we've been able
24 to here. But they see the decision as damaging to the
25 El Paso and Alcan case.

1 REP. MILES: But they don't have any strong feeling on the
2 exemption either?

3 COMMISSIONER MARTIN: No.

4 SENATOR RADER: Senator Croft.

5 SENATOR CROFT: Could I -- just so we get it in perspective,
6 the State had certain points that it wanted to make
7 in the FPC hearing. One was support of the El Paso
8 route, two was, I guess, some support of Alcan just
9 so the State could keep that option open, three was
10 to convince Judge Litt that we were not a person within
11 the meaning of the Natural Gas Act and thus were not
12 under the terms of it. Obviously, we didn't want him
13 to come out for repeal of 13-B. Could you list the
14 major objectives that the State had in its participation
15 before the FPC? Just kind of run through it as to how
16 we came out under his decision.

17 COMMISSIONER MARTIN: I don't think a list is necessary,
18 Senator Croft. I'll just say that you listed at least
19 the major ones, and there are a number of minor ones.
20 My thought is that Judge Litt's decision went very much
21 against the State's interests.

22 SENATOR CROFT: On all of the major points?

23 COMMISSIONER MARTIN: On the major points.

24 SENATOR CROFT: On the most of the minor ones too?

25 COMMISSIONER MARTIN: Yes.

1 MR. BONESS: Senator, I'd like to respond to that. What I
2 believe you stated are really the ultimate objectives
3 that the State's case took. But, in fact, there are a
4 number of specific kinds of points which come up during
5 the hearing; for example, the question of whether Arctic
6 Gas would be able to construct its line from snow roads
7 was debated at length. That's a much finer question.
8 It goes to the State's objective because part of the
9 reason the State opposes Arctic Gas is that it is going
10 to involve substantial delays and substantial increases.
11 The State put on considerable testimony on that point.

12 El Paso hired special consultants to put on
13 considerable testimony on that point. Mr. Latts, who
14 was the Federal Government pipeline person, put on
15 testimony to the effect that it couldn't be done, and the
16 Judge essentially rejected all of that testimony.

17 There are a number of other kinds of things like
18 that, the question of whether adequate water would be
19 available to manufacture snow if, indeed, they were
20 going to use snow roads; the question of whether snow
21 fences would be adequate. It really breaks down into
22 a number of very specific kinds of things.

23 With respect to the El Paso proposal, questions
24 with respect to the amount of gravel available and a
25 number of things like that. And the Judge, in my opinion,

1 as far as his opinion that I've read, really accepted
2 Arctic Gas' arguments in almost all cases and ignored
3 the arguments of the State and others with experience
4 in the gas pipeline construction here in Alaska.

5 COMMISSIONER MARTIN: I might just add to that, I think
6 your question -- I don't think you assume this, but it
7 may create the implication that it was sort of the State
8 against these others. But the State was merely a part
9 of a much larger presentation, whereas the bulk of the
10 evidence was put on by El Paso, by Alcan, or some of
11 the other parties who were intervenors to the case.
12 Although we took a major role on most of these issues,
13 we were not (let's say) the leading case.

14 SENATOR CROFT: On some of them we were the only people
15 that were really interested in it, and that is particularly
16 true with regard to whether the State is a person
17 within the interpretation of the Natural Gas Act.

18 MR. BONESS: Senator, if I may respond to that one. The
19 State filed a brief on that very early in the proceeding.
20 No one filed a brief in opposition to that and, in fact,
21 I believe you would not find that in the record at all
22 except occasionally the Judge making a comment, "Well,
23 whether the State is or isn't a person, will you tell
24 us what you're going to do?"

25 The legal merits of that question were never

1 discussed or debated in the hearing at any point and,
2 quite frankly, I'm a little bit surprised to find as
3 much discussion of the issue in the Judge's opinion as
4 there is. I think it was, if anything, a gratuitous
5 effort on the part of the Judge to make sure that the
6 State does not get powers beyond those which he believes
7 we should have.

8 SENATOR CROFT: But in terms of that, in terms of 13-B,
9 in terms of the regulation of rates within the State,
10 which I think you, Commissioner Martin, made reference
11 to Tuesday when we had the first summary of Judge
12 Litt's decision, all of those points were basically
13 points that it was not particularly an adversary situation
14 and yet he recommended against us on all of those as
15 well; is that correct?

16 COMMISSIONER MARTIN: Exactly right, and that's exactly
17 why I answered Mr. Parr's question that it was a very
18 overtly Federally oriented decision. On the question of,
19 let's say, rates he treated it very lightly in the
20 decision in most cases, much more lightly than I thought
21 he would given the fact I had been on the stand for
22 eight hours on that issue one day. But, you're right,
23 he took it on his own initiative to deal with those
24 issues, as Fred says, gratuitously.

25 SENATOR RADER: Any further questions just on the decision?

1 Commissioner, why don't you go ahead and give us your
2 general presentation?

3 COMMISSIONER MARTIN: Thank you, Senator. Last week, Mr.
4 Chairman, the committee had comprehensive hearings on
5 the gas line route issue and on the contracts, and as
6 the opening witness for the State and the spokesman
7 designated by the Governor, I took the approach basically
8 of attempting to lay the contracts and the route preference
9 decision before this committee, and to do so, at least
10 in my own view, for my own part without heavy advocacy
11 or really without a series of conclusionary statements.
12 I, in fact, didn't make an opening statement. And I did
13 that for several reasons that are somewhat important to
14 me and I think to the proceedings.

15 One is, I think this issue is critical, and I
16 believe it to be (like you) basically non-adversary and
17 non-partisan.

18 Secondly, to a very large extent I served as not
19 just the negotiator for the State, but the negotiator
20 for the Legislature as well as the Executive on this
21 matter, and I wanted the committee to have the best
22 opportunity to understand factually what the contracts
23 did as opposed to having to deal initially with a large
24 number of the conclusions or implications that might
25 spring from the contracts.

1 And I also wanted to hear, as a negotiator,
2 very much what other people had to say about the
3 contracts because no matter how substantial the level
4 of care is, and it was substantial on these contracts,
5 there is always a great deal more to be learned, par-
6 ticularly from the consultants and others that have an
7 opportunity to examine these contracts in a clear,
8 objective light. Basically I guess what I wanted to do
9 was to see how well the contracts and the route preference
10 stood on their own merits and to get an indication for
11 my own part how well we did.

12 I've never said to this committee, and I'm not
13 going to start saying today, that State decisions on this
14 issue are clear-cut. Yet I heard a number of people
15 say statements last week that were amazingly absolute,
16 in my view. Virtually any course that we take, Senator,
17 and I wouldn't want the committee to be mistaken about
18 this, is going to have substantial trade-offs, it's going
19 to have risks associated with it, and it's going to have
20 both advantages and disadvantages. I think that although
21 there are a number of people that really don't like to
22 hear this kind of conclusion, I think that the differences
23 between the alternative courses that are available to us
24 are going to depend very much on subjective judgments
25 made not just by myself or by the Governor, but by members

1 of this committee. Some things are going to be, and
2 remain, difficult to quantify. I think they're going
3 to have to be worked out subjectively by all of us
4 working together. That's very true of these contracts.

5 Now, my opinion after seeing the hearings for a
6 week, Senator, is that they were very useful. They
7 were comprehensive, and on balance I think they developed
8 some good information on very complex issues. There
9 were a number of factual errors made, and we're going to
10 try to be able to respond to those today. There were
11 some very legitimate differences expressed with regard
12 to State policy objectives that might be pursued. There
13 were some wide ranging political judgments expressed.
14 I think there was some good, expert consultation supplied
15 to the committee.

16 We paid close attention to the hearings. We had
17 them monitored throughout your consideration, and I
18 think we came away with a pretty good idea of what it
19 was we ought to do in future response to this committee.

20 I'm going to say some things in my statement
21 today and I'm going to be prepared to respond to questions,
22 and it may well be that we'll turn in additional written
23 information at a later time if we feel that everything
24 hasn't been covered.

25 It was a little hard to tell, looking at the

1 testimony last week, what the most shocking piece of
2 testimony was. It was probably a toss-up between Arlon
3 Tussing telling us that the entire State and its
4 leadership have been tricked into believing that we
5 have any role in this decision at all; it could have
6 been Mr. Dallas telling us we made a big mistake by
7 not coercing a gasoline plant in Fairbanks as a part
8 of these contracts; or it might have been that the
9 buyers couldn't assign a dollar for dollar value
10 to what it was they proposed to do.

11 But let me say that, at least from my personal
12 judgment, the most shocking piece of evidence before
13 the committee last week was probably Judge Litt's decision.
14 It was something that didn't happen here at all. In the
15 terms of the sort of significance that we have to deal
16 with in these hearings, it seemed to me that, as I said
17 earlier in response to Mr. Croft's question -- it seems
18 to me that we learned from that decision a great deal
19 more about the uphill battle we have to face and a good
20 deal more about the sorts of Federal orientation that
21 we're likely to meet as this issue is developed in
22 Congress.

23 What I'd like to do today, Mr. Chairman, is to
24 continue in the role of elaborating on the contract
25 factually and to respond to your questions. But I'd also

1 like to do one other thing that I feel somewhat compelled
2 to do in the role that I've tried to fulfill for the
3 State, and that is to try to add at least some perspective
4 to the issue based on my own judgment and on my experience
5 as a negotiator for this contract and on my experience
6 in dealing with this issue on behalf of the State
7 in the Federal context. I've spent time on this issue,
8 both for this Administration and for the last one,
9 and think that the committee probably can benefit from
10 at least what some of my judgments, again admitting
11 that they're only subjective, with some of the others
12 that have been made, to add my words to theirs.

13 In other words, I feel that after hearing a
14 great deal of useful testimony last week, I think that
15 it will be useful for me to at least give you the benefit
16 of my advice as well as the information I can supply.
17 First, I want to make it clear that I believe after
18 hearing everything, and you always hear these things
19 with a certain amount of trepidation as a person who
20 negotiates it, particularly in the context of our statute,
21 I want to share with you my belief that both the contract
22 and the route preference held up remarkably well during the
23 course of the hearings last week. No witness, with the
24 exception of those who favor another route, such as Mr.
25 Ward, Mr. Thompson or Mr. Tussing, made any substantial

1 allegation that the best route for Alaska was anything
2 but the Trans-Alaska route.

3 In addition to that, the clear-cut consensus
4 of the consulting experts hired by the Legislature was
5 that these are good contracts achieving some objectives
6 now which may not be reasonably expected to be surpassed
7 or even equalled later. Third, on taking into account
8 all that was discussed last week, I believe that no
9 questions have been raised which cannot be reasonably
10 answered and none that persuaded me on balance that
11 these contracts do not best achieve a series of crucially
12 important objectives for the State.

13 Now, beneath all of the specifics which have
14 been raised is the overall issue raised best by Mr.
15 Gruening, "What do we get and what do we give up?"
16 Slightly below that is a similar question, and I think
17 it went unspoken in many cases last week, "Can't we do
18 better in the future if we just wait now?" The answers
19 to those questions are complex and they depend on many
20 variables, and rather than cite them all, let me give you
21 an example of what I mean.

22 To the question, "What do we get," the variable
23 is, "What do we want?" And I think that what we want
24 is something that people have not been clear in addressing
25 beyond the words and the implications that were created

1 by public opinion and legislative actions and adminis-
2 trative actions since last year.

3 What do we want? It might be price, it might be
4 in-State use in the future, it might be the route that's
5 best for Alaska, it might be a lump sum payment, it
6 might be total future flexibility with regard to this
7 gas for the next three or four years. But in any case,
8 at some point what we want has to be defined rather
9 clearly. In my view it was defined rather clearly at
10 the time we led up to these contracts, and we ought to
11 establish that ground again.

12 To the question, what do we want, my own fear is
13 that one of the things that comes out of the hearings
14 last week is that the answer of too many people is
15 "everything." I just want to make it clear, both as an
16 advisor and a negotiator, I don't think we can expect
17 to get everything, and perhaps we didn't in these contracts.
18 But I don't think we can answer that question by saying,
19 "Everything."

20 Over all, and I want to make this very clear
21 because I believe the hearings narrowed in many cases
22 to an investigation of specific values, pro or con,
23 that were inherent in the contract. Let me make clear
24 what my own feeling as your advisor is on this matter.
25 Over all, what I believe we got in the contracts is a

1 balanced package of terms on key objectives for the State.
2 In my view the objectives are right, the terms are solid,
3 and there exists real risk that such a package cannot
4 come together in the future in exactly this way.
5 That may not mean, in your own mind, that you should do
6 it. But I want you to be clear that my feeling is that
7 that's my conclusion, and it will be difficult to put
8 this kind of package together again in this way.

9 I believe that many of the statements that were
10 made last week missed the balanced nature of these con-
11 tracts, and I believe they missed the present opportunity
12 they represent, and I believe that there was a certain
13 misconception with regard to what we can absolutely rely
14 on to be accomplished in the future.

15 What you get, in other words, is an approach
16 with many facets and many aspects to it, which is avail-
17 able now, and one which provides a whole series of terms
18 giving protections for the State which may or may not be
19 available later, but achieving this combination at a
20 later time, if it does represent desirable alternatives
21 and desirable objectives, may not be a dependable
22 assumption.

23 I do not propose to speak to you in absolute
24 terms as some did last week because I don't think this
25 is an absolute issue. I am going to lay out, however,

1 some of the benefits and risks as I see them, and to
2 give you the opportunity to work with me to try to balance
3 those risks and benefits, to look at these contracts
4 as a unit rather than in looking at them, as we did
5 last week in so many instances, as a series of specific
6 issues, all of which can be considered, I think according
7 to the assumption that we can achieve the same combination
8 again or whether we can't achieve it again.

9 First, in these contracts the State gets a
10 reasonable approach, in my view, to a decision on this
11 entire issue, and it gets it within the formidable
12 constraints of our royalty process. Now, our statute
13 is wise in the public interest, and I've said so before;
14 but it's cumbersome and it's politically charged. It's
15 a one-year cycle or perhaps somewhat less in which the
16 Administration, the Commissioner of Natural Resources
17 and others must either guess or ascertain what the public
18 will and the legislative will is with regard to royalty
19 oil or gas, then must work through the businesslike
20 task of negotiating an entire contract to deal with
21 these issues, and then must go through two levels of
22 review, which can be extremely time consuming, during
23 which time the circumstances that favor or disfavor any
24 deals so made can change.

25 The present contracts, in my opinion, have done

1 very well in this process, and they're based on a
2 reasonably identifiable public and legislative will.
3 In other words, we started with a reasonably good idea
4 of what was desired and we went through at least a very
5 large percentage of the complicated and cumbersome nature
6 of our process in fairly good form, and we're still
7 proceeding in that, in my view. Now, how well this
8 process works in the future is going to have a great
9 deal with how well it works in this instance and how
10 well all of us work with the process, and that has
11 nothing to do with whether the contracts are approved
12 or not. It has to do with the way in which we deal
13 with them.

14 To reject these contracts now, particularly
15 without a good understandable, specific basis of
16 guidance as to where we go next, leaves us with a process
17 which is neither rapid nor flexible, our royalty process,
18 and perhaps without clear direction, and still facing
19 the same problems which we believe were answered very
20 successfully in this contract. So I think that there's
21 an inherent risk in starting over again without clear
22 guidance. If we have the clear guidance and we have
23 the time, then it may well be a different case. But I
24 think that we have an alternative now that it's going
25 to be difficult to duplicate given the nature of the

1 process. I think it's a risk of rejection you should
2 clearly face; that is, very simply, the risk of putting
3 together a deal in this form and of this nature again.

4 Second, in these contracts we did get the best
5 price for royalty gas sold under any reasonably foresee-
6 able circumstances. I say that after listening to
7 testimony last week, hearing your consultants deal with
8 it very thoroughly. Quite frankly, after the strong
9 testimony that your own consultants gave, I'm hopeful
10 that this issue is put largely to rest. If it is not,
11 simply let me say that I believe that it should be,
12 and that the State can say with some certainty that it
13 did get the best price that it can reasonably expect to
14 get under any foreseeable circumstances.

15 For you to reject these contracts on this basis,
16 you must conclude that it is not only technically possible
17 to get a better price later, but that it is probable or
18 even possible that we can better or even equal what is
19 presently available to us.

20 For the record, my advice to you is that it is
21 not a risk worth taking, and it's not a possibility
22 that you can or should rely on, and not something you
23 can assure the people of the State is capable of
24 accomplishment. Remember that under these contracts
25 we tie the price the State gets for its gas to the best

1 price coming from the Prudhoe Bay oil field, oil and
2 gas field, so that if only one buyer gets a terrific
3 deal on his gas we're tied to that price. So we have
4 the benefit of virtually every other good negotiation
5 for gas from that field.

6 Third, there is the issue of in-State use.
7 What we get, again in a balanced package, is a negotiated
8 term in this contract that allows us to sell our gas
9 but not really to sell it, to take back virtually every
10 cubic foot of gas that we can use for Alaska's future.
11 So far as I am aware, this term is without precedent
12 in gas purchase history. The driving force for the term,
13 in my view, is uncertainty; uncertainty about what we will
14 ever use, which allows both the buyer and the seller to
15 make of it what they wish.

16 To reject this contract, you must accept the
17 risk that this total take-back term can be equalled or
18 surpassed later. I do not know how, quite frankly, it
19 can be surpassed. And as your negotiator, I can advise
20 you that I believe there are substantial risks to be
21 acknowledged if you were to act in the belief that such
22 a term can simply be renegotiated equally. I think there
23 are a number of reasons that indicate that it will be
24 quite difficult to establish such a term again.

25 Fourth, there is the protection of the take-back

1 provision itself. What we get, in my view, is the best
2 foreseeable opportunity that Alaska will have to protect
3 its ability to use gas in the State. We not only have
4 negotiated the best possible take-back provision, simply
5 the right to take back all of the gas, but we are able to
6 advance it for Federal approval at probably the most
7 advantageous time foreseeable for doing so..

8 To reject the contract now, I believe that you
9 must accept the risk that Section 13-B will remain
10 unchallenged and on the books and that at some later
11 time you will be not only able to negotiate the same
12 kick-back term, but that we will have the same or better
13 chance to get it approved at the Federal level. My
14 opinion, and again I'm acting in an advisory capacity
15 here, is that our best chance to avoid that risk is
16 by acting now.

17 And fifth, there is just the question of the route
18 itself. On the one hand we had Arlon Tussing, a good
19 friend on whom I've shared many opinions on this issue,
20 who basically indicated that we should fold our tents
21 and wait quietly for the end on the gas line issue.
22 On the other hand, we have the Congressional Delegation
23 and the Governor stating in no uncertain terms, as I
24 see it, that the State does have a definite role in this
25 gas line proceeding and that these contracts are important

1 to the outcome, that the combination of buyers is right,
2 and that the decision should be made as reasonably
3 quickly as possible.

4 For my own part, again giving you the benefit
5 of my feeling about this, I certainly want to come down
6 on the side of saying I think we do have a role in this,
7 and I say it from the perspective of participating
8 both in the Native Land Claims and Trans-Alaska Pipeline
9 decisions in Washington. I think it's simply fallacious
10 to assume the State has no role whatever and that we
11 should simply accept what comes our way. Again, I
12 would reiterate that what I say about the route is totally
13 separate from all the other points about the protections
14 that we may be able to gain from these contracts.

15 To reject these contracts, in my view, you
16 have to be willing to accept the risk that the additional
17 help afforded by the buyers either won't be any help
18 at all or that it won't help enough, and accept the
19 fact that no matter what your individual reasons, your
20 action in rejecting these contracts is going to be
21 perceived broadly as a rejection of the Trans-Alaska
22 route. For my own part, given the fact that the contracts
23 will be void if we lose, given the fact that they are
24 clearly of extreme importance to our Congressional
25 Delegation, given the fact that they will be void if

1 the full take-back scheme is not approved Federally,
2 given the fact that we will be doing all we can to
3 develop the in-State uses which could conceivably mean
4 that we never really sell a cubic foot of gas, that is,
5 get something for nothing; given those facts, I don't
6 think the risk of rejecting the additional assistance
7 makes a great deal of sense.

8 In conclusion, I would say that after a full
9 week of testimony a number of specific points have been
10 raised, but no one has yet suggested a concrete com-
11 prehensive alternative to the kind of advantages that
12 are suggested by these contracts.

13 Now, I'm going to be pleased to answer your
14 questions, but I hope that that additional subjective
15 judgment helps you at least to understand what I think
16 is important about the contracts.

17 Thank you, Mr. Chairman.

18 SENATOR RADER: Senator Huber.

19 SENATOR HUBER: Thank you, Mr. Chairman. Commissioner Martin,
20 would you care to comment on whether the course that we
21 embark upon with these contracts is anywhere as near
22 strong enough to win the route decision, especially in
23 light of Judge Litt's decision? Might not we be relying
24 on too little too late? Might not the contracts' greatest
25 drawbacks be that they stand in the way of an all-out

1 effort, such as that outlined by Jess Barry of Anchorage
2 when he talked to us Friday?

3 COMMISSIONER MARTIN: I'm sorry that I didn't read that
4 statement, but it seems to me that you're going to
5 get the maximum amount of effort that we can expect to
6 see from these contracts as they're presently framed.
7 In my view that would be my position, Senator Huber,
8 and it seems to me that we can always say that we're
9 later than we would like to be. Had not legislative
10 approval been necessary, had it not been as difficult
11 as it was to negotiate what I think are good contracts,
12 we may very well have been able to go earlier. But it
13 seems to me that we have an opportunity to do the right
14 thing now.

15 SENATOR HUBER: You're not familiar with Jess Barry's
16 proposal that he made before us Friday then?

17 COMMISSIONER MARTIN: Is it the proposal to eliminate the
18 flexibility provision in the contract?

19 SENATOR HUBER: No. It's a total proposal to get behind
20 it much harder. He likened it onto the way Alaska got
21 behind the Tennessee Plan to become a State, and he
22 meant getting with El Paso and joining with them, using
23 the State's bonding ability and everything else to help
24 in building the line so that we had something really
25 to sell to the people of the Lower 48, that Alaska is

1 getting in there to get them the energy they need.
2 COMMISSIONER MARTIN: I'd say two things, Senator. I haven't
3 read the proposal in detail. I'd be glad to do it.
4 I think that there will probably be things that we should
5 consider that would be of even more assistance. But if
6 I understand what you're saying, nothing that he proposes
7 in any way conflicts with the value or the benefits of
8 engaging in this contract.

9 SENATOR HUBER: That part may be true. Thank you.

10 SENATOR RADER: Representative Hayes.

11 REP. HAYES: Mr. Martin, on Friday Mr. Moody, who was
12 retained by this group, testified regarding one provision
13 in the contract which has been discussed as being one
14 of the major pluses, and that was the take-back provision.
15 He indicated that the contract was so strong in favor
16 of the State, particularly in that respect, that when the
17 producer/owners get around to financing the project
18 they may very well be faced with the problem, in dealing
19 with the financial institutions, of coming back to the
20 State and asking for some subordination or some relief
21 relating to that particular paragraph of the contract.
22 Have you taken that into consideration, or do you have
23 any opinion on it as far as ---

24 COMMISSIONER MARTIN: I've heard that point, Representative
25 Hayes, and, of course, it came up in negotiations as the

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

B-32

1 buyers attempted to tell us that we may, indeed, be
2 driving too hard a bargain. But it seems to me that
3 that again does not supply a reason to vote against the
4 contract, but only a fact that we may have to acknowledge
5 in the future. My own view is that he over-stated the
6 possibility of that happening. But, in any sense, I
7 think we ought to acknowledge it; but it doesn't give
8 me any pause at all in going ahead with the contracts.

9 REP. HAYES I think he made a statement to deal with
10 the alternative, which would not be entering into any
11 contract, and by not entering into any contract you would
12 not be put into the position of having to commit your
13 royalty gas. But then I think he, on the other hand,
14 said that if the State doesn't have their act together
15 by that time, by the time the pipeline is built, that
16 we may very well lose it anyway, the FPC may take it.
17 Do you agree with that?

18 COMMISSIONER MARTIN: That's the point I guess I was getting
19 at, and I would say this: a number of factors are going
20 to have to develop. Certification is the first of
21 several. Beyond certification, for which financing will
22 be a part, there will actually be the putting together
23 of a package to build whatever pipeline is certificated.
24 I think the State gives up nothing by going with these
25 contracts now that it can't adjust to and have a reasonable

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

opportunity to adjust to at a later time.

REP. HAYES: Thank you.

SENATOR RADER: Representative Gruening.

REP. GRUENING: Commissioner, can we infer from what you've said that the Administration would not take kindly to any suggestions of amendment to this contract? Do you see any -- in other words, let me just say the consultants did suggest some areas where the contracts weren't perfect and there were some areas where we could lose something in terms of price.

COMMISSIONER MARTIN: So far as I'm aware, Mr. Gruening, none of the consultants suggested amendment. They suggested in many cases clarifications which they felt would be useful, and we'll attempt to supply those. Our position on amending the contract is that if it's in the public interest to do so, we're not totally closed to the possibility. The Legislature should be advised that amendments are a rejection of the present contracts. Our procedure doesn't provide for amendments, but merely approval or disapproval by the Legislature. We'll take into consideration the reasons, if they're stated in a unified manner, that a rejection is undertaken and attempt to renegotiate the contract if it seems desirable to do so. At the present time, frankly, we have not yet had pointed out to us in any unified way suggestions for

B-34

1 amendments of the contract which would cause us to believe
2 they ought to be amended. I'm not saying we're closed
3 to it, but I'm saying it has implications for timing
4 and it has implications for future decisions on this
5 which we'll just have to discuss.

6 REP. GRUENING: Have you considered a special bill to allow
7 an expedited procedure for amendment?

8 COMMISSIONER MARTIN: I've given it some thought and I'm
9 not unwilling to discuss it. But as I've said before,
10 the way in which the Legislature deals with these
11 contracts is going to have a great deal to do with what
12 happens in the future in the royalty process. I think
13 you are well familiar with my view, that that's going
14 to have to be done in a way that doesn't create the
15 impression of the Legislature renegotiating the contracts.
16 I think that if you do that you'll simply find that
17 future individuals occupying my office are not going to
18 be willing to put anything on the line in negotiations.

19 REP. GRUENING: I'd like to call your attention to the
20 statutory provisions I think that govern you and the
21 Royalty Board, and I don't know if you were here but
22 you probably had an observer when Red Boucher made his
23 comments on a finding of surplus and immediate, domestic--
24 along with domestic and industrial needs for the royalty
25 gas. He stated that he was aware of no study that had been

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

submitted in accordance with the statute; in other words, a report showing an immediate and long-range domestic and industrial needs of the State for royalty gas. Is that a correct assessment, or what reports or report have been submitted in accordance with the statute?

COMMISSIONER MARTIN: There are really two answers to that question. First, I don't believe it's a correct statement. Two items have been submitted to the Legislature to fulfill that requirement. The first is this analysis, which is included in all the legislative packets. I understood that it got left out of a few, but eighty came over to the Legislature. The second was, this document here, which wasn't in all the packets but which was given to the Chairmen, at least to Senator Rader, which is the background document for this. And this document, Mr. Chairman, is a lengthy bibliography which indicates the nature of all backup information dealing with surplus gas.

Now, these things do exactly what the statute demands, and that is to analyze the present and future demands for surplus royalty gas. I'll go one step further than that. The Legislature has a question before it. I think we could spend a good deal of time deciding whether or not this is exactly what you had in mind for your report. In my mind it's unquestionable that this

B-36

1 deals with what we have, what the future may bring, and
2 what kind of surplus we have. So it's a technical decision
3 for the Legislature, which gives you every ability to
4 deal with the issue of future surplus. I should also
5 say that the Legislature received a copy of the Royalty
6 Board minutes and the indications of the Royalty Board's
7 consideration of this in which this was also well
8 discussed, and all of these documents referenced.

9 But as a further point, let me just say that
10 that point as a technical objection is exactly the kind
11 of thing that the Legislature should avoid to use as
12 an escape hatch for this kind of decision. The plain
13 and simple fact of the matter is that these contracts
14 take care of the surplus provision by definition.
15 There is no question that the future uses of royalty
16 gas in these contracts are protected by the terms of
17 the contract itself. Any future use -- and those future
18 uses are unknown -- is protected by the terms of the
19 contract. So that the analysis itself, while it's
20 interesting and fulfills the terms of the statutes,
21 is really not necessary to appreciate the fact that
22 we don't sell any future gas that's not surplus.

23 REP. GRUENING: Mr. Martin, I don't think it was the intention
24 of that question or any of the Legislators here in
25 raising that, to find an escape. I think we're looking

1 to see whether you and the Board have complied with the
2 law.

3 COMMISSIONER MARTIN: I understand.

4 REP. GRUENING: We have to examine, you know, it's our role
5 to examine that.

6 COMMISSIONER MARTIN: I understand, and I wasn't suggesting
7 that. I'm saying that -- I wasn't suggesting that motive.
8 I was suggesting that I think that it's not an appropriate
9 one, either in terms of being fulfilled or in reading
10 the contract fairly. I might say that I've asked Mr.
11 Boness, as well, to look at the material that was
12 submitted and to consider whether or not he thinks it's
13 reasonable in terms of fulfilling the law, that the
14 procedure might not have been fulfilled, and I'd ask
15 him to talk to that.

16 REP. GRUENING: No, let me just mention, you stated that
17 the take-back provisions in the contract -- the inference
18 was that that made the subject irrelevant as far as
19 surplus ---

20 COMMISSIONER MARTIN: No, I didn't say irrelevant.

21 REP. GRUENING: The inference was that the take-back pro-
22 visions had something to do with the compliance with
23 the statute, and it's just my reading that whether or
24 not there are take-back provisions in the contract
25 wouldn't have any effect on whether we find, in fact,

1 that you complied with the need to find a surplus.
2 COMMISSIONER MARTIN: I'm in agreement with you on that.
3 I didn't mean to suggest that they avoid the need for
4 fulfilling the requirement. I don't think they do.
5 But I think, to a large extent, the relationship between
6 those two ought to be understood in terms of the
7 objective of the statute, which is to protect us from
8 contracting away anything that is not surplus.

9 REP. GRUENING: These two reports, these are the documents
10 in which you place your reliance for compliance with
11 the statute?

12 COMMISSIONER MARTIN: That's right.

13 MR. BONESS: Representative Gruening ---

14 SENATOR CROFT: Could I ask?

15 SENATOR RADER: Senator Croft.

16 SENATOR CROFT: That particular statute, 38.05.184(d), that's
17 what we're referring to; right?

18 It says, "The Commissioner shall make public, in
19 writing, the specific findings and reasons on which his
20 determination is based and shall, within 10 days of the
21 convening of a regular session ..." -- I must have missed
22 that in my copy. Did you, yourself, Commissioner, make
23 specific findings?

24 MR. BONESS: Senator Croft, that refers to specific findings
25 in writing, I believe, for waiving of the competitive

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

bid provision; is that not correct?

SENATOR CROFT: That's not correct. "...within 10 days of the convening of a regular session of the legislature, submit a report showing the immediate and long-range domestic and industrial needs of the state for oil and gas and an analysis of how these needs are to be met."

MR. BONESS: That's right, that's the statute.

SENATOR CROFT: My question is, where are the specific findings by the Commissioner?

MR. BONESS: These documents.

SENATOR CROFT: I thought those were done by the staff.

COMMISSIONER MARTIN: They were submitted as a part of the information submitted from my office to the Legislature, and by the Governor.

MR. BONESS: Senator Croft, you're not suggesting that the Commissioner, himself, personally has to perform the economic analysis, are you?

SENATOR CROFT: Yes. It seems to me that the Supreme Court in the Kachemak Bay decision would probably read that statute the same way.

MR. BONESS: Well, I would not recommend that. If you look at the ---

SENATOR CROFT: That was the argument the State was making in the Kachemak Bay case, wasn't it, that the Director of the Division of Lands didn't actually have to do it?

1 MR. BONESS: Senator, I'd prefer not to debate that point.
2 I would point out that almost all of the statutes dealing
3 with the responsibilities of the Department of Natural
4 Resources refer only to two persons, the Commissioner
5 of Natural Resources and the Director of the Division
6 of Lands. As a legal matter, I would not render an
7 opinion that said that those two individuals had to
8 perform all of the tasks now being performed by however
9 many people are employed in that agency.

10 SENATOR CROFT: But isn't that the question we're talking
11 about with regard to whether 38.05.184(d) has been
12 complied with?

13 MR. BONESS: Yes, it is, and I believe these documents do
14 comply with that.

15 SENATOR CROFT: Then you are rendering a legal opinion that
16 that statute has been complied with?

17 MR. BONESS: That's right.

18 SENATOR RADER: Any further questions?

19 SENATOR CROFT: I had some additional questions. Commissioner,
20 with regard to your statement that, "We have gotten the
21 best price we could reasonably expect to get under the
22 circumstances," one of the things that Mr. Moody said
23 was that we are conceding by these contracts that the
24 State sale price is limited to the amount which the
25 Commission will permit the buyers to retain in their

1 jurisdictional rates. Do you mean by saying that we've
2 got the best price reasonably possible that we had no
3 chance of making the argument before the FPC and won't
4 be able to make the argument successfully before the FPC
5 that we are not a person within the meaning of the
6 Natural Gas Act?

7 MR. BONESS: No, Senator, it does not mean that at all.

8 SENATOR CROFT: Are we going to concede the point before
9 the FPC that we are a person?

10 MR. BONESS: No, we are not. We definitely are not going
11 to concede that point.

12 SENATOR CROFT: Do you think we have a reasonable chance
13 of prevailing on that?

14 MR. BONESS: Yes, I do.

15 SENATOR CROFT: And if we do prevail on that point then our
16 rates are not limited by the FPC?

17 MR. BONESS: No, I can't agree with that.

18 SENATOR CROFT: Isn't that what Mr. Moody said?

19 MR. BONESS: No. Let me tell you what I believe Mr. Moody
20 had in mind. Mr. Moody and Mr. Swanson both addressed
21 the question to the effect that the State might argue
22 in the rate setting proceeding which will occur sometime
23 in the future before the Federal Power Commission, that
24 the State might have a special argument to the effect
25

1 that royalty gas should receive a higher price than
2 working interest gas because the State is a state, and
3 the money received by the State will go to public
4 purposes. I'm afraid I don't recall what Mr. Swanson
5 and Mr. Moody's assessment of that is. I believe their
6 assessment was that that's pretty unlikely, although
7 I'm afraid I don't know whether they told the committee
8 that or I just recollect that from conversations with
9 them. But I am willing to state that it's my opinion
10 that that outcome is extremely unlikely, and there are
11 two reasons for it. First of all, in effect, what you're
12 doing is, you're saying that the working interest owners
13 have put money in at risk and have incurred certain
14 costs, they should receive a price less than the State,
15 where the State hasn't incurred any costs, hasn't put
16 any money at risk in terms of the development or
17 exploration of the field, and yet should receive a
18 higher price simply because it's going to put its money
19 to a public purpose presumably, and the oil companies
20 are not.

21 Furthermore, when you analyze that through, what
22 you're really saying is the purchasers of gas are going
23 to be paying a higher price for that gas which is sold
24 by the State of Alaska. I think when you carry that
25 argument through, what you're really saying is consumers

1 in New York and in the East are transferring money to
2 the treasury of the State of Alaska, and I think when
3 the argument is cast in those terms it's unlikely to be
4 persuasive at the Federal Power Commission. There is
5 no obligation on the Federal Power Commission to so find
6 that State owned royalty gas should receive a higher
7 price, and I just personally do not believe that there
8 are many compelling arguments that can be made to cause
9 the FPC to associate a higher price with respect to
10 State royalty gas than other gas.

11 SENATOR CROFT: I had thought that the position of the State,
12 Mr. Chairman, was that sales of royalty gas are not to
13 be regulated by the Federal Power Commission.

14 MR. BONESS: That's right.

15 SENATOR CROFT: And that was what Mr. Moody was also suggesting.

16 MR. BONESS: That's right.

17 SENATOR CROFT: And if they're not regulated, then a price
18 higher than what they allow could be obtained?

19 MR. BONESS: Only if you can find somebody to pay it.

20 SENATOR CROFT: That's correct, and what you're saying is
21 you think that there may well be -- we may well win
22 with regard to this point before the Federal Power
23 Commission if we don't execute these contracts, but
24 that we can't find anybody to pay the higher price?

25 MR. BONESS: I think that's a part of the problem.

1 SENATOR CROFT: And who did we negotiate with to determine
2 if they would pay a higher price?

3 COMMISSIONER MARTIN: We didn't negotiate with anybody,
4 Senator Croft, but we've solicited nation-wide two times
5 to attempt to find buyers who would come and negotiate
6 with us on those or any other terms to provide for in-State
7 use or for other purchases of our gas, and we haven't
8 found people who will do it. So the answer is, we didn't
9 negotiate with anybody, but we didn't find anybody to
10 negotiate with.

11 MR. BONESS: I would go beyond that, Senator. We still
12 confront another legal problem, and Mr. Moody did concur
13 on this, and that is the problem of sales to people
14 who are not regulated by the Federal Power Commission
15 and whom you seem to be suggesting might be willing to
16 pay a higher price.

17 SENATOR CROFT: No, no. What I'm talking about is because
18 this sale is not regulated. That's the State's position,
19 isn't it?

20 MR. BONESS: That's correct.

21 SENATOR CROFT: Do you agree with Mr. Moody that we are now
22 conceding that the FPC does regulate the price?

23 MR. BONESS: No, I certainly do not. In fact, Mr. Byrd
24 pointed out that the contracts were drafted to make sure
25 that there was no argument available to the Federal

1 Power Commission that the State was placing itself in
2 a position identical to that of the producer. We tie
3 ourselves to the price the pipeline companies are allowed
4 to include in their jurisdictional rate base. We do
5 not, although as a matter of convenience it's easy to
6 think of us as tying ourselves to the producers, and
7 indeed in many ways we do, as a legal matter I believe
8 we protected ourselves from an argument that these
9 contracts constitute an admission that we're subject
10 to the Federal Power Commission's jurisdiction because
11 of the way it's drafted.

12 SENATOR CROFT: So that you disagree with his statement
13 that we are conceding the point of FPC regulation?

14 MR. BONESS: Senator, I never understood Mr. Moody to say
15 that we were conceding we were subject to jurisdiction.
16 I understood him to say that we would find ourselves
17 being indirectly regulated by the Federal Power Com-
18 mission with respect to price. I agree with that, I
19 believe it's inescapable for us. But if you're talking
20 about a technical, legal matter, I do not believe
21 we have conceded it.

22 SENATOR CROFT: We've conceded that the only price that
23 these buyers can pay is what can be built into their
24 rate base?

25 MR. BONESS: That's correct.

1 SENATOR CROFT: And so that we have, in effect, given any
2 authority that we have to try and determine a rate.

3 MR. BONESS: That's correct.

4 SENATOR CROFT: And you'd agree with his point on that?

5 MR. BONESS: Yes, I do.

6 SENATOR CROFT: That whatever authority we had to try and get
7 the highest rate with regard to future sales is given
8 up and our sole rate determination is based upon what
9 third parties agree to?

10 MR. BONESS: The rate will be determined by outside parties,
11 yes.

12 SENATOR CROFT: Do you also agree with his point that there
13 is no price at this time and that if the status quo
14 remains that you will have to go back and renegotiate
15 these contracts in order to get a price?

16 MR. BONESS: No. If the status quo remains, there will be
17 no gas produced in Prudhoe Bay. The producers haven't
18 entered into contracts.

19 SENATOR CROFT: If the status quo with regard to no deregula-
20 tion, his point in item number three ---

21 MR. BONESS: If gas continues to be regulated the price that
22 Prudhoe Bay gas may be sold in interstate commerce for
23 resale will be set by the Federal Power Commission. It
24 will not be necessary to renegotiate the contracts. We
25 will accept the price that the pipeline companies are

1 allowed to include in their jurisdictional rate base.
2 That price will be determined by the Federal Power
3 Commission. I believe what Mr. Moody said was the
4 State ought to be prepared to participate in that rate
5 setting proceeding.

6 SENATOR CROFT: Maybe I'm missing something. What I'm
7 referring to, so there is no question, if I could,
8 Mr. Chairman, is on his page seven of his report,
9 Item Number Three.

10 MR. BONESS: Neither Section 6.3 nor 6.4 yields a present
11 price for their conditions precedent deregulation has
12 not occurred. Now, it's your suggestion that deregulation
13 does occur.

14 SENATOR CROFT: No, I'm saying if it doesn't. Isn't that
15 what he says, "I am at a loss, therefore, to advise
16 the committee on the sale price which will be applicable
17 at the time of first delivery."

18 MR. BONESS: If the status quo prevails.

19 SENATOR CROFT: Which means no deregulation, I assume?

20 MR. BONESS: All right, and the reason he's at a loss is
21 because -- it relates to the first sentence in that
22 paragraph, which says, "At this time the State cannot
23 determine its sale price because no rates have been set
24 for Alaska gas at this time." That's why he's at a loss
25 to tell you whether you're going to get Twenty Cents

1 or Two Dollars an mcf, because that rate making proceeding
2 has not occurred yet. It will occur before gas flows.

3 SENATOR CROFT: Then what does he mean by, " if the status
4 quo prevails through the time of first delivery"?

5 MR. BONESS: Meaning if no rate making hearing occurs before
6 the time of first delivery there will be no rate established.

7 I believe Mr. Moody went at some length to indicate
8 how the various ways of rate making proceeding could
9 come up. As you recall, he indicated there were a number
10 of ways. The FPC could adopt a rule making proceeding
11 and just decide to establish an Alaska rate as it did
12 for the National rate. The producers could enter into
13 contracts and file those contracts with the Federal
14 Power Commission, and a rate could be established that
15 way. And the third way a rate could be established is,
16 gas would start to flow and the pipeline company would
17 file a tariff, and the purchasers, or the producers'
18 gas would file tariffs for sales of it, and the FPC
19 would then investigate those tariffs and decide whether
20 it is. One of those three ways of rate making will
21 come about. It is most likely that will occur before
22 the gas begins to flow. It's conceivable it will not.

23 SENATOR CROFT: And that's what he's referring to?

24 MR. BONESS: That's right.

25 SENATOR CROFT: When he says the status quo?

1 MR. BONESS: That's right.
2 SENATOR CROFT: And if it doesn't occur, if none of those
3 three things occur, then there will have to be an addendum
4 to the contracts or modification
5 MR. BONESS: There will have to be a rate established at that
6 time, yes.
7 SENATOR CROFT: So as I understand it, with regard to
8 point three, you agree that there is no price in these
9 contracts but you think that by the time the gas is
10 produced there likely will be.
11 MR. BONESS: That's correct.
12 SENATOR RADER: Let me ask a question here. As I understood
13 it -- I think maybe you've answered the question and
14 maybe you haven't, I don't know. These contracts, as
15 I understand it, do not for a moment admit that the
16 State is under the regulation or jurisdiction for purposes
17 of sale of our gas, but what it does recognize is the
18 purchasers are under regulation, because it has to go
19 in a pipeline which is under regulation and that,
20 therefore, we indirectly, because our purchasers are
21 under regulation, that the price that we can get on an
22 interstate commerce carrier here will be regulated because
23 the purchaser is regulated; not because we're regulated;
24 is that correct?
25 MR. BONESS: Yes, it is.

1 SENATOR RADER: There is no way to avoid that for any gas
2 that goes into interstate commerce, is there?

3 MR. BONESS: Any gas that goes into interstate commerce for
4 resale would be the problem with respect to the provisions
5 we're now talking about, the regulation of natural gas
6 companies. Even if we made a sale of gas into interstate
7 commerce which was not for resale, the problem would
8 still exist because of the Federal Power Commission's
9 jurisdiction over the transportation aspects of the
10 pipeline. They could, in effect, veto a sale of gas
11 over which they did not have any direct jurisdiction
12 by vetoing transportation authority, and they have done
13 that in many cases. In fact, I was advised over the
14 weekend that last week the Federal Power Commission, with
15 respect to emergency sales in Tennessee Natural, which is
16 not related in any way to the pipeline we're selling gas
17 to, but in that proceeding they have a special procedure
18 called emergency sales which allows gas to be sold for
19 sixty days in an essentially unregulated fashion. The FPC
20 routinely grants certificates. Nevertheless, Tennessee
21 Natural negotiated a contract for Two Dollars and Seventy-
22 Five Cents per mcf, which the FPC felt was too high and
23 denied that certificate. They can apply the same kind
24 of approach to the State. If we were to negotiate a
25 contract for the sale of gas, for example, for boiler

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

B-51

AGO 546460

1 fuel, which would be a direct use and the FPC wouldn't
2 have jurisdiction over that sale, even assuming we were
3 a person, they could veto and probably would veto the
4 transportation aspects of that arrangement.

5 SENATOR RADER: Senator Croft.

6 SENATOR CROFT: I had a couple more. With regard, Commissioner
7 Martin, to these people that you had asked to bid, as I
8 understand it, competitive bidding and public bidding,
9 you asked for competitive bids?

10 COMMISSIONER MARTIN: No, sir. We went though, two times,
11 by national publication to express interest in having
12 buyers for Alaska royalty oil or gas. In each case we
13 indicated we wanted to have all expressions of interest
14 but that we favored expressions of interest which leaned
15 toward in-State use. I've expressed to this committee
16 and others before that, at least at this time, not a
17 great deal of interest has been expressed. I've given
18 the committee my findings with respect to competitive
19 sales in this situation and I've told them my view that
20 competitive sales are going to be difficult, even though
21 they're desirable, so long as we have fixed stated
22 objectives, and some people would be better than others
23 at fulfilling them.

24 SENATOR CROFT: Is competitive bidding, in your mind, the
25 same as public bidding?

1 COMMISSIONER MARTIN: No, I think that you could make
2 distinctions between the two.

3 SENATOR CROFT: I don't want to be overly technical, but I
4 noticed that the approval of the request of Commissioner
5 of Natural Resources to waive requirements of competitive
6 bidding, that it actually says that, "Now, therefor, the
7 Alaska Royalty Oil and Gas Development Advisory Board
8 hereby grants to the Commissioner of Natural Resources
9 its approval of his request to waive public bidding."
10 What's actually meant was competitive bidding?

11 COMMISSIONER MARTIN: I would think so in that context, yes.

12 SENATOR CROFT: I assume, Mr. Boness, you'd say legally
13 that there is no problem with that?

14 MR. BONESS: Senator, I haven't been involved in the drafting
15 of those. I apologize for the error, but I assure you
16 that it was not my intent and, I suspect, the intent
17 of the Royalty Board to draw any distinction between
18 public and competitive bidding.

19 SENATOR CROFT: But there is a difference between the two?

20 COMMISSIONER MARTIN: There could be in some context; I don't
21 think there is one intended there.

22 SENATOR CROFT: One final question, if I could. Commissioner
23 Martin, before the Royalty Gas Advisory Board, I think
24 you made some apologies to the Governor and said that
25 what you had thought we had done here was harness a team

1 of powerful horses to plow a very rocky field. I'm
2 curious with regard to, say, the Tenneco provision,
3 or the switching provision and Tenneco, who said basically
4 that they didn't think they would be able to switch;
5 do you really believe that with that switching provision
6 you're going to be able to take all of these powerful
7 horses with you if you decide to go in some other
8 direction?

9 COMMISSIONER MARTIN: I've always regretted that statement,
10 right from the time I wrote it, Senator. First of all,
11 we don't intend to switch. I've said that on many
12 occasions.

13 Secondly, it seems to me the situation that
14 would have to exist at the time any switch were desirable
15 would be really quite an extraordinary one. But my
16 point has been continually that I think that it's an
17 important benefit for the State to preserve, simply
18 because of the kind of flexibility that's afforded may
19 turn out to be in our interest at a later time.

20 For political purposes, I think it would clearly
21 be a greater expression of political faith for the
22 Governor, for the Legislature or for others to say,
23 "We're going all or none for one route." Quite frankly,
24 that's the position I take. I think that's where we are
25 going. But it does seem to me that it is at least

1 possible in the future that circumstances could change
2 and that El Paso could be shown to be and concluded to
3 be, by all the important decision-makers in this State,
4 a loser in the process, and it could be at that time
5 that Alcan, which is a second choice, far superior to
6 Arctic, could be at some future time our only remaining
7 alternative. If that situation existed it would not
8 be any lack of credibility that would confront us, because
9 our first choice would simply be out of the field and
10 we would not be saying that it's a worse possibility;
11 we'd simply be saying that that is no longer a possibility
12 and then we could switch the support.

13 SENATOR CROFT: I understand that that wouldn't cause you
14 a credibility problem, but Tenneco said it would cause
15 them a problem. My question is, do you believe that if
16 you switched you'd take Tenneco and El Paso with you?

17 COMMISSIONER MARTIN: My belief is yes, and I haven't read
18 the transcript of their response. But I recall talking
19 at length with our buyers on this issue really to ascertain
20 their level of commitment to the route that the State
21 favored. My feeling was that the buyers that we
22 eventually sold to do have a deep commitment to the El Paso
23 route. I never have heard them address the question
24 that you just said and the context I just did, "What if
25 it were only a choice between Alcan and Arctic, and

1 could you then with credibility switch and support
2 another route?" I would think that their answer would
3 be pretty much the same as mine, and that is, "If those
4 are your two alternatives, yes." You could make a
5 credible argument as between the two alternatives, so
6 I don't even agree with their assessment and I don't
7 think they answered in that context. I may be wrong.

8 SENATOR CROFT: Well, I guess the hearings will show whether
9 they did or not. Let me ask one final question in that
10 regard, with regard to this team of powerful horses,
11 and if it makes you uncomfortable I don't want to belabor
12 it, but I am curious as to exactly why you feel that
13 way with regard to El Paso. I mean, it seems to me,
14 and as Professor Tussing pointed out, that El Paso's
15 primary sales area is California, and yet one of the
16 areas of the country where most resistance to the El Paso
17 project exists, if not the area in which the greatest
18 opposition exists is in the primary market area of one
19 of the three companies with whom you contracted; how
20 can you really say El Paso brings to these contracts a
21 tremendous ability when their track record of two years,
22 more than two years now in California indicates just the
23 opposite?

24 COMMISSIONER MARTIN: Well, I think I tried to address this
25 question with you before, Senator Croft. I'll say two

1 things. One is, that's a subjective judgment I think
2 a number of people are going to have to make on their
3 own. In trying to assess that I've tried to do what I
4 have with the others, and that is to get the broadest
5 consensus as to which companies can help. Our Delegation
6 is unanimous in feeling, to the contrary of what you've
7 just suggested, that El Paso can be of help and should
8 get gas under this contract, and that it will help.

9 It seems to me that in spite of whatever dif-
10 ficulties exist in California, their argument is enhanced
11 by sale of the gas because they then can say that
12 they will not only win the route but will have a gas
13 supply to bring to their constituency, and that's the
14 difference. The difference is that they are put in a
15 position of being able to give gas to their consumers
16 as opposed to simply having a pipeline certificated in
17 their name but with no gas to go through it to their
18 consumers, and that, I suppose, is a very important
19 difference.

20 SENATOR RADER: Representative Parr:

21 REP. PARR: One final question, Mr. Chairman. Mr. Martin,
22 in talking about what went on last week there's one point
23 you went over in kind of a hurry and yet to me it is
24 one of the rather difficult points. The reason that
25 we're talking about going into contracts at this time is

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

very simple; we want to get some political clout,
national constituency, call it what you will, right, to
help us get the Trans-Alaska route ---

COMMISSIONER MARTIN: Mr. Parr ---

REP. PARR: Let me finish my question.

COMMISSIONER MARTIN: I'm sorry. You asked me "right" and
I thought that was the question.

REP. PARR: I'm sorry, I'm leading up to it; beg your pardon.
That was the reason that we were going into these contracts
at all, as I understood it. So we thought, "Well, now,
what kind of assistance are these companies going to
give us?" The contract, I think, just says actively
support; without looking back at it, that's my recollection
of what it says. And we tried to get that made a little
more specific, and we never got it last week. At least
I never heard it. In fact, I think I phrased the question
to the gentleman from Tenneco who had told us they had
Seven Billion Dollars in assets and did a Five Hundred
Million Dollar business. You know, I couldn't quite
believe they weren't going to budget something for this
effort. They weren't, or at least they haven't.

So would you mind commenting on that whole area, please?

COMMISSIONER MARTIN: Yes, Mr. Parr. I wish I could somehow
communicate to you, in spite of your characterization
of the issue, make it clear that my feeling is that that's

1 not the only reason. I tried very hard in my opening
2 statement to lay out a number of areas that I thought
3 were of equal importance in these contracts. So I'm
4 going to lay it on you squarely, that in rejecting these
5 contracts, should you choose to do so -- I want you to
6 know that my view is that regardless of your own character-
7 ization, my feeling is that you would not just be
8 rejecting whatever political clout you choose to assign
9 to these contracts, but one of the best opportunities
10 we have to accomplish all of the other objectives I
11 laid out. Now, in terms of the political issue itself,
12 which is one of many, let me say again, I don't think
13 that you are going to get a quantifiable idea of what
14 these companies will do.

15 Let me try to give you an idea of what I think
16 will happen. First, they've already intervened in the
17 FPC, as I discussed with Senator Croft. I don't think
18 they were the difference, pro or con, in that fight.

19 Secondly, I think each of them will mount
20 substantial efforts in support of the Trans-Alaska
21 pipeline in Congress. Those efforts will consist of
22 the retention of lobbyists, assignment of company
23 personnel, and the development of information within
24 their companies in support of that route, information
25 which, quite frankly, would be very difficult to produce

1 in the volumes and to disseminate in the way that would
2 be useful, without additional parties in the fight.
3 In addition to that I expect that they'll do substantial
4 work in their constituent areas to attempt to indicate
5 to people the benefits of the Trans-Alaska line as a
6 way to bring gas into their areas and will try to
7 mobilize those people at a local level to deal with
8 their Congressmen and Senators on the issue.

9 I also think that they'll participate with
10 El Paso as the design, and the details of any El Paso
11 route through Alaska that are put together. Both Tenneco
12 and Southern have substantial offshore capability and
13 substantial LNG experience. In my view, and I think in
14 the view of others, they have an opportunity to sub-
15 stantially and materially improve the quality of the
16 overall project once it's funded and to prove to Members
17 of Congress and the Administration that they're capable
18 of doing so as it's developed.

19 One of the problems with El Paso that's been
20 pointed out in the past has been that El Paso has not done
21 as well or as complete a job in its homework in terms of
22 design in proposing this route as they could have. I
23 think that both Tenneco and Southern have the capability
24 to substantially improve that.

25 I think that generally categorizes the sorts of

1 things that they're expected to do. My guess is that
2 overall the expenditures, while I can't give you a
3 budget figure either, will be in the over Hundred
4 Thousand Dollar category, and I also believe, it's my
5 personal belief -- and I also believe that this view
6 can only be made subjectively. In trying to deal with
7 my own subjective judgment, I feel compelled not to
8 try to rely on an individual judgment, but to check
9 it with others.

10 I've consulted with the Congressional Delegation
11 from beginning to end on this and they share, generally
12 speaking, the advantages that I outlined. But I don't
13 think that even the Congressional Delegation will be
14 able to give you a dollar for dollar quantification
15 of what will happen. They only know that it's very
16 valuable.

17 REP. PARR: Mr. Chairman.

18 SENATOR RADER: I'm quite certain that we're not going
19 to be able to conclude with the witnesses here. It's
20 12:00 o'clock now. The Senate goes in at 2:00 o'clock
21 and we should be through at 3:00 o'clock. I know that
22 Representative Chatterton has a series of questions that
23 he wants answered, and I think there's still a number
24 of unanswered questions that other members want to
25 depose. It would be my suggestion that we recess until

1 3:00 o'clock. I don't think there's any point in
2 coming back here at 1:30 for twenty minutes to try to
3 put anything together between 1:30 and the time the
4 Senate goes into session, although I think that we
5 could have a good two-hour shot at it between 3:00 and
6 5:00, or if we want to go we can go beyond that.

7 Does that sound appropriate to the committee?

8 Now, unless I'm interrupting you right in the
9 middle of a series of questions.

10 REP. PARR: No, a very short thing, Mr. Chairman, since I
11 won't be able to be back at 3:00. I've cancelled
12 committee meetings all last week for this and I can't
13 keep on doing it. I'd like to ask one very brief one.

14 SENATOR RADER: Go ahead.

15 REP. PARR: The first thing I'd like to say is to summarize
16 what Mr. Martin just said as I understand it, and I
17 guess this is where we have subjective judgment
18 disagreeing. First, I do think that perhaps my charac-
19 terization is accurate. If it weren't for the chance
20 to get a political clout we would be in no hurry to
21 enter into any contracts, number one.

22 Secondly, that what Mr. Martin has just said,
23 and if you listened to it carefully, he kept saying,
24 "I think," "I believe," and "the Congressional Delegation
25 believes," and he admitted, he said at the end -- not

1 admitted, he said at the end, "This is a subjective
2 judgment." So what we're really face down to is, are
3 we willing to subjectively have faith in these companies
4 to really make a significant effort. They have been
5 unwilling to quantify in any way the number of people
6 they will assign, the number of dollars they will spend,
7 or anything else at all. So we simply either have to
8 have faith in them or not.

9 I'm sorry, Mr. Chairman, to take so long but
10 that's the end of my statement, and I won't be here
11 this afternoon.

12 SENATOR RADER: Do we have any further questions that cannot
13 wait until 3:00 o'clock? We will stand in recess
14 until 3:00 o'clock.

15 (Whereupon the hearing recessed at 12:05 p.m.
16 and reconvened at 3:00 p.m.)

17 SENATOR RADER: The joint hearing will come to order. We
18 have clean copies of two documents which should be made
19 exhibits. The first would be the Federal Power Commission
20 News Release No. 22868. It will be Exhibit 28.

21 (Whereupon Exhibit 28 was duly marked.)

22 SENATOR RADER: That one is entitled "FPC Judge Recommends
23 Approval of Arctic Gas' \$8.5 Billion Alaskan Gas Project."
24 It consists of eleven pages. And Exhibit 29 will be
25 Federal Power Commission News Release No. 22869, entitled

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

"Alaskan Natural Gas Fact Sheet," consisting of four numbered pages and three unnumbered attachments. Give those to the reporter.

(Whereupon Exhibit 29 was duly marked.)

SENATOR RADER: Exhibit No. 30 is a letter from Ruth A. M. Schmidt, Ph.D. of Anchorage, Alaska, dated January 30, 1977, consisting of two pages, addressed to the House Special Committee on Royalty Gas Sale, Attention Representative Clark Gruening. That will be introduced then as Exhibit 30.

(Whereupon Exhibit 30 was duly marked.)

SENATOR RADER: Did you want this read or just introduced as an exhibit?

REP. GRUENING: Introduced as an exhibit. Why don't we make copies for everybody?

SENATOR RADER: Besides, I hate to keep our witnesses longer. Senator Poland, why don't you join us up here? It would be more convenient, I think, for participation, and if Colletta or Senator Butrovich come we can make some other arrangements.

SENATOR CROFT: Mr. Chairman, I might indicate that at 3:30 I'm going to have to go to a Judiciary Committee meeting. When that's over I'll return here.

SENATOR RADER: Fine. Under those circumstances, Senator Croft, do you have any particular further questions of

1 these witnesses?

2 SENATOR CROFT: I do, but I think Mr. Chatterton and Mr.
3 Hayes do.

4 REP. CHATTERTON: I'll yield to you.

5 SENATOR CROFT: Let me ask, in light of the fact, Mr.

6 Chairman, that we've now been furnished pages two and
7 three of the Power Commission news release that summarized
8 in ten pages Judge Litt's decision in that regard, (or
9 eleven pages) and the two and three that we had were a
10 part of another press release of the same date from the
11 Federal Power Commission, and the two and three that we
12 now have have some information that refer to prices,
13 which is what my questions were about, Commissioner
14 Martin and Mr. Boness. On page two there's some
15 obviously different language. Instead of describing
16 the El Paso and the Alcan projects he talked about
17 rolled in prices and city gate. But on page three in the
18 next to the last full paragraph of that page and in
19 the last full paragraph, he makes two comments.

20 In the middle of the next to the last full
21 paragraph he says, "The important missing ingredient was
22 sales contracts by any of the thirteen producers who hold
23 interest in Prudhoe Bay reserves." Then at the last of
24 the last full paragraph he says, "The producers, like
25 G. B. Shaw's dinnertime companion, have a price at which

1 they would sell their 'service,' and all their protes-
2 tations to the contrary cannot hide that they are mainly
3 dickering over price. Then on page ten, it seemed to me,
4 he made another reference to the fact that the producers'
5 failure to sign sales contracts indicates where their
6 concern lies.

7 I understand your feeling that the State got
8 the best possible price under the circumstances, but isn't
9 that a pretty clear indication that Judge Litt believes
10 that it's the producers' opinion that if they wait
11 until a later date that they can get the highest price,
12 and his feeling that the reason they are waiting is solely
13 to get a higher price?

14 COMMISSIONER MARTIN: Yes, sir, we think they're dickering
15 with the FPC over price. Let me put that in some perspec-
16 tive in terms of what that means to us. They definitely
17 are trying to deal with the FPC and to maximize their
18 advantage. But let me point out that it may or may not
19 be the case at a later time that they get a better price.
20 For instance, it may be they don't or, on the other hand,
21 it may be that some get a very good price under a
22 deregulated situation and others get a worse price.
23 But whatever that price is, under the contracts we have
24 we're going to get the benefit of the best deal that
25 anybody makes. So we basically tied ourselves to the

1 very best that anyone can do.

2 The second factor is simply to, I think, look
3 just very briefly at the fact that the significance that
4 he attaches to it beyond that is simply not to regard it
5 as an important influence on the decision, but simply
6 his irritation in not having information in regard to
7 who the buyers will be for financing purposes. So I
8 think that the State still stands in a better situation
9 by having sold and created some kind of an incentive
10 in favor of the route we support, as opposed to these
11 guys who, you know, are going to sell -- just like
12 Columbia -- to people who believe that they'll get the
13 gas whichever way the pipeline goes. Let me ask
14 Mr. Boness to respond a little further.

15 MR. BONESS: Yes. There's a basic difference between the
16 producers and the State that has to be faced up to, and
17 that is, the producers get to decide whether the gas is
18 ever produced or not. The State does not find itself
19 in that position.

20 The producers are telling the Federal Power
21 Commission, "If you don't set a high enough price for us
22 we're not going to sell the gas, we're never going to
23 commit it to the interstate market; we're not going to
24 produce it; we'll continue to reinject it as long as
25 we're allowed to do so." And in that context, they are

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

dickering with the FPC.

As you recall, both Rush Moody and Dr. Swanson indicated that the range of the price that could be set for this gas is very wide. That gas could be set as low as Twenty Cents because of the problems associated with establishing gas prices for a reservoir which has both oil and gas in it, or it could be as high as the national price, which is now a Dollar Forty-Two, and conceivably it could be higher. That's the dickering that's going on between the Federal Power Commission and the producers. But the State does not participate in that threshold decision with respect to whether the gas is produced, except for the conservation statute, but you have to realize that's a limited powers kind of statute.

If I may, Senator Croft, I would quote to you from a statement made by an attorney for Exxon to the Federal Power Commission at the time the Judge was asking why they wouldn't enter into contracts. I think it really offers a great deal of insight into where the producers are at. And with the committee's indulgence I would do that, if I may.

Mr. Erck, (who is the attorney for Exxon) said, "First of all, Exxon's position with respect to the negotiation of definitive gas purchase and sales contracts

1 concerning the North Slope of Alaska has not changed.
2 If a favorable regulatory climate exists and the
3 State of Alaska has approved a unitization agreement
4 and operating plan at the time the Commission certifies
5 a viable transportation system, Exxon will enter into
6 negotiations leading to the sale of gas from the North
7 Slope pending the resolution of other uncertainties of
8 the Commission. The Commission's removal of such
9 disincentives as Order No. 53 and Opinion 740-B would
10 improve the regulatory environment for gas purchase and
11 sales contracts. Apparently the Commission is not
12 totally unaware of these impediments since it has issued
13 Opinion No. 766 and 767 in Dockets No. (and I won't
14 burden you with those). These are progressive opinions,
15 and hopefully indicate a trend towards improvement of
16 the regulatory climate.

17 "Now, the pervading attitude of the Commission
18 at the time one of the competing projects in this pro-
19 ceeding is certificated is inextricably connected to
20 Exxon's willingness to negotiate definitive gas purchase
21 and sale contracts.

22 "So let me hasten to reaffirm that we do not
23 want to delay this pipeline. It is in our interest
24 that the gas pipeline proceed as fast as possible. And
25 as far as we know -- as far as our willingness to proceed

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

B-69

AGO 546477

1 in light of what I have indicated, we would foresee that
2 gas should be deliverable into the line when it is laid."

3 Senator, as I read that, and other statements
4 of a similar nature have been made, I think the producers
5 are telling the Commission that they want a favorable
6 regulatory climate, and what they are really doing is
7 tying their ability to withhold Prudhoe Bay gas to the
8 overall position that the Federal Power Commission has
9 taken on any number of issues of a regulatory nature,
10 which are not necessarily related at all to Prudhoe Bay
11 gas. They realize that they have the upper hand at
12 this time, and I think they are making the most of it.

13 The State doesn't participate in that kind of
14 dealings with the Federal Power Commission. I think
15 that's what Judge Litt is really referring to. Judge
16 Litt believes it is in the national interest for the
17 producers to commit their gas at this time, and maybe
18 it is; but the producers are taking the position that
19 they want to do everything they can to "create a favorable
20 climate," regulatory climate.

21 SENATOR CROFT: One further question in that regard.

22 Your statement is that we're going to get whatever the
23 comparable private sales will produce, even if the
24 companies are correct in their efforts, that we'll
25 benefit from them. In that regard, what would be your

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

B-70

AGO 546478

1 response to Mr. Moody's comment on page eight at the top,
2 number five, when he says by these contracts you have
3 limited yourself to whatever private sales produce and
4 you've given up your capacity to insist on a higher
5 rate?

6 MR. BONESS: That again goes to the question of whether the
7 State can make any separate arguments that it, as a State
8 and owner of royalty gas, should be treated better than the
9 producers. As I indicated this morning, there is
10 certainly no compulsion and legal requirement that the
11 FPC find that because the State will dedicate its share
12 of the revenues to public purposes that the State thereby
13 is automatically entitled to higher revenues. As I
14 indicated, I believe that argument ultimately comes
15 down to requiring consumers in Midwestern and Eastern
16 States and the Lower 48 States generally, to pay a higher
17 price which, in effect, is transferred into the State
18 treasury and I think when cast in those terms, it's an
19 argument very likely not to succeed before the Federal
20 Power Commission.

21 SENATOR CROFT: You do agree with him that through these
22 contracts we're giving up our right to make that argument?

23 MR. BONESS: No, I wouldn't even agree with that, Senator,
24 and here's why -- if, indeed, the argument is a valid
25 argument, then it can be made that our gas purchasers

1 should be allowed to pass that through. Our contract
2 says they can pay us whatever they're allowed to include
3 in the jurisdictional rate base. To the extent that that
4 argument can be made, we can make it and say they should
5 be allowed to include it in their jurisdictional rate
6 base. If the argument has any validity, I believe that
7 would be as valid in that context as in the context of
8 simply establishing a higher price for State royalty gas.

9 SENATOR CROFT: Even if we've tied ourselves to whatever
10 they agreed to privately?

11 MR. BONESS: Well now, you see, that's the point I made
12 this morning. As a general matter, people are saying
13 we are tying ourselves to the producers, and in practice
14 that's usually the case. But as a technical, legal
15 matter, the contract is drafted to allow us to receive
16 whatever price our purchasers are allowed to include in
17 their jurisdictional rate base. If the argument has
18 validity that the State should receive a higher price
19 because of its royalty gas, then that argument can be
20 put forward before the FPC with respect to the price we
21 charge our purchasers, wholly independent of the question
22 of whether or not the FPC can regulate the producers
23 and whether or not they can regulate us.

24 SENATOR CROFT: So your position is that we've not given
25 up on it, even if he feels that we have.

1 MR. BONESS: Well, I haven't discussed that point with Mr.
2 Moody, but I believe what I have said is correct, that
3 we could make that argument and if it does have validity
4 then the purchasers would be allowed to include the rate
5 in their jurisdictional ---

6 SENATOR CROFT: You don't question that he doesn't take that
7 point of view?

8 MR. BONESS: Well, if I had time I would read it, and could
9 I respond to that and say what I think he's saying there?

10 SENATOR CROFT: You haven't had a chance to go through this
11 before?

12 MR. BONESS: I have read it, but I would like to read that
13 again if you're asking me to interpret what Mr. Moody's
14 position is.

15 COMMISSIONER MARTIN: I might also say, Senator, he doesn't
16 address here, but I understood that he addressed, at
17 least in some of his testimony, the probability of
18 that argument, aside from the technical ability of it
19 to ever be made, the probability of it ever succeeding,
20 which, at least in my understanding, he feels is extremely
21 low.

22 MR. BONESS: I have read it and to the extent that I do
23 disagree with him, I believe we can still make the
24 argument in the context of the present contracts, and I
25 believe we have not tied ourselves exactly to the price

1 the producers are allowed to receive. We have tied
2 ourselves to the price the pipeline companies are allowed
3 to include in their jurisdictional rate base. Therefore,
4 I believe we could make the argument that we, as a State,
5 ought to be treated separate and differently.

6 I would also point out that even as a legal
7 matter I am not convinced we would want to make that
8 argument. As Mr. Moody, himself, pointed out, or perhaps
9 it was Dr. Swanson, pointed out the other side of that
10 argument is the State should receive less because the
11 State has incurred no risk and, therefore, it would have
12 to be a well researched and carefully thought out decision
13 to pursue that line of argument, recognizing that if we
14 did pursue it somebody would take the other side of it.

15 SENATOR CROFT: Thank you.

16 SENATOR HUBER: Mr. Chairman, I have something that came up.

17 SENATOR RADER: Senator Huber, go ahead.

18 SENATOR HUBER: I just wanted to get something clear that
19 came up out of Senator Croft's questioning. I believe I
20 understood you to say the companies could withhold the
21 production to gas, and this is the context I wanted to
22 ask it in. Doesn't the State still have the right under
23 lease terms to cancel leases for failure to produce
24 when the ability to do so is possible but not exercised
25 by the lessee? Don't we have that right?

1 MR. BONESS: I believe that's correct, Senator. But if there's
2 no pipeline in which they can deliver the gas then I
3 doubt that we can cancel the lease.

4 SENATOR HÜBER: Well, if there's no way to use the gas,
5 let's put it that way.

6 COMMISSIONER MARTIN: That's right.

7 SENATOR HUBER: If there is no way to sell the gas. I hate
8 to see them keep tying this to an FPC controlled pipeline.
9 I wanted to make sure that there wasn't something that
10 was cancelling or changing the provisions that are in
11 the lease that the State has the right to force them to
12 produce.

13 MR. BONESS: You're correct, Senator.

14 SENATOR HUBER: Thank you.

15 SENATOR RADER: Mr. Chatterton.

16 REP. CHATTERTON: Mr. Chairman, thank you. Mr. Commissioner,
17 I have a series of questions that you will have to
18 accept me on faith are not meant to be controversial,
19 argumentative or in any way entrapment questions. Please
20 accept me on faith. The reason for the series of
21 questions will be to put into the record something that
22 I believe should be put into the record from a document
23 that is too much, too voluminous, in the interest of
24 efficiency, to make an exhibit. So I will attempt to get
25 the salient points of that document into the record

1 through the question and answer route.

2 So, I'll start my questions: are you aware of
3 a report that was prepared and presented by H. K. Van
4 Poolen to your Department dated January 1976?

5 COMMISSIONER MARTIN: Yes.

6 REP. CHATTERTON: You also are aware that that report, in
7 effect, includes the comparison of some twenty-nine
8 separate forecasts based on various operating programs
9 and production schedules for the Prudhoe Bay field?

10 COMMISSIONER MARTIN: Yes.

11 REP. CHATTERTON: Are you aware of this section on page five,
12 and I will quote, and I will quote in context. It's
13 on page five of that report entitled "Prediction of
14 Reservoir Fluid Recovery Sadlerochit Formation Prudhoe
15 Bay Field", and again dated January 1976. On page five
16 and under "Qualifications" that the authors placed
17 before here, before you, it says, "The numbers in this
18 report should be considered relative rather than absolute.
19 Reservoir performance predictions on a field without
20 production history are approximate at best. Absolute
21 values should be used with caution, but relative values
22 can be used to compare production schedules with con-
23 fidence", relative to one another, absolute number not.
24 Do you concur with that premise?

25 COMMISSIONER MARTIN: Yes, I concur with that statement.

1 REP. CHATTERTON: I would now like to ask you if you would
2 concur with this statement which appears on page three
3 of the aforementioned report, and I will quote in con-
4 text. It's under "Summary" of the report, and it's
5 item two under that summary. It says, "The highest oil
6 recoveries were obtained under conditions of an aquifer
7 supplemented by water injection and no gas sales." I'll
8 get the numbers later. Do you concur with that?

9 COMMISSIONER MARTIN: Mr. Chatterton, let me say before I
10 agree to this, I don't have the document before me.
11 I've studied it and ---

12 REP. CHATTERTON: I'm not trying to trip you up.

13 COMMISSIONER MARTIN: I understand you're not and I'm not
14 trying to be defensive against that. I just want to
15 say as a preface to all my answers, I'll give you the
16 best answers I can, but within the context of being the
17 Commissioner and not a technical expert with regard
18 to this study. I believe that that conclusion is right
19 and that sounds accurate from the study, as I recall.

20 REP. CHATTERTON: Maybe we can get it this way. You, as
21 Commissioner for the Department, did accept the report?

22 COMMISSIONER MARTIN: I've accepted the report, and let me
23 say that there is still work being done on that report.
24 As a matter of fact, as you may know, one of the reasons
25 we brought Mr. Hamilton here last week was to update the

1 committee on the new work. The trend of the new work
2 is similar to the work in the report you have in your
3 hands.

4 REP. CHATTERTON: I believe his testimony, or an answer to
5 a question was that trend of the new work that had been
6 accomplished to date indicates that's there is no
7 substantive change to the findings of this report.

8 COMMISSIONER MARTIN: That is accurate.

9 SENATOR HUBER: He didn't testify; isn't that clear?

10 He did not testify, he went back without testifying.

11 REP. CHATTERTON: He answered a question to our Chairman
12 from the floor.

13 SENATOR RADER: I think that's correct. We asked him if
14 the updating material would substantially change the
15 material previously submitted to the committee, and
16 he said that he did not feel that it would make a
17 substantial difference.

18 COMMISSIONER MARTIN: The answer is yes, it generally tends
19 to bear out the work already done.

20 SENATOR RADER: Although he did not take a seat and testify,
21 he stated that from the floor.

22 COMMISSIONER MARTIN: In any event, the answer to your last
23 question is yes, I recall that statement.

24 SENATOR RADER: I'd like to ask the reporter, did the
25 reporter take down that dialogue between me and Mr.

1 Hamilton when I asked him about his testimony, and I
2 think Senator Huber also at the same time suggested that
3 he would be the best judge of whether or not he should
4 testify.

5 MRS. SANDERS: I've taken down everything, but that notebook
6 is not here; it's at my office.

7 SENATOR RADER: If it's important, I'm sure we can get
8 Mr. Hamilton back.

9 REP. CHATTERTON: I do not think it's important as far as
10 I'm concerned, Mr. Chairman. Thank you, I will continue.
11 I would now like to read to you off of page seven of the
12 aforementioned report and under "Recommendations" there
13 are three, and this is half of recommendation number three.
14 In the interest of time I'll read half. I'll read it
15 all if you like. It says, "Although the prediction runs
16 made in this study indicate that early gas sales will
17 generally result in reduced oil recoveries, it should be
18 recognized that important economic factors were not
19 included in any of the boundary conditions." And I again,
20 Mr. Commissioner, call your attention to the "early gas
21 sales will generally result in reduced oil recoveries."
22 Realizing you're not testifying expertly, you do accept
23 that part of the recommendation of the report?

24 COMMISSIONER MARTIN: Yes, that there were not economic
25 parameters set on the various variables.

1 REP. CHATTERTON: Thank you. Now, just to get into the
2 record some numbers, I would now like to go to Table
3 Number One of that report, which is a tabulation of
4 the twenty-nine runs of various operating conditions
5 and production schedules forecast for the field, to
6 give this committee and the record some ideas of the
7 importance of gas sales versus no gas sales.

8 There's actually four different conditions
9 here as far as operating conditions and production
10 schedules. I'll take condition one first for a com-
11 parison. Keeping common will be no aquifer activity.
12 Production will be at the rate, black oil production
13 at the rate of 1.2 million barrels per day. All other
14 conditions will be the same with the exception of gas
15 sales.

16 Run number one gives an estimated cumulative
17 oil recovery from the Prudhoe Bay field of 7.38 billion
18 barrels. That run, there is no gas sales.

19 Run number four is an ultimate economic recovery
20 of 610 billion, that is 1.28 billion barrels less where
21 again all conditions are the same excepting after two
22 and three-quarter years following the commencement of
23 oil production gas production will start at the rate of
24 two billion cubic feet per day. Will you accept this
25 as I've read it correctly?

1 COMMISSIONER MARTIN: I think so, Mr. Chatterton. It sounds
2 like one of the scenarios.

3 REP. PARR: In the interest of time I will not carry this
4 on other than to say that anyone referring to runs seven
5 as compared to runs thirteen will see the same type of
6 difference between ultimate recovery of gas sales
7 versus no gas sales. They will see the same results
8 between runs number ten and number sixteen, no gas
9 sales and gas sales; again the recovery will be lower
10 in this case by the amount of 1.24 billion barrels --
11 not million, billion. And again you'll see the same
12 thing between runs twenty and runs twenty-five. If you'll
13 accept that I will go to the next question, and this
14 ceases to be necessarily non-argumentative or non-
15 controversial or non-entrapping. So it's varied there.

16 My question is one where we have to hypothesize.
17 If we had had gas cap producibility at Prudhoe Bay last
18 week and a transmission system from Prudhoe Bay to the
19 South 48, do you believe that possibly, because of quasi-
20 emergency situations, the South 48 might have called
21 upon Prudhoe Bay gas production even though it might
22 well have been in the disinterest of Alaskans?

23 COMMISSIONER MARTIN: Rather than speculate on what they
24 might have done last week, let me just say that it's
25 clear to me (I consulted with Mr. Boness) the Federal

1 Government certainly has the power in time of national
2 emergency to do that. It seems to me that that is a
3 power limited to extraordinary circumstances which could
4 well exist under certain circumstances. Whether last
5 week's would have qualified, I really don't know.

6 REP. CHATTERTON: Thank you. The last question, Mr. Chairman,
7 Mr. Commissioner. As Commissioner of your Department,
8 would you be fairly certain that you would support the
9 findings of your Oil and Gas Conservation Committee
10 even though their findings might strongly recommend
11 that there not be any export of associated gas from the
12 Prudhoe Bay field?

13 COMMISSIONER MARTIN: I've been on the record pretty clearly
14 on this, in the FPC, and in this committee, and publicly,
15 Representative Chatterton, saying that I believe the
16 decisions of the committee, so long as they are legitimately
17 guided by the confines of the State Conservation Statute,
18 will be a controlling factor in this matter and not over-
19 turned by other political factors. So in that regard,
20 I have advised, under some pressure by the FPC Hearing
21 Judge, advised the Federal Government that they could
22 not have an absolute guarantee or absolute predictability
23 with regard to rates of production from the Prudhoe
24 Bay field.

25 REP. CHATTERTON: Thank you, Commissioner and Mr. Chairman.

1 SENATOR RADER: Any further questions? Representative
2 Gruening.

3 REP. GRUENING: There is one provision that concerns me and
4 I'm wondering whether the three purchasers, any one
5 of the three purchasers insisted on its inclusion.
6 That has to do with the replacement of gas taken back
7 at one and one half times the rate. Was Tenneco one
8 of the purchasers, or the purchaser to insist on that
9 provision?

10 COMMISSIONER MARTIN: They were the major purchaser to insist
11 on it. The others asked for it and indicated that they
12 wanted it, and we included it in all the contracts to
13 make them uniform. I should point out that this was
14 clearly a term that allowed us to come to an agreement
15 with Tenneco and without it we would have been unable
16 to do so. If they had not been in we might have been
17 able to negotiate the others out of that.

18 I should also indicate, if it's of interest
19 to you, Mr. Chairman, that I assume you appreciate the
20 limitations of that additional fifty percent recovery
21 term.

22 MR. BONESS: No, the first recovery, everybody demanded that.

23 COMMISSIONER MARTIN: Yes, the first recovery, everybody
24 demanded. It's the additional fifty percent that was
25 primarily demanded by Tenneco, was asked by the others,

1 and we included it to make the terms uniform.

2 SENATOR RADER: Any further question of any members, or
3 Senator Poland?

4 COMMISSIONER MARTIN: Senator Rader.

5 SENATOR RADER: Yes, did you wish to sum up?

6 COMMISSIONER MARTIN: Senator, I don't want to make a lengthy
7 summary. I just want to go back a little bit, and I'm
8 not going to review all the points I made this morning
9 but I don't want to leave the committee without trying
10 to stress again that there's no question that the center-
11 piece, or the most important aspect, or the most important
12 aspect of these contracts now relates to the fact that we
13 can get whatever support, political or substantive or
14 otherwise comes to us on the gas line route issue.
15 This is the only time it's important. It may have been
16 important somewhat earlier. It won't be important again.

17 But I do want to add to that that the other
18 provisions in this contract, whether they come from the
19 13-B argument, or Mr. Moody's theory of last year, or
20 the fact that we've negotiated a very good price term,
21 or the fact that we've negotiated good terms for take-back,
22 are extremely important aspects of this contract, and I
23 think the committee must take very seriously the possi-
24 bility that certain of these terms cannot be renegotiated
25 and put in a new contract. I do not think that, as your

1 negotiator you can act with absolute certainty that those
2 terms are going to come our way every time we sit down
3 to negotiate gas contracts. I'm not saying we can't
4 accomplish them again; we'll certainly try to. But I
5 do not want to leave the committee with the impression
6 that they are automatically to be included in any con-
7 tract, or that they can be protected in any subsequent
8 contract at a later time. They came hard and we had some
9 very difficult negotiations to get there.

10 Let me indicate just very briefly, at least on
11 a couple of those points, just to give you an idea of
12 why I think that it may be difficult in the future.
13 If you consider the situation that we'll be in later,
14 there are several factors that deal with the issue of
15 price. One is, of course, the fact that I tried to bring
16 up of the institutional constraints that we have on
17 royalty gas contracting.

18 If we are caught in a crunch where the State
19 does not have a position and does not have a contract,
20 yet we get caught in a situation where perhaps Arctic
21 is certified, if we lose support and if this is a fact,
22 we're losing support and Arctic is certified, we are
23 then under a time pressure that we are not now under and
24 our buyers will know that. They will know that our
25 alternatives are limited and they will know that they

1 have us much more at their mercy than they do at the
2 present time. I'm not saying that will happen, but it
3 could put us in a bargaining position we're not in now.

4 At the same time, if the State is the last
5 one-eighth to sell, if the producers go ahead and sell,
6 consider the alternatives that we face. By selling now
7 and including the term that gives us the best price,
8 we automatically benefit by the very best deal that any
9 producer makes.

10 If we wait and we are one of the last eighths,
11 or we're the last eighth or the last percentage to sell
12 it could very well be the case that one of the producers
13 has made an extraordinarily good deal. It will then be
14 our job to try to make a better deal than they made, and
15 I should point out that that will be a good deal more
16 difficult to equal or surpass than it would be by simply
17 taking advantage of it right now.

18 At the same time, I think that once in-State uses
19 are developed and the present period of uncertainty is
20 past, so that we know what it is we're going to use our
21 royalty gas for, we can offer less to buyers. Under
22 the present circumstances, our buyers think they're going
23 to get most of our gas and we think we're going to use
24 most of it. But as we continue to develop in-State uses
25 they're going to know that they're going to get less.

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

B-86

AGO 546494

1 And in the case of a company like Tenneco, they're
2 interested in fairly substantial volumes of gas. They
3 have other alternatives, as to other gas companies such
4 as Algerian projects, Russian projects or other large
5 fields, and as the amount that they know they will get
6 from us diminishes, I think our field of negotiation
7 diminishes somewhat also.

8 I might also indicate, if there is any action --
9 we've been dealing in these hearings on many occasions
10 with possible but unlikely situations and I've been, I
11 think, fairly frank in admitting what is possible in
12 trying to give you an idea of what is probable. One of
13 the things that may well happen if we wait, and this
14 goes to the idea of future negotiations, is that if
15 Congress is likely to take any action with regard to
16 controlling gas in the future, my guess is that they
17 will take it with respect to uncommitted gas. There is
18 no reason that Congress should reward people who are
19 presently withholding their gas from the market.
20 If I were a Congressman, I would not lean heavily toward
21 the position of favoring the producers who are now
22 dickering with the FPC. I would lean toward favoring
23 the individuals who have committed their gas and attempted
24 to make it known how they're going to put it into the
25 national consumer supply.

1 So I think that all of these factors added up
2 provide extremely cogent reasons for considering that
3 some of these terms may be difficult to immediately
4 recapture. As I say, I'm not saying it can't be done,
5 but I'm saying that it's difficult and we ought to
6 acknowledge those factors. It's a calculated risk
7 that has to be considered. I think the Legislature has
8 to consider it as it considers these contracts.

9 SENATOR RADER: Representative Gruening.

10 REP. GRUENING: That raises a question. You mentioned the
11 disadvantage we might be at in terms of just selling it
12 for the price, for a certain price if the Arctic route
13 is certified. Rush Moody's testimony was that our
14 one-eighth is very crucial to the financing of that line.
15 He, frankly, didn't see under present economics how it
16 could be financed without the eight-eighths. Wouldn't
17 that make you conclude that our one-eighth share would
18 have some leverage in dealing with somebody in selling
19 our gas?

20 COMMISSIONER MARTIN: Yes, but we'll have exactly the same
21 leverage in that regard whether or not we've gone into
22 these contracts. If Arctic is certified it will have to
23 be with the knowledge that it will not have state royalty
24 gas. Whether or not we sign these contracts, that will
25 be the case. There will be, of course, the strong feeling

1 that they will get our gas one way or the other, but as
2 I see it that argument doesn't go to whether or not these
3 contracts should be approved.

4 REP. GRUENING: And conversely, if El Paso is selected and
5 we don't go into these contracts, do you see any reason
6 to believe that we would be at any disadvantage in dealing
7 with El Paso or anybody else that is building an all
8 Alaska line?

9 COMMISSIONER MARTIN: For some of the reasons I just
10 explained, yes, I think we would be at a greater dis-
11 advantage than we are now, particularly if all of the
12 other buyers have sold or are in the process of selling
13 and that one or more of them have driven a particularly
14 excellent bargain. Under these contracts we have the
15 benefit of that bargain. Without these contracts we
16 would have the duty of trying to come up to it or surpass
17 it and, depending on what that is, it might be a very
18 difficult task.

19 REP. GRUENING: Given the fact that we might know better
20 what our in-State uses are, we may only wish to sell a
21 portion of it; isn't a spot sale, or a sale of a smaller
22 amount, sometimes not able to bring a higher price?

23 COMMISSIONER MARTIN: Mr. Gruening, that's one of the reasons
24 that I've focused on something that I don't think people
25 are too interested in, and that is the institutional

1 constraints under which we operate. To be very frank
2 with you, I don't think our system is set up to do a good
3 job of spot selling of royalty oil or gas and I don't
4 think it will be so long as we have to negotiate with
5 somebody and then go through a Royalty Board and the
6 Legislature. It simply asks the buyer to do too much.
7 It asks them to have the State assess its position,
8 negotiate with them, and then wait for a period of months
9 while economic conditions change, to have it approved.
10 So I think that spot selling, while it's a possibility,
11 represents a dim possibility for ever being a major
12 policy of the State.

13 REP. GRUENING: I might suggest, Commissioner, that one
14 of the reasons this hearing process has been maybe a
15 little longer than it might be is because the contracts
16 are being offered for other than for money return; they're
17 being offered for political purposes.

18 COMMISSIONER MARTIN: Absolutely.

19 REP. GRUENING: They are, as you admit, quite unique, probably
20 very unique.

21 COMMISSIONER MARTIN: That's right.

22 REP. GRUENING: But anyway, I do want to nail down exactly
23 what was behind this report. Could you identify for the
24 record exactly -- this is the report upon which you feel
25 that you're in compliance with this 38.05.184(d), I guess.

1 COMMISSIONER MARTIN: Yes, in the document cited therein.

2 But also we filed, Mr. Gruening, this report here,
3 which is the more formidable statement. The blue document
4 is actually a summary of this one. But it also references
5 all the other documents that are a part of the analysis.

6 REP. GRUENING: So you're saying that all the references
7 on page eleven of this January 7, 1977, report are
8 included as constituting a report showing the immediate
9 and long-range gas needs?

10 COMMISSIONER MARTIN: That's right.

11 REP. GRUENING: This morning it was just the one report, and
12 now it's the whole ---

13 COMMISSIONER MARTIN: No, I think I mentioned the reference
14 reports, Mr. Chairman.

15 REP. GRUENING: Oh, the entire list of references would be
16 included?

17 COMMISSIONER MARTIN: Yes.

18 SENATOR RADER: Do you have anything further? Any further
19 questions of the Commissioner or Mr. Boness? Thank you,
20 gentlemen, both very much.

21 We have the Lt. Governor with us, who said that
22 he would like to make a very, very brief statement.

23 COMMISSIONER MARTIN: Mr. Chairman, I take it the committee
24 is aware of the relative schedules of Mr. Boness and
25 myself; that's been communicated to the committee?

1 SENATOR RADER: I have a schedule and I believe Mr. Gruening
2 has a schedule. Yes, we both have your schedules.
3 I don't know whether Senator Poland has a schedule.

4 SENATOR POLAND: I do.

5 SENATOR RADER: You do.

6 SENATOR POLAND: Yes.

7 SENATOR RADER: And I assume Senator Sackett. Commissioner,
8 I did not give Mr. Sackett a schedule.

9 COMMISSIONER MARTIN: I sent him one.

10 SENATOR RADER: All right, fine.

11 LT. GOVERNOR THOMAS: Mr. Chairman.

12 SENATOR RADER: Lt. Governor.

13 LT. GOVERNOR THOMAS: Thank you very much. I'll be very brief,
14 Members of the Joint Committee. I wanted to just say a
15 word or two regarding the other than monetary aspects of
16 this contract, going to the political, public information,
17 generally gaining support in the rest of the nation for
18 the route, that most of us, I think eighty-five percent
19 of Alaskans, wish to see win out.

20 I just received a copy of a Resolution that has
21 been passed by both Houses of the State of Alabama, and
22 I'd like to turn that over to you, Mr. Chairman. I'll
23 read only the last Whereas and the first Resolve clause.

24 "WHEREAS, this contract must be approved by the
25 legislature of the State of Alaska; now therefore

1 "BE IT RESOLVED BY THE LEGISLATURE OF ALABAMA,
2 BOTH HOUSES THEREOF CONCURRING, That the State of Alabama
3 urges the Legislature of our sister state, the State of
4 Alaska, to lend its approval to this contract and to take
5 the necessary steps to the end that the contract will
6 be ratified and the natural gas can be expeditiously
7 transported for use by our citizens and industries."

8 Mr. Chairman, that I think, in conjunction with
9 a letter that you all have received a copy of, the letter
10 from Jerry Beasley, Lt. Governor of Alabama, indicates
11 the kind of friends and allies and support that this
12 contract we're dealing with, our surplus royalty gas,
13 can engender.

14 I have one other point I would like to make,
15 and this is from the point of view of one who expects
16 to go out and do a selling job, radio and television,
17 wherever possible, as I've done before, and that is to
18 say that with the passage of this contract, your endorsement
19 of this contract, we will have an awful lot more horse-
20 power, the ground will be well laid for us to go on.

21 I would say that it's probably not so important
22 that it pass as that it would be very detrimental if it
23 did not pass because our opponents would quickly get
24 the word around the country that the Legislature of Alaska
25 saw fit not to endorse this proposal, and it would be

1 interpreted, I'm sure, and I see really no easy way or
2 any way at all overcome the interpretation that this
3 would show "Alaskans really don't care which way the
4 gas flows." So from that point of view, I would urge
5 you to be as hasty as possible, while at the same time
6 taking plenty of time to deliberate, and having sat
7 where you are I understand that you're moving as rapidly
8 as you possibly can right now; but I think it would be
9 a great assist to all of us who will be out, and our
10 allies such as the people in these other states, in
11 trying to gain approval in Washington of the all-American
12 delivery system.

13 That's all I have to say, Mr. Chairman.

14 SENATOR RADER: Mr. Lt. Governor, can we enter Exhibit 31,
15 the Resolution to which you just made reference?

16 LT. GOVERNOR THOMAS: Yes, sir. I'll leave it right here.

17 SENATOR RADER: That will be Exhibit No. 31 according to my
18 numbering system. Is that correct?

19 MRS. SANDERS: Yes.

20 (Whereupon Exhibit 31 was duly marked.)

21 SENATOR RADER: Just a second. Do you have any questions of
22 the Lt. Governor, or did you wish to submit to questions
23 here?

24 LT. GOVERNOR THOMAS: I'd be happy to, but I'm not the
25 technician regarding the contract.

1 SENATOR RADER: Does anybody have any questions of the Lt.
2 Governor? Thank you very much, sir.

3 LT. GOVERNOR THOMAS: Thank you.

4 SENATOR RADER: Are there any other persons who desire to be
5 heard on the subject that we've been discussing and
6 hearing so much about the last three or four days?

7 Under the circumstances, these joint hearings
8 are adjourned with no intention to reconvene.

9 (Whereupon the hearing was concluded
10 at 4:00 p.m.)

11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

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

B-95

AGO 546503

11 SENATOR RADER: The committee will take that up at a later
12 date. Commissioner Martin called me and asked if he
13 might take the stand for a few moments this morning to
14 clarify testimony given yesterday or make additional
15 points. Commissioner, glad to have you back.

16 COMMISSIONER MARTIN: Senator, thank you. Then I will be
17 very brief. I know the schedule you have. I really
18 had two purposes. The first I see has been taken care
19 of after coming down. I was concerned -- as you said
20 yesterday, I don't think -- notwithstanding some remarks
21 that were in an adversary proceeding, we want to share
22 everything with the committee. I wanted to bring down
23 the press release from the Federal Power Commission but
24 I see that the committee got it about the same time we
25 did. It was probably a bonanza for the telephone company

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

C-1

AGO 546504

1 this morning, as I think it was telecopied about three
2 different ways. In any case, I have several extra copies
3 of it here and I also have one copy, Senator Rader,
4 of something we're doing now, and that is we're tele-
5 copying up what we think at least are pages that have
6 something to do with the State in the four hundred and
7 thirty-three page or four hundred and thirty page decision.
8 We're making arrangements to have the opinion itself
9 flown up, but it looks like the best we're going to be
10 able to do, even with good weather, is to get it up
11 here on the first plane tomorrow morning from Seattle,
12 which means 9:00 or 10:00 o'clock, as I understand it.
13 We'll take a look at it immediately and try to give you
14 the best summary we can late in your hearings tomorrow
15 afternoon, if that's acceptable to the committee, and
16 try to duplicate copies for everyone as a part of that.

17 I might just say that in looking through the
18 decision, just very briefly, Senator, for those -- has
19 it been distributed? Well, I'll be glad to make these
20 copies available to the committee. I didn't bring
21 enough for everyone, but let me pass them around. I
22 understood that the committee had been distributed
23 copies but ---

24 SENATOR RADER: I don't know whether all the committee has.
25 I see that this area here though all has copies.

1 COMMISSIONER MARTIN: Just very briefly and I don't intend
2 to summarize this at all, Senator Rader. The decision
3 is extremely heavily weighted in favor of Arctic Gas,
4 substantially more weighted than we had expected or I
5 think most had expected. It takes up most of the
6 opinion really dealing with the benefits of Arctic
7 Natural Gas' proposal which is regarded by the judge
8 as superior on most -- on every ground for the permit.

9 And then on page nine near the bottom there is
10 a short summary paragraph dealing with El Paso, which
11 the judge says that, "if Arctic Gas is unable to accept
12 a certificate, El Paso's proposal, with modifications,
13 would also meet the public convenience and necessity."
14 He goes on to call it a "viable" proposal and then
15 criticizes it on a number of grounds following. A short
16 summary of the Alcan route follows on page ten of the
17 lengthy memorandum in which he says, "As to Alcan, Judge
18 Litt said the record does not support even the possibility
19 that a certificate could be granted it. Its design is
20 clearly neither efficient nor economic since the pipeline
21 is undersized." And then goes on to criticize it on a
22 number of other grounds, putting it sort of in a third
23 position in his release. So, I think at the very minimum
24 we can regard both of the choices that we favor as
25 possibilities for Alaska taking a very substantial blow

1 in this Hearing Judge's opinion this morning, probably
2 Alcan slightly more than El Paso.

3 I also will give you the first five pages of
4 approximately twenty pages we hoped to telecopy yesterday.
5 I don't have copies of these, Senator, which seem to
6 affect the State. And there is some good news and some
7 bad news. I might say in view of the recent letter that
8 you just read from Farmland that there is at least some
9 disagreement on that because, contrary to their assertions
10 that the State is opposed to the economic development,
11 Judge Litt finds that we are so much in favor of it that
12 he finds it irresponsible. So, it's a can't win situation.
13 He thinks we are going too far and Farmland, apparently,
14 not far enough.

15 With very quick reference to that, let me say
16 that so far as I'm aware, we have opened our files one
17 hundred percent to the committee and that communication
18 that Senator Huber talked to has been, so far as I know,
19 either forwarded to the committee or made available to
20 it along with all the other information. I don't want
21 to take the time of other witnesses now to respond to
22 that, but I assure you I'll be more than pleased to do so
23 at an appropriate time.

24 Two very quick points, Senator. First -- and they
25 both relate to what I think were factual misrepresentations

1 based on testimony given yesterday that may have been
2 either members' misunderstandings or my failure to explain
3 myself properly. First, I understand that it was indicated
4 last night in some news reports that people couldn't
5 understand how the state would oppose the treaty. I
6 specifically said yesterday, that without actually seeing
7 the treaty I couldn't take a final position on it, but
8 the state in no way intends to oppose the treaty and
9 in fact supports the enhanced relationship with Canada
10 on all matters including energy matters. And, I want to
11 be very clear about that now. We simply -- I'm not going
12 to say we absolutely won't until I read the words and I
13 don't think you'd expect me to. But I see no chance that
14 we would and we don't want to and we don't intend to. So
15 let that be well understood.

16 Secondly, there apparently was some substantial
17 misunderstanding about whether or not the state could
18 take the gas off under this contract in the state, use it
19 for a petrochemical plant and then export the results
20 of that process. The answer to that is unquestionably
21 "yes". There is no qualification at all that the state
22 must then subsequently utilize all the products from such
23 a process in the state. We have the total right to take
24 the gas off under this contract so long as it is used in
25 the state for some process except liquefaction for export.

1 And there is no limitation on that in terms of utilization
2 of the product.

3 One final very quick matter and that is on the
4 matter of price. We do disagree with some of the
5 characterizations about the state not getting the best
6 price. We do believe that we have gotten the best price
7 under the circumstances and tomorrow, as I indicated,
8 after hearing the testimony of some of your consultants,
9 Senator, we'll be prepared to respond to that at the end
10 of the hearings as the committee sees fit.

11 SENATOR RADER: Are there any questions of the Commissioner?

12 SENATOR HUBER: One quick one.

13 SENATOR RADER: Senator Huber?

14 SENATOR HUBER: Mr. Commissioner, you might ask the judge
15 there when he is finished with his crystal ball, knowing
16 what's in the structure down there, to send it up to you
17 so you can give it to your Department of Oil and Gas
18 so we can get on with determining what we should be
19 taking up there.

20 COMMISSIONER MARTIN: We'll ask them that, Senator.

21 SENATOR RADER: Representative Chatterton?

22 REP. CHATTERTON: Mr. Chairman, Mr. Commissioner, in view of
23 this much stronger position of Judge Litt than what you
24 anticipated yesterday, are you now possibly willing to
25 give reconsideration in exchanging taxpayer's gas for

1 lobbying rights?

2 COMMISSIONER MARTIN: No, sir. We believe the contracts are
3 still a viable and important alternative. This morning
4 I made the comment after seeing the opinion that maybe
5 those yesterday who leaned toward the Alcan route and
6 wanted us to regard the decision as very, very crucial,
7 and we said we think this decision is only a part of the
8 process. may now change and say this decision is deter-
9 minative. We still think this decision is an important
10 part but hardly determinative in the final outcome and
11 that the contracts we're advancing may be possibly a
12 little more important by virtue of it, rather than less.

13 REP. CHATTERTON: Thank you.

14 SENATOR RADER: Any further questions of the Commissioner?
15 Senator Croft?

16 SENATOR CROFT: Commissioner, just so I understand it, because
17 I heard your testimony yesterday, did I understand you to
18 say that you testified yesterday that the unequivocal
19 answer is "yes" that we can export those products after
20 they are used in a petrochemical facility? Because I
21 understood you yesterday to say --

22 COMMISSIONER MARTIN: Apparently that was misunderstood and I
23 talked to several people. Most people understood it the
24 way I expressed it a second ago rather than your way,
25 Senator Croft, but I wanted to clear it up today. There

1 is no question under the contract, in my view, that we
2 have the right to take the gas off, to utilize it in
3 Alaska for any purpose except liquefaction for export
4 and then to export the products that are made therefrom.

5 SENATOR CROFT: And can we then export the LNG under the
6 contract?

7 COMMISSIONER MARTIN: No, sir. If we take it --

8 SENATOR CROFT: Does it all have to be used in the state?

9 COMMISSIONER MARTIN: That's what I made clear yesterday.

10 But we can liquefy gas so long as the LNG is being used
11 in the state, so we even have the flexibility to go through
12 liquefaction and then tanker that around and use it in
13 other communities on the coast.

14 SENATOR CROFT: One final question. If -- and this didn't
15 originate with me but somebody else asked me to ask it.
16 If the primary purpose of these contracts is to gain
17 additional support for the El Paso route, why did the
18 state contract with El Paso to give them twenty-five
19 percent of the Prudhoe Bay --

20 COMMISSIONER MARTIN: That is a very good question and I think
21 the answer to it goes very much to the reason that these
22 contracts are a little misleading in terms of totally
23 construing them as pure political support. The fact is
24 that El Paso can benefit just as much from telling its
25 citizens that it has an opportunity to own gas pursuant

1 to its success as any other company. As it was before,
2 El Paso was a sponsor of the gas line which was very
3 much in the state's interest but without any ownership
4 of gas and only a prospective chance of getting it.
5 But under these contracts they too could say that they
6 have an opportunity to supply gas to their constituents
7 where they couldn't have said that before.

8 SENATOR RADER: Any further questions of the Commissioner?
9 Mr. Swanson?

10 REP. SWANSON: Yes. If we lose both these battles, both
11 the El Paso and the Alcan will you switch your support
12 now to Arctic or Tenneco?

13 COMMISSIONER MARTIN: No, sir. The state's position, I think,
14 on that by all its findings is very clear. We believe
15 that the Arctic offers very little benefit to the state
16 and would be a last choice. We have testified to that
17 extensively in the FPC.

18 SENATOR RADER: Any further questions, Mr. Swanson? Mr.
19 Gruening?

20 REP. GRUENING: Yesterday I think a questions was asked by
21 Representative Meekins if a commitment of royalty gas
22 prior to construction, let's say the petrochemical
23 facility in Alaska would not be considered an in-state
24 use. It's a commitment on an arrangement where the gas
25 went out of the state but that was part of the contract

1 under which this construction --

2 COMMISSIONER MARTIN: Yes, sir. I responded to Mr. Meekins
3 that that is the item that we have committed, the export
4 of gas -- of surplus gas is the thing that we have sold
5 under this contract and that kind of a negotiated deal
6 would not be possible.

7 REP. GRUENING: Regardless of whether it was part of a contract
8 to build a petrochemical facility?

9 COMMISSIONER MARTIN: That's right, because that gas would
10 not be used in Alaska. It would be used as an enticement
11 to come. That in fact is the sort of deal that Farmland
12 International offered and it's one of the reasons why
13 it was unacceptable.

14 SENATOR RADER: Representative Chatterton?

15 REP. CHATTERTON: Mr. Chairman, I'm sorry. Commissioner, in
16 answer to a question that you gave here just a moment
17 ago, I think I have got to ask you another question. You
18 answered a question as to whether you would switch your
19 support in any way, in any shape or form to the Arctic
20 Gas proposal and you answered that "no", I believe.

21 COMMISSIONER MARTIN: Yes.

22 REP. CHATTERTON: So, in effect you're really saying -- or
23 reconfirming that the only reason for these gas sales
24 contracts are to gain or buy additional lobbying effort
25 for one or two choices. There is no other advantage to

1 the contracts, is that right?

2 COMMISSIONER MARTIN: No. I think I made it clear yesterday
3 in great detail that I thought there were several advantages
4 to the contract of which that one may very well be the
5 principal one. But the contracts would be, I think,
6 valuable under any circumstances. I think Mr. Swanson's
7 question, does the state intend to switch its support to
8 Arctic in certain circumstances, my answer was "no". The
9 present Arctic proposal would be of very little benefit
10 to the state.

11 REP. CHATTERTON: Thank you, Commissioner.

12 SENATOR RADER: Senator Huber? Incidentally, I want to invite
13 legislators in the audience to seat themselves at vacant
14 places at the table if you desire, with the understanding
15 that if committee members come in that you will relinquish
16 your seat to them. But if you wish to participate, it's a
17 little bit easier and more convenient, you are certainly
18 welcome. There are two seats here and there is one over
19 here to take advantage of that. Senator Huber?

20 SENATOR HUBER: Mr. Chairman, Commissioner, I want to clear
21 up something that looked like, from press reports and so
22 forth last night, it kind of sounded like from the meeting
23 the amendment that was gotten in Congress by our delegation
24 to allow us to withdraw our gas, it seemed like the
25 testimony was such to make one believe that we had no

1 choice other than that and I think that's what is
2 causing part of the confusion about the Arctic Gas.
3 And would you reaffirm if we never --

4 COMMISSIONER MARTIN: Oh, I understand.

5 SENATOR HUBER: If we never commit our gas, say the Arctic
6 route is chosen and the State of Alaska never commits
7 any of its gas thereby not allowing any of it to flow --
8 to start flowing to the South 48, that it is still our
9 gas under current laws in Congress -- previous laws or
10 current laws, we can't have it confiscated on us until --

11 COMMISSIONER MARTIN: I understand the question now, Senator.
12 I think that is a good question if that is the way you
13 are going. I think that the committee could very well
14 conclude, based on the utilization of Section 13(b) or
15 the theory that Mr. Moody advanced last year, that there
16 might be enough benefits in these contracts to consider
17 going ahead with them or something very much like them
18 under any circumstances. But, as I understood Mr.
19 Swanson's question, he asked if we would switch our
20 support to Arctic and I took it in terms of just an
21 evaluation of the route, my answer would be "no". But
22 yes, I think that it would be a legitimate consideration,
23 given the other benefits of this contract, to at least
24 consider utilizing either the contracts or the format
25 to try to gain the same kinds of protection.

1 I might add that Judge Litt's decision is ap-
2 parently going to be very sobering in that regard, because
3 he specifically recommends the repeal of 13(b) and makes
4 it plenty clear that as far as he is concerned, unless
5 there is something like that, the FPC will have no
6 intention whatever of approving any state off take.
7 It's a decision highly influenced by strong national
8 interest.

9 SENATOR HUBER: And, Mr. Chairman, even if 13(b) is repealed,
10 the State of Alaska if it wants to ever use any of this
11 gas, the only choice we would have would be never to
12 commit it in the first place thereby depriving the people
13 of the Southern 48 states of having any portion of it
14 because there is no law that says they can confiscate
15 our gas.

16 COMMISSIONER MARTIN: Well, Senator, that's not the only
17 alternative we would have because as you know, the terms
18 of this contract provide that should the arrangement for
19 off take not be approved by the federal government, the
20 contracts fail. In other words, we are then back to
21 ground zero and have whatever alternatives we might have
22 minus the loss of time which is inherent in attempting to
23 get that approval.

24 SENATOR HUBER: I wanted it clear that the FPC can't just
25 assert our royalty share of gas. It requires us to have

1 committed it in the first place and allowed it to flow
2 before they can assert it even without 13(b)?

3 COMMISSIONER MARTIN: Yes, but not through the contract. It
4 means allowing it to flow, it is different from committing
5 it. It is the first flow of the gas which we believe is
6 the most substantial problem. And so, in the event that
7 these contracts were approved, but not subsequently
8 approved to the federal level in terms of the off-take
9 provisions, we would then be back in the situation where
10 we would have to act before the gas first started to
11 flow to look at our other alternatives. The other
12 alternatives being in-state pipelines or other alternatives.

13 SENATOR HUBER: That's why it would seem that the judge's
14 strong decision for Arctic Gas, as he made it, didn't
15 take into consideration the fact that if he allows Alaska
16 no use of their gas and you may very well get to the
17 point where Alaska says "you don't get our gas then."
18 We certainly haven't taken that stance.

19 COMMISSIONER MARTIN: We haven't taken that position. We
20 think that is not a good position to take in the national
21 decision process at this time, Senator Huber, although
22 I can understand your sentiment in perhaps wanting to
23 get there. We have not taken that tack, attempting to
24 carve out a way to utilize the gas on a cooperative way
25 rather than doing it through confrontation.

1 SENATOR HUBER: That is why I'm disappointed in his deter-
2 mination.

3 COMMISSIONER MARTIN: He incidentally has searched, as you'll
4 see from the release and then later from the decision,
5 substantial state jurisdiction, including the ability
6 for the FPC to allocate and take the gas. So I think that
7 while this doesn't speak to the FPC or to the federal
8 decision making process, there are a number of things of
9 great concern to the state in this contract -- or in
10 this decision.

11 SENATOR HUBER: Thank you, Mr. Commissioner.

12 SENATOR RADER: Any further questions?

13 REP. CHATTERTON: Yes, Mr. Chairman.

14 SENATOR RADER: Mr. Chatterton?

15 REP. CHATTERTON: Mr. Commissioner, if we initially take our
16 royalty gas in value instead of in-kind, do we keep all
17 options open for intrastate usage?

18 COMMISSIONER MARTIN: Mr. Chatterton, rather than whether it
19 is taken in value or kind, the point you must operate
20 from is the point that gas first flows through the pipe-
21 line and if at the time it first flows through the pipe-
22 line and is merged in the interstate stream, we are
23 allowing our gas to flow without any arrangement to take
24 it off -- any approved federal arrangement to take it off.
25 That is the risk of loss of the gas, if at that time we

1 have not taken in-kind and protected it, then the
2 problem would attach.

3 SENATOR RADER: Mr. Parr?

4 REP. PARR: Mr. Commissioner, in this press release on page
5 four, the second paragraph, Judge Litt finds that "The
6 Commission clearly has full jurisdiction over producer
7 wellhead sales in interstate commerce, transport of the
8 gas within Alaska, and transport and sale within the
9 lower 48 states". Now at that second clause, does that
10 mean in the judge's opinion that if we built our own
11 pipeline, let's say from Prudhoe Bay to Anchorage, that
12 the FPC would still have jurisdiction?

13 COMMISSIONER MARTIN: Yes, sir.

14 REP. PARR: Even if it never got into the interstate pipeline?
15 Intrastate pipelines are not regulated by the FPC.

16 COMMISSIONER MARTIN: We're giving you the present state of
17 the law. The judge is apparently making a somewhat
18 extended statement regarding it.

19 REP. PARR: Under existing law, as far as you know, intrastate
20 pipelines are not regulated by FPC?

21 COMMISSIONER MARTIN: Yes.

22 REP. PARR: Is that correct?

23 COMMISSIONER MARTIN: That's right.

24 REP. PARR: And so what the judge is doing is either trying
25 to change it by his statement or interpreting it different

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17

than you?

COMMISSIONER MARTIN: He has made a number of very extreme statements, obviously taking a very strong position in the case, Mr. Parr.

REP. PARR: Thank you.

SENATOR RADER: Any further questions of the Commissioner?
Thank you very much, Commissioner.

COMMISSIONER MARTIN: Thank you for your courtesy. I thought it would be helpful, Mr. Chairman.

SENATOR RADER: We appreciate it.

COMMISSIONER MARTIN: We will give you additional copies of this today as they come in that are out of the decision. Those are just miscellaneous pages.

SENATOR RADER: Well, I think that we will probably rely upon your analysis of this tomorrow rather than our hour by hour report here.

COMMISSIONER MARTIN: Those are all out of context.