

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86/252

652 SCOMM21: ROYALTY OIL & GAS FILES 1977-78

is reporting same on a Current Report on Form 8-K under the caption "Other Materially Important Events". The Company does not deem such matters material and the disclosure thereof shall not be deemed an admission of materiality.

EFFECT OF ALASKA'S ROYALTY GAS ON NATURAL GAS SUPPLY:

TENNECO MARKET AREA (25 states)

Prudhoe Bay natural gas production rate is assumed to be
2.0 Bcf/day

Yearly Prudhoe Bay natural gas production 730 Bcf.

Royalty Share of Prudhoe Bay production = $1/8$ of 730 Bcf = 91.25 Bcf/Year.

Tenneco Share of Royalty Gas = 50 % of 91.25 Bcf = 45.625 Bcf/year.

Tenneco Summary of Operating Data (from "Tenneco Statistics 1975")

Volume of Gas sold and transported: 1,634 Bcf
Volume of Gas purchased: 1,459 Bcf

Tenneco's share of 25-state gas market:
1,284 Bcf
9.9 %

Tenneco's share of royalty gas as a per cent of Tenneco's
share of 25-state gas market:

$$(45.625 \text{ Bcf/year} / 1,284 \text{ Bcf/year}) = 3.55 \%$$

Tenneco's share of royalty gas as a per cent of total
25-state gas consumption:

$$(45.625 \text{ Bcf/year} / 12,879 \text{ Bcf/year}) = 0.35 \%$$

Total U.S. Consumption of Natural Gas In 1975 (rounded): 19,000 Bcf

Yearly Royalty Gas Production as a percent of total U.S. Consumption:

$$(91.25 \text{ Bcf/year} / 19,000 \text{ Bcf/year}) = 0.48 \%$$

Yearly Prudhoe Bay gas production as a percent of total U.S.
Consumption:

$$(730 \text{ Bcf/year} / 19,000 \text{ Bcf/year}) = 3.84 \%$$

Note: Above calculations do not take into account shrinkage of
natural gas through transportation (e.g. 6% loss in liquefaction
and deliquification).

TABLE IEFFECT OF ALASKA'S ROYALTY GAS ON NATURAL GAS SUPPLY:
TENNECO MARKET AREA

<u>STATE</u>	<u>1975 Consumption (Bcf)</u>	<u>Tenneco % Share of Market</u>	<u>Tenneco Share of Market (Bcf)^{as}</u>	<u>Tenneco Royalty Gas Share of Market (%)^{as}</u>
*Alabama	260	10	26	.36
Arkansas	270	41	42	4.03
Connecticut	64	46	29	1.63
Illinois	1130	16	181	.57
Indiana	488	41	44	4.03
Kentucky	208	13	27	.46
Louisiana	1376	41	413	4.03
Maine	2	91	2	3.23
Maryland	147	20	29	.71
Massachusetts	153	53	81	1.88
Michigan	902	6	54	.21
Minnesota	318	2	6	.07
*Mississippi	208	4	8	.14
N. Hampshire	8	72	6	2.55
New Jersey	279	6	17	.21
New York	571	27	154	.96
No. Dakota	26	21	5	.75
Ohio	951	21	200	.75
Pennsylvania	698	27	188	.96
Rhode Island	22	23	5	.82
*Tennessee	255	39	99	1.39
*Texas	3911	41	439	4.03
Virginia	123	20	25	.71
W. Virginia	172	19	33	.68
Wisconsin	<u>367</u>	<u>14</u>	<u>51</u>	.50
TOTAL 25 STATES	12,879	9.9	1284	AG0 667934

Notes to Table I:

- * indicates state will receive additional royalty gas supplies from Southern Natural Gas:

Alabama receives 66% of supply from Southern
Mississippi receives 13% of supply from Southern
Tennessee receives 8 % of supply from Southern
- ** Tenneco share of market expressed in Bcf was calculated by multiplying each state's 1975 consumption by Tenneco's percentage share of market (Source of these figures was Table II from "Why Tenneco", published by Tenneco). Minor inaccuracies may have occurred due to rounding.
- *** Figures for Tenneco Royalty Gas share of market assume equal distribution among states by relative share of consumption

Tenneco was chosen as an example of the impact of royalty gas commitment because original data was readily accessible. Figures for 1976 consumption among the states served by Southern Natural Gas indicate similar results. El Paso service area figures were not available.

The calculations indicate that the addition of Alaska's royalty gas to U.S. supply will increase total U.S. supply by less than 1/2 of one percent.

Prepared for House Special Committee on the Sale of Royalty Gas

TENNECO'S INTERSTATE NATURAL GAS PIPELINES

MARKET AREA

Market Impact

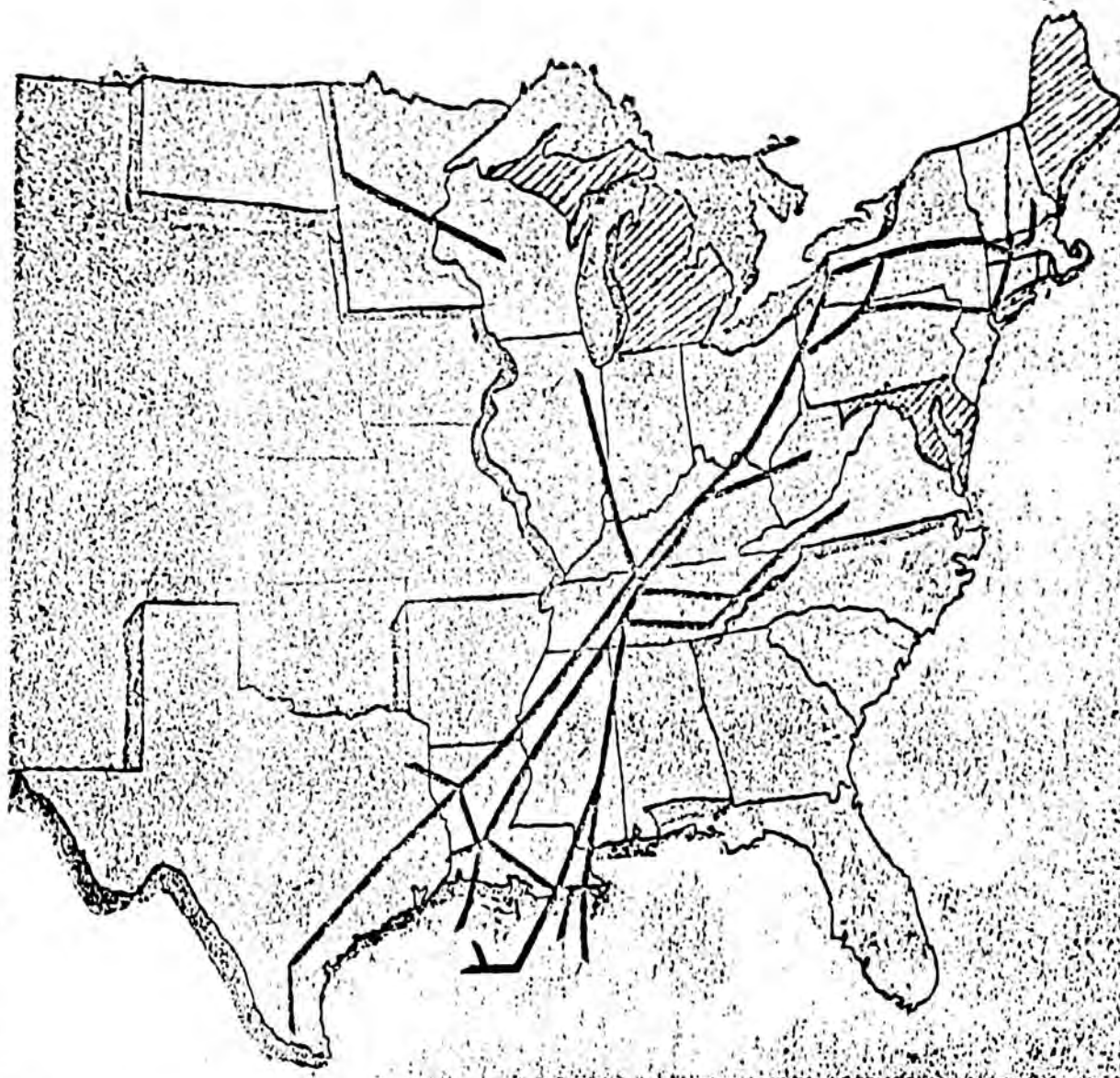
State	1975 ¹ Natural Gas Consumption (Bcf)	Tenneco's Share of Total State Gas Market	Population ²
Alabama	260	10%	3,577,000
Arkansas	270	<1	2,062,000
Connecticut	64	46	3,088,000
Illinois	1,130	16	11,131,000
Indiana	488	<1	5,330,000
Kentucky	208	13	3,357,000
Louisiana ³	1,376	<1	3,764,000
Maine ²	2	91	1,047,000
Maryland ²	147	20	4,094,000
Massachusetts	153	53	5,800,000
Michigan ²	902	6	9,098,000
Minnesota	318	2	3,917,000
Mississippi	208	4	2,324,000
New Hampshire	8	72	808,000
New Jersey	279	6	7,330,000
New York	571	27	18,111,000
North Dakota	25	21	637,000
Ohio	951	21	10,737,000
Pennsylvania	698	27	11,835,000
Rhode Island	22	23	937,000
Tennessee	225	39	4,129,000
Texas ²	3,911	<1	12,050,000
Virginia	123	20	4,908,000
West Virginia	172	19	1,791,000
Wisconsin	367	14	4,566,000
TOTAL	12,879		136,428,000

% of
United States 68% 65%

¹ Gas consumption based on Gas Requirements Committee, September, 1976 Report. Population data based on 1975 Statistical Abstract of the United States.

² Served indirectly through another wholesaler.

³ Louisiana provides 75% of Tenneco's gas. Texas provides 16%.



Source: "Why Tenneco" published by Tenneco
1976

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

Form 8

AMENDMENT TO APPLICATION OR REPORT

Filed pursuant to Section 12, 13 or 15(d) of the
Securities Exchange Act of 1934

For the Month of January 1976

Tenneco Inc.
P. O. Box 2511
Houston, Texas 77001

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 8

AMENDMENT TO APPLICATION OR REPORT

Filed pursuant to Section 12, 13 or 15(d)

of

THE SECURITIES EXCHANGE ACT OF 1934

TENNECO INC.

(Exact name of registrant as specified in charter)

AMENDMENT NO. 1

The undersigned registrant hereby amends its Current Report on Form 8-K for the month of January 1976 by providing information for the following item as set forth in the pages attached hereto:

ITEM 13

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this amendment to be signed on its behalf by the undersigned, thereunto duly authorized.

TENNECO INC.

BY EDWARD J. HARRISON
Edward J. Harrison
Senior Vice President and
General Counsel

Date: February 13, 1976

Item 13. Other Materially Important Events

In March 1975 the management and the Audit Committee (composed of four outside directors) of Tenneco Inc. reviewed certain payments to foreign business consultants during 1974 in connection with the acquisition or proposed acquisition of properties or materials from foreign governments or agencies thereof. It was concluded at such time that the payments were for valid business purposes and that there was no indication the payments were illegal or improper. Accordingly, no action was taken. Later in 1975, however, the matter was reconsidered by management because of the publicity concerning the new and emerging concept of "sensitive payments" and the concern expressed by various Securities and Exchange Commission (the "Commission") representatives with respect thereto. At a meeting in October 1975 the Audit Committee, with the concurrence of the full Board of Directors, determined that in light of the information presented at the meeting concerning such 1974 payments and the recent publicity concerning foreign and domestic bribes and political activities of an illegal or questionable nature by other corporations, management should undertake at once a full and complete review of the Company's foreign and domestic operations. Tenneco Inc. and its subsidiaries are hereinafter referred to as the "Company" unless otherwise indicated. The Audit Committee authorized Arthur Andersen & Co., the Company's independent public accountants, and Baker & Botts, the Company's outside legal counsel, to assist in such review. The Commission was promptly advised that, in compliance with the Commission's publicly enunciated and recommended voluntary disclosure program, the review was being made for the period beginning January 1, 1970 and that a report to the Audit Committee and to the Commission would be made as promptly as practicable.

The review has been conducted by representatives of Arthur Andersen & Co. and Baker & Botts, with the active assistance and cooperation of the Company's management. Interim reports by such representatives to the staff of the Commission were made on October 30, and December 18, 1975 and January 20, 1976. Reports to the Audit Committee, and to the full Board of Directors, were made on December 10, 1975 and January 7, 1976.

Information was obtained through written inquiries and personal interviews of executive personnel and other employees of the Company and of certain foreign consultants. Approximately seventy-five such persons have been contracted in one manner or the other, or both. Although no pattern of improper or questionable conduct was revealed either in foreign or domestic operations reviewed at the direction of the Audit Committee, there have been reports of apparently improper or questionable practices in certain instances.

The Company uses numerous local attorneys, advisers, consultants and agents in connection with certain of its foreign operations in approximately 24 countries. These individuals are independent businessmen, many of whom have written contracts with the Company relating to specific countries or areas or to specific projects. During the period January 1, 1970 through September 30, 1975, the Company made or accrued payments aggregating approximately \$12 million to such persons (or entities designated by them). Although it is not feasible to state with substantial certainty that none of the payments during such period, other than those described in the following paragraph, were indirectly for the

use or benefit of employees of foreign governments or agencies thereof, the investigation did not reveal the existence of any other payments to foreign government employees or military personnel or that any such payments were being "kicked back" to the Company or its employees or used to create a "slush fund" of any kind. However, in some cases the payments are made to the consultant or his nominee outside the country of his residence and verification of the end use of the payments is not feasible. The question of whether local laws of the countries involved are being violated by making such payments to the consultant or his nominee outside the country of his residence is being reviewed and will be reported to the Audit Committee.

Of the payments reviewed for such period, (i) \$10,000 is known to have been paid to a foreign government employee, (ii) \$25,000 is known to have been invested in a U.S. concern in which one or more foreign government employees probably have a beneficial interest, (iii) approximately \$500,000 was paid to the military and to certain military personnel in a foreign country for protection of a subsidiary's employees working in remote, dangerous locations and for rental of military aircraft and related equipment and (iv) a local sales manager of a subsidiary purchased in 1975 out of the subsidiary's petty cash fund merchandise valued at approximately \$480 and gave same to three employees or officials of a foreign government purchasing office or agency to which the subsidiary was selling equipment. The two payments totaling \$10,000 were improperly described on the books of the Company and may have been improperly deducted for U.S. income tax purposes. The \$25,000 investment is properly described on the books of the Company. The payments totaling \$500,000 for military protection and equipment were properly described on the Company's books and are considered properly deductible for U.S. income tax purposes because of the absolute necessity of military protection in that particular country. The \$480 payment was not correctly described on the Company's books.

In connection with negotiations involving proposed long-term, multi-billion dollar purchases of raw materials from certain countries, consultants have contractual commitments to receive from the Company additional sums aggregating up to approximately \$12.0 million (subject to adjustments, not presently subject to determination, under certain circumstances because of fluctuating currency exchange rates) plus out-of-pocket expenses upon successful conclusion of all phases of such arrangements.

Under contractual arrangements in four countries, the Company has made scholarship payments from time to time aggregating \$330,000 for the five years and nine months ended September 30, 1975.

In connection with certain sales of products through independent dealers in foreign countries, the Company follows the practice, where requested by such dealers, of withholding all or a portion of the dealer's commission as an account payable to the dealer or of paying all or a portion of the dealer's commission to a bank account outside the country in which the dealer resides. Such deposits are made by check directly to the dealer's designated bank account. Commissions not paid by check are either disbursed in cash or by credit

against amounts due the Company. The payments are properly described on the Company's books and the Company's tax returns. The question of whether local laws of the countries involved are being violated is being reviewed and will be reported to the Audit Committee.

The Audit Committee of the Board of Directors has directed management of the Company to formulate procedures and policies to eliminate possible irregularities in connection with foreign operations and to present such procedures and policies to the Audit Committee and the Board of Directors for review, comment and approval. Thereafter, management will be charged with the responsibility, through internal audit procedures and such other techniques as may be deemed reasonably necessary (including disciplinary action, and, where appropriate, dismissal for violations), of insuring compliance with such procedures and policies on a company-wide basis. In this connection, and in addition to broader policy statements to be enunciated with respect to U.S. and foreign business operations in general, management intends to recommend the affirmation of substantially the following policy regarding payments which may be made in any country in connection with the purchases of products or raw materials or the sale of products or services:

"The Board of Directors and management of Tenneco Inc., having due regard for and recognition of the responsibilities arising from and attendant to international operations, hereby affirm the corporate policy of Tenneco Inc., its subsidiaries and divisions to the effect that all employees and agents are to comply with the ethical standards and legal requirements of each foreign country in which business is conducted."

Commencing in 1966 or 1967 many high-level executives of the Company made annual cash contributions of \$2,000 each to a fund to be used for political contributions. It is reported that approximately twenty executives made contributions each year and that the fund did not exceed \$40,000 in any one year. It is reported that this fund was discontinued after 1973. Under applicable Federal law, the legality of the fund turns primarily on "voluntariness". If there was direct or indirect coercion or inducement, whether in terms of advancement or company cars or other job perquisites, the fund would probably be deemed illegal. "Voluntariness" is a subjective determination by each individual participant, and most participants would probably state that their contributions were made voluntarily. For this reason, it is believed that the establishment of the fund did not violate Federal law.

Another employee fund was established at the Newport News Shipbuilding subsidiary before it was acquired by the Company in 1968. Cash contributions were made to the fund by high-level executives of the subsidiary. It is believed that contributions were made only once in the aggregate amount of approximately \$10,000. The fund presently has a balance of \$2,370 and is in the custody of the subsidiary's general counsel. Disbursements from the fund were made at the direction of the President of the subsidiary. The establishment of the fund is considered to comply with applicable Federal law on the basis that contributions were made voluntarily.

Recipients of campaign contributions from the Company's executive fund are believed to have been generally

determined by the chief executive officer of the Company. During the fund's existence from 1966 or 1967 until 1973, campaign contributions were made in Federal elections and in state and local elections. It is believed that contributions in state and local elections were made primarily in Texas and Louisiana. Contributions from a voluntary employee fund are specifically permitted by Federal election law and the Supreme Court has held that such voluntary employee funds were permissible prior to enactment of such election law. It is believed that such contributions are also permissible under Texas and Louisiana law, although no specific statutory authority exists, because of analogous Federal judicial precedent exempting voluntary employee funds and the intent of the law to prohibit only contributions of corporate money.

Contributions were made from the Newport News Shipbuilding employee fund in one Federal election and various state and local elections in Virginia. The contribution to the Federal election is believed to comply with Federal election law on the basis that the contribution was made from a voluntary employee fund. The state and local contributions are likewise believed to be permissible. In any event, state and local corporate contributions are permitted by Virginia law.

During the period from January 1, 1970 through December 1, 1975, three subsidiaries, Tenneco West, Inc., Heggblade-Marguleas-Tenneco Inc. and Stockdale Development Corporation, made campaign contributions in California elections aggregating approximately \$180,000. State and local corporate campaign contributions are permissible under California law.

It has been reported that since 1970 two corporate campaign contributions of \$100 each were made by local sales managers of a subsidiary, J. I. Case, in connection with state or local elections in Rhode Island and Florida, in both of which states corporate campaign contributions in state and local elections are believed to be permissible. In one or, perhaps, both of such cases, the contribution was not correctly described on the subsidiary's books and/or was improperly deducted for tax purposes.

Beginning prior to 1970 and continuing until August 1972, it is reported that cash amounts ranging from \$200 to \$2,000 were given on several occasions by the President of a subsidiary, Midwestern Gas Transmission Company, to state public utility commission chairmen in Indiana, Illinois, Kentucky and Wisconsin. The subsidiary officer states that the money was understood to be given in turn by the recipients to various charitable projects of their choice. In 1972 the same subsidiary officer gave \$2,000 in cash to the chairman of the Pennsylvania Public Utility Commission. The officer states that the Pennsylvania chairman requested the money for use as a contribution to a chairtable dinner in Washington, D.C., honoring a U.S. Senator from Pennsylvania. The money was given to the Pennsylvania chairman several months after the dinner, and the Pennsylvania chairman states that the money was applied as a reimbursement of his contribution to the dinner. Two other employees of the Company state that they believe or had heard that the money was given to the Pennsylvania chairman to obtain his influence with the head of the General Services Administration, which was participating as an

intervenor in a Federal Power Commission regulatory proceeding, Rate Proceeding 71-6, to which a Company division, Tennessee Gas Pipeline, was a party. The subsidiary officer who delivered the payment and the Pennsylvania chairman deny that this payment had any connection with such proceeding. The money was given to the Pennsylvania chairman several months after the regulatory proceeding had been ultimately resolved in a manner favorable to the division. The Company's executive fund may have been the source of these payments, although this has not been clearly determined since there are no records of disbursements from the fund and the recollections of the subsidiary President and the administrator of the fund differ.

Beginning on October 27, 1970, and continuing until September 1975, a subsidiary, Tenneco Oil Company, made payments of \$2,000 per month to the sheriff of a Louisiana parish who is also an attorney. There are conflicting statements regarding the reason or reasons for the payments. The payments were approved by senior management of the subsidiary, but there is no evidence that the Board of Directors or high-level management of Tenneco Inc. were aware of the arrangement. The sheriff is presently under investigation by officials of the U.S. Department of Justice, and the Company does not believe that it would be appropriate to comment further about the matter pending resolution of such Federal investigation.

In June 1970, a \$2,000 cash campaign contribution was made to a State District Judge in Louisiana for use in his race for a Louisiana appellate court seat. Approximately eighteen months prior to the contribution, the Judge had granted an injunction against violence on the picket line in connection with a union strike at the plant of a Company subsidiary, Tenneco Oil Company. Approximately two months after the contribution was made, the union filed a motion to dissolve the injunction, which was denied by the Judge in late 1970. The \$2,000 was given to the Judge by a local employee of the subsidiary. The payment was approved by senior management of the subsidiary, but there is no evidence that the Board of Directors or high-level management of Tenneco Inc. were aware of this payment. The money probably came from either the personal funds of an officer of the subsidiary or the Company's executive fund, and not from corporate funds. It is believed that the campaign contribution did not violate the Louisiana prohibition against corporate contributions which was then in effect because the money probably did not come from corporate funds.

In 1972 contributions of \$1,000 each were made by a subsidiary, Tenneco Oil Company, to two Louisiana District Judges and a Louisiana District Attorney who were running for re-election, all in the same parish. The contributions were made in cash by an employee from the subsidiary's working fund account. The payments were incorrectly described on the subsidiary's books and improperly deducted for tax purposes. The contributions were approved by senior management of the subsidiary, but there is no evidence that the Board of Directors or high-level management of Tenneco Inc. were aware of the payments. The contributions violated the then existing Louisiana prohibition against corporate campaign contributions.

Tenneco proposes to turn over to the Internal Revenue Service the relevant information relating to the foregoing matters and to amend tax returns and make additional payments where appropriate. It is not considered at this time that material income tax deficiencies will result.

At its meeting in October 1975 the Audit Committee of the Board of Directors approved and adopted the following policy statements:

1. The use of assets of the Company or any subsidiary for any unlawful or improper purpose is strictly prohibited;
2. No undisclosed or unrecorded fund or asset of the Company or any subsidiary shall be established for any purpose;
3. No false or artificial entries shall be made in the books and records of the Company or its subsidiaries for any reason, and no employee shall engage in any arrangement that results in such prohibited act;
4. No payment on behalf of the Company or any of its subsidiaries shall be approved or made with the intention or understanding that any part of such payment is to be used for any purpose other than that described by the documents supporting the payment;
5. Any employee having information or knowledge of any unrecorded fund or asset or any prohibited act shall promptly report such matter to the chief executive officer or general counsel of Tenneco Inc.;
6. All executive officers of the Company shall be responsible for the enforcement of and compliance with this policy including necessary distribution to ensure employee knowledge and compliance;
7. Appropriate officers and employees will periodically be required to certify compliance with this policy; and
8. This policy is applicable to Tenneco Inc. and all its domestic and foreign subsidiaries.

The Audit Committee has also directed management to implement procedures for insuring compliance with such policies and to report to the Audit Committee and to the Board of Directors with respect thereto. Following such report and review thereof by the Board of Directors of the Company, a definitive statement of such policies and procedures will be distributed on a company-wide basis.

The matters described herein have been voluntarily disclosed by the Company, and the Company has advised the staff of the Commission that its documents, books and records relating to the investigation ordered by the Audit Committee will be made available at the Company's offices for examination by the staff of the Commission upon request.

In keeping with the practice of other companies reporting matters of the type described herein, the Company

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

Form 8

AMENDMENT TO APPLICATION OR REPORT

Filed pursuant to Section 12, 13 or 15(d) of the
Securities Exchange Act of 1934

For the Month of January 1976

Tenneco Inc.
P. O. Box 2511
Houston, Texas 77001

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 8

AMENDMENT TO APPLICATION OR REPORT
Filed pursuant to Section 12, 13 or 15(d)
of
THE SECURITIES EXCHANGE ACT OF 1934

TENNECO INC.
(Exact name of registrant as specified in charter)

AMENDMENT NO. 2

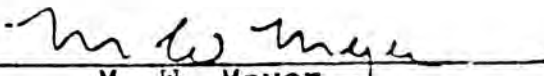
The undersigned registrant hereby amends its Current Report on Form 8-K for the month of January 1976 by providing information for the following item as set forth in the pages attached hereto:

ITEM 13

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this amendment to be signed on its behalf by the undersigned, thereunto duly authorized.

TENNECO INC.

By


M. W. Meyer
Assistant Secretary

Date: February 23, 1976

Item 13. Other Materially Important Events.

February 13, 1976 Tenneco Inc. filed Amendment No. 1 to its Form 8-K Current Report for the month of January 1976, containing in part the following statements:

"Beginning prior to 1970 and continuing until August 1972, it is reported that cash amounts ranging from \$200 to \$2,000 were given on several occasions by the President of a subsidiary, Midwestern Gas Transmission Company, to state public utility commission chairmen in Indiana, Illinois, Kentucky and Wisconsin. The subsidiary officer states that the money was understood to be given in turn by the recipients to various charitable projects of their choice."

By affidavit dated February 23, 1976 George Perrine made the following statements:

"I was President of Midwestern Gas Transmission Company from 1961 until August 1972. I am presently a consultant to Tenneco Inc. Although I gave the information quoted above in substantially the language therein to Tenneco Inc. representatives, upon further reflection I am unable to recall any names, dates or amounts or whether any sums were actually delivered to public utility commission chairmen, members or employees in any of the states of Indiana, Illinois, Kentucky or Wisconsin or elsewhere. Because of such inability to recall specific information, I have concluded that my original statement was in error."

Item 14. Financial Statements and Exhibits.

(b) Exhibits

1. Affidavit of George Perrine dated February 23, 1976.

THE STATE OF TEXAS §

COUNTY OF HARRIS §

AFFIDAVIT OF GEORGE PERRINE

BEFORE ME, this day personally appeared George Perrine, who, after being duly sworn, deposed and said:

I.

My name is George Perrine. I have personal knowledge of every statement made in this Affidavit and am fully competent to testify about the matters stated herein.

II.

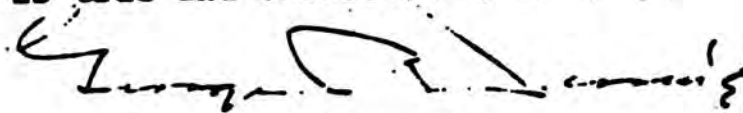
I understand that Tenneco Inc. has filed Amendment No. 1 on Form 8 amending its Current Report on Form 8-K for the month of January 1976, and that the following appears as part of said Amendment:

"Beginning prior to 1970 and continuing until August 1972, it is reported that cash amounts ranging from \$200 to \$2,000 were given on several occasions by the President of a subsidiary, Midwestern Gas Transmission Company, to state public utility commission chairmen in Indiana, Illinois, Kentucky and Wisconsin. The subsidiary officer states that the money was understood to be given in turn by the recipients to various charitable projects of their choice."

III.

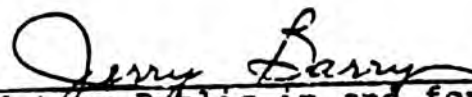
I was President of Midwestern Gas Transmission Company from 1961 until August 1972. I am presently a consultant to Tenneco Inc. Although I gave the information quoted above in substantially the language therein to Tenneco Inc. representatives, upon further reflection I am unable to recall any names, dates or amounts or whether any sums were actually delivered to public utility commission chairmen, members or employees in any of the states of Indiana, Illinois, Kentucky or Wisconsin or elsewhere. Because of such inability to recall specific information, I have concluded that my original statement was in error.

Further, the affiant sayeth not and I have read
the foregoing Affidavit and it is true and correct.



George Perrine

SUBSCRIBED AND SWORN TO before me by George Perrine
on this 23rd day of February, 1976.



Notary Public in and for
Harris County, Texas

JERRY BARRY

My Comm. Expires: February 28, 1977

77

112677

EFFECT OF ALASKA'S ROYALTY GAS ON NATURAL GAS SUPPLY:

TENNECO MARKET AREA (25 states)

Prudhoe Bay natural gas production rate is assumed to be
2.0 Bcf/day

Yearly Prudhoe Bay natural gas production 730 Bcf.

Royalty Share of Prudhoe Bay production = $1/8$ of 730 Bcf = 91.25 Bcf/Year.

Tenneco Share of Royalty Gas = 50 % of 91.25 Bcf = 45.625 Bcf/year.

Tenneco Summary of Operating Data (from "Tenneco Statistics 1975")

Volume of Gas sold and transported: 1,634 Bcf
Volume of Gas purchased: 1,459 Bcf

Tenneco's share of 25-state gas market:
1,284 Bcf
9.9 %

Tenneco's share of royalty gas as a per cent of Tenneco's
share of 25-state gas market:

$$(45.625 \text{ Bcf/year} / 1,284 \text{ Bcf/year}) = 3.55 \%$$

Tenneco's share of royalty gas as a per cent of total
25-state gas consumption:

$$(45.625 \text{ Bcf/year} / 12,879 \text{ Bcf/year}) = 0.35 \%$$

Total U.S. Consumption of Natural Gas in 1975 (rounded): 19,000 Bcf

Yearly Royalty Gas Production as a percent of total U.S. Consumption:

$$(91.25 \text{ Bcf/year} / 19,000 \text{ Bcf/year}) = 0.48 \%$$

Yearly Prudhoe Bay gas production as a percent of total U.S.
Consumption:

$$(730 \text{ Bcf/year} / 19,000 \text{ Bcf/year}) = 3.84 \%$$

Note: Above calculations do not take into account shrinkage of
natural gas through transportation (e.g. 6% loss in liquefaction
and deliquification).

TABLE I

EFFECT OF ALASKA'S ROYALTY GAS ON NATURAL GAS SUPPLY:
TENNECO MARKET AREA

<u>STATE</u>	<u>1975 Consumption (Bcf)</u>	<u>Tenneco % Share of Market</u>	<u>Tenneco Share of Market (Bcf)**</u>	<u>Tenneco Royalty Gas Share of Market (%)**</u>
*Alabama	260	10	26	.36
Arkansas	270	41	42	4.03
Connecticut	64	46	29	1.63
Illinois	1130	16	181	.57
Indiana	488	41	44	4.03
Kentucky	208	13	27	.46
Louisiana	1376	41	413	4.03
Maine	2	91	2	3.23
Maryland	147	20	29	.71
Massachusetts	153	53	81	1.88
Michigan	902	6	54	.21
Minnesota	318	2	6	.07
*Mississippi	208	4	8	.14
N. Hampshire	8	72	6	2.55
New Jersey	279	6	17	.21
New York	571	27	154	.96
No. Dakota	26	21	5	.75
Ohio	951	21	200	.75
Pennsylvania	698	27	188	.96
Rhode Island	22	23	5	.82
*Tennessee	255	39	99	1.39
*Texas	3911	41	439	4.03
Virginia	123	20	25	.71
W. Virginia	172	19	33	.68
Wisconsin	367	14	51	.50
TOTAL 25 STATES	12,879	9.9	1284	25

Notes to Table I:

- * indicates state will receive additional royalty gas supplies from Southern Natural Gas:

Alabama receives 66% of supply from Southern
Mississippi receives 13% of supply from Southern
Tennessee receives 8 % of supply from Southern
- ** Tenneco share of market expressed in Bcf as calculated by multiplying each state's 1975 consumption by Tenneco's percentage share of market (Source of these figures was Table II from "Why Tenneco", published by Tenneco). Minor inaccuracies may have occurred due to rounding.
- *** Figures for Tenneco Royalty Gas share of market assume equal distribution among states by relative share of consumption

Tenneco was chosen as an example of the impact of royalty gas commitment because original data was readily accessible. Figures for 1976 consumption among the states served by Southern Natural Gas indicate similar results. El Paso service area figures were not available.

The calculations indicate that the addition of Alaska's royalty gas to U.S. supply will increase total U.S. supply by less than 1/2 of one percent.

Prepared for House Special Committee on the Sale of Royalty Gas

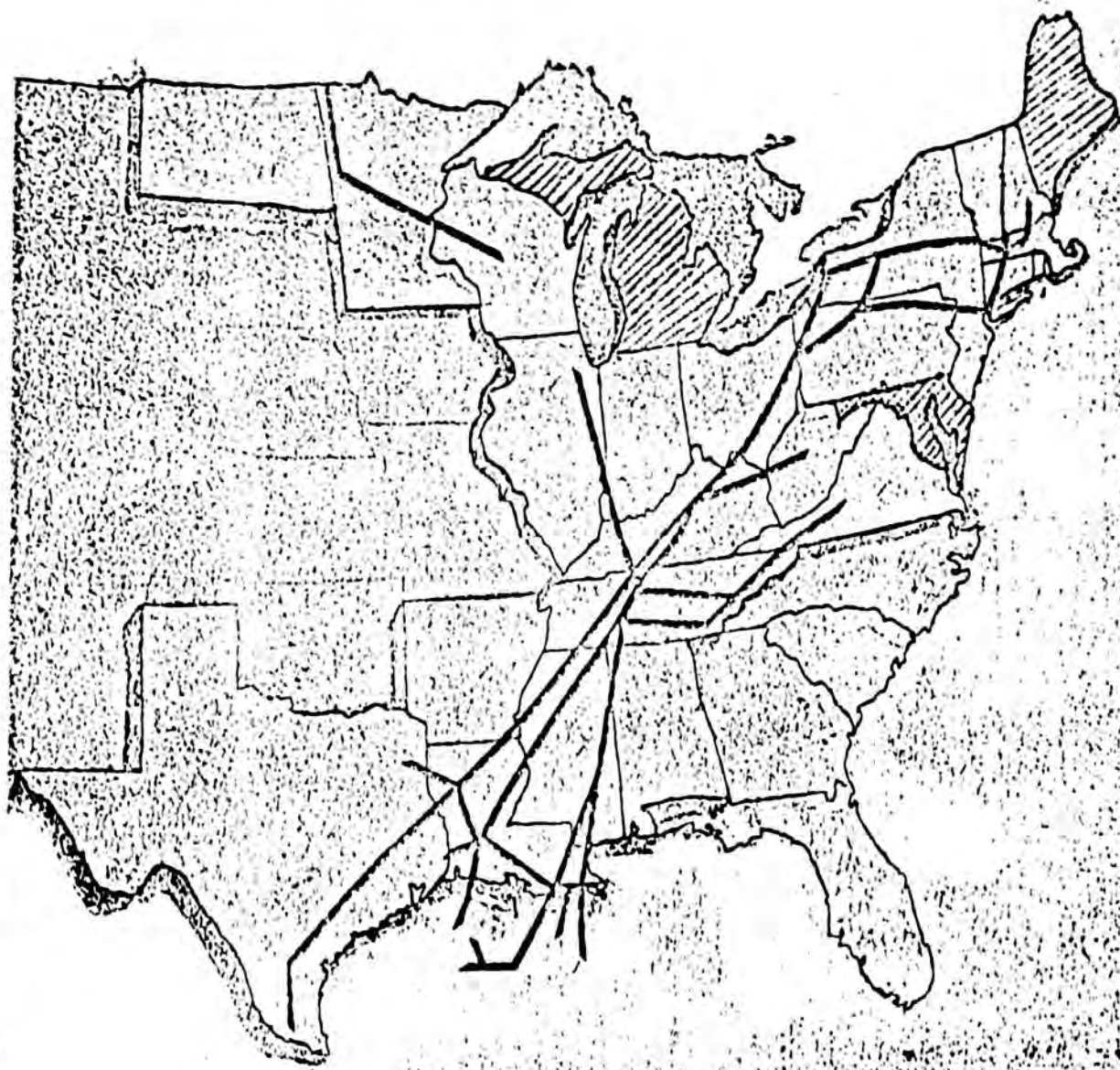
TENNECO'S INTERSTATE NATURAL GAS PIPELINES MARKET AREA

Market Impact

State	1975 ¹ Natural Gas Consumption (Bcf)	Tenneco's Share of Total State Gas Market	Population ²
Alabama	260	10%	3,577,000
Arkansas	270	<1	2,062,000
Connecticut	64	46	3,088,000
Illinois	1,130	16	11,131,000
Indiana	488	<1	5,330,000
Kentucky	208	13	3,357,000
Louisiana ³	1,376	<1	3,764,000
Maine ²	2	91	1,047,000
Maryland ²	147	20	4,092,000
Massachusetts	153	53	5,800,000
Michigan ²	902	6	9,098,000
Minnesota	318	2	3,917,000
Mississippi	208	4	2,324,000
New Hampshire	8	72	808,000
New Jersey	279	6	7,330,000
New York	571	27	18,111,000
North Dakota	26	21	637,000
Ohio	951	21	10,737,000
Pennsylvania	698	27	11,835,000
Rhode Island	22	23	537,000
Tennessee	225	39	4,129,000
Texas ²	3,911	<1	12,050,000
Virginia	123	20	4,908,000
West Virginia	172	19	1,791,000
Wisconsin	367	14	4,566,000
TOTAL	12,879		136,428,000

% of
United States 68% 65%

¹ Gas consumption based on Gas Requirements Committee, September, 1976 Report. Population data based on 1975 Statistical Abstract of the United States.
² Served indirectly through another wholesaler.
³ Louisiana provides 75% of Tenneco's gas. Texas provides 16%.



Source: "Why Tenneco" published by Tenneco
1976

SCOMM

#21:22



C. V. "CHAT" CHATTERTON

2308 BONIFACE PARKWAY
ANCHORAGE, ALASKA 99504
(907) 333-8161

WHILE IN JUNEAU
POUCH V
JUNEAU, ALASKA 99311
(907) 586-2660

February 10, 1977

Representative Clark Gruening, Chairman
Special Committee to Consider Sale of Royalty Gas
Alaska State Legislature

Dear Representative Gruening:

Per your request, my comments follow regarding the salient points which I was able to gather from the recent public hearings regarding the proposed Royalty Gas Sales Contracts.

Given assurance under present Federal statute and regulation, that wellhead price for natural gas at Prudhoe Bay will be a constant figure; that availability of a marketplace for Prudhoe Bay natural gas is equally equivalent regardless of route, there is little question but what a trans-Alaska transmission system for movement of the Prudhoe Bay natural gas is in the best interest of Alaska. And for as long as the foregoing premises remain constant, the best interest of Alaskans will continue to be best served by a trans-Alaska routing.

Testimony was strongly suggestive that present Federal statutes and regulations regarding the establishment of a wellhead price for natural gas at Prudhoe Bay will continue to be in existence for several years to come. In fact, our own retained expert testified that he saw little chance for relaxation of current regulations establishing wellhead price in less than ten years.

With possible relaxation of Federal regulatory statutes some ten-plus years from now, it could very well be that the wellhead price of Prudhoe Bay gas will be a function of the total capital outlay and operating expense required for a transmission system from Prudhoe Bay to a marketplace in the South 48. Under such relaxation of regulations wellhead price at Prudhoe Bay might be substantially lower for a transmission system to the South 48 which was substantially higher in cost to construct and operate than a less expensive alternate. Such a potential lowering in wellhead price might indeed result in a negative financial offset for Alaskans

than Alaskans might gain from the construction and operation of an All-Alaska system.

I further gathered from testimony that the Alaska Pipeline Act requires the Federal Government to make a binding decision upon the routing of a transmission system within the forthcoming year. Because of the short time fuse on the Federal decision as to route selection we cannot worry about what may or may not happen to FPC regulations ten years from now. Rather, we are forced to base our decisions upon facts as they exist today. And conditions today certainly favor the All-Alaska transmission route as being in the best interest of Alaskans.

Testimony, although quite varied as to degree, was strongly suggestive that legislative approval of the proposed Gas Sales Contract would, at least provide minuscule strengthening of Alaska's hand on the Federal level with respect to encouraging a final decision in favor of the Alaska route.

Testimony was also introduced that indicated, on the basis of all predicted reservoir performance, that with an operating and production program calling for 1.2 million barrels per day of oil, early gas sales in the amount of 2 billion cubic feet per day, or more, would sacrifice ultimate recovery of hydrocarbons (or energy) from the Prudhoe Bay reservoir. And testimony generally stated that the economic threshold, with respect to a daily throughput, was approximately 2 billion cubic feet per day of natural gas in order to make the transmission system a viable economic venture. Further, testimony indicated that at best, reservoir predictions were relative and not absolute. Only by close monitor and observance of actual reservoir performance after production is initiated and continued over a long time period can we gain, beyond all reasonable doubt, sufficient knowledge to make a determination as to what amounts of gas, if any, is indeed surplus to the needs to insure maximum ultimate recovery of hydrocarbons from the reservoir.

The best interest of we Alaskans and those who follow can only be served by maximizing ultimate hydrocarbon recovery from that field. This is one point that in our deliberations we should never overlook. Nor should we overlook the fact that we are dealing at Prudhoe Bay with a reserve of crude oil with associated gas. Crude oil is the prime resource by several fold with respect to both volume and value of the hydrocarbon reserve that nature saw fit to place in the Prudhoe Bay reservoir. Retaining gas within the reservoir will assure that we will always be able to maximize the recovery of crude

oil from the reservoir. By retaining associated gas in the reservoir until the maximum ultimate recovery of black oil is achieved assures us that we still have remaining in that reservoir the associated gas which some two or three decades from now will have increased value over that of today. Once black oil is fully recovered, we still have an economic reserve within the reservoir of salable gas that will continue for several years to come, one or two decades to yield a non-renewable income for the State of Alaska.

Testimony indicated that, had a transmission system from the Prudhoe gas cap to the South 48 been in existence a week ago, the President of the United States would have had the full authority to call upon the production of that natural gas to meet the South 48 needs, even though it could be extremely detrimental to the welfare of we Alaskans by materially affecting ultimate recovery from our Alaskan oil field. Such national emergency needs can well develop again and again. So long as we have no transmission system to the South 48 to move natural gas, we Alaskans can rest assured that the maximum benefit will continue to be achieved from the Prudhoe Bay reservoir. Only when we are assured, beyond all reasonable doubt, that the associated gas is indeed surplus to our needs should we permit the construction of a transmission system from Prudhoe Bay to the South 48.

However, testimony was strongly suggestive that our state's 1/8th Royalty Gas was merely a 1/8th tail attempting to wag a 7/8ths dog. In other words, contractual sale or commitment of Alaska's 1/8th associated gas today would in no way aide or abet the early construction of a transmission system to the South 48. The other 7/8ths of the dog is needed before sufficient volumes are realized to make a gas transmission system economically viable. As of this date, according to testimony, the other 7/8ths of the associated gas has not been committed for sale.

Testimony further was suggestive that in view of the control exercised under statute by our Alaska Oil & Gas Conservation committee, it would be doubtful if sufficient financing could be obtained for the construction of a gas transmission system until the Conservation Committee can first assure the financial centers that 2 billion cubic feet a day of associated gas or more would be available day after day on an uninterrupted basis for approximately a twenty year period. And it is my conviction that so long as our Oil & Gas Conservation Committee is isolated from political and economic pressures, they will continue to act with utmost prudence to insure the maximum benefit to Alaskans from our

* Solution gas from 1.2 MM Bbls/Dy oil production is less than 1 billion cu ft/Dy

Representative Clark Gruening
February 10, 1977
page 4

natural resources within the State. In short, it may well be ten to twenty years before the Conservation Committee can with any degree of certainty assure that associated gas is surplus to our needs, and can be exported at an uninterrupted 2 billion cubic foot daily rate for a twenty year period.

Based principally upon the foregoing, it is my determination that the approval of the Royalty Gas Sales Contract by the Legislature will have a plus value in the selection by the Federal Government for the routing of a gas transmission system from Prudhoe Bay to the South 48. Further, it is now my conviction that approval of the Royalty Gas Sales Contracts by the Legislature will not aide or abet early construction of a gas outlet for Prudhoe Bay's associated natural gas. I say this because it is my strong belief that the overriding consideration governing the availability of finance for a transmission system is the Oil & Gas Conservation Committee's ability to "turn-off the valve" at any point in time; whenever they believe that continued gas production is deleterious to overall reservoir performance with resulting loss in ultimate recovery.

Should public money enter into the picture, of course, the premise upon which I base my position no longer is valid. But in no way do I see public funds being made available at this point in time for assistance in the financing of a transmission system.

Accordingly, it is my recommendation that the Legislature approve the Royalty Gas Sales Contracts as they now stand before us.

Representative C. V. "Chat" Chatterton
Special Committee to Consider Sale of Royalty Gas

El Paso Seeks Continued Rate Base Treatment of Advance Payments for Alaskan Gas Beyond Initial Five-Year Term

On 10/6/78 the FERC issued notice of a petition filed 9/27/78 by El Paso Natural Gas Co. (RP72-116) requesting approval for continued rate base treatment of Alaskan advance payments made to Atlantic Richfield Co., Amoco Production Co. and Phillips Petroleum Co. under agreements dated in 1972. In the aggregate, these advances totalled \$3.9 million as of 7/31/78.

Each of the agreements provides for recoupment of the advance payments from the proceeds of oil and gas production from the prospect areas for which the funds were advanced. In addition, El Paso's agreement with Phillips contains a backup provision whereby, if the advances have not been fully recovered by El Paso within a specified time (five years after the date of first deliveries from the funded area, or eight years from the date of the first advance), Phillips will assign a portion of its net revenues from oil and gas leases in the Prudhoe Bay area as an additional source of recoupment.

Rate base inclusion of the above advances was approved by FPC Opinion No. 673 (issued 11/6/73) ^{1/} subject to termination of such treatment and reduction of El Paso's rates if gas deliveries had not commenced within five years and no determination had been made that recovery would be made in economic consideration other than gas. The Commission provided, however, that El Paso could seek continued rate base treatment upon submission of evidence explaining why recoupment of the advances had not commenced, why further rate base inclusion was warranted, and what costs would result for El Paso's customers. In accordance with these conditions, El Paso asked to continue rate base treatment until five years from commencement of gas deliveries from the Kavic prospect area through the Alaska natural gas transportation system (or until full recovery of the advances, if earlier) in the case of the advances to Atlantic Richfield and Amoco, and until full recoupment of the advance to Phillips. In view of the backup recoupment provision in its advance payment agreement with Phillips, El Paso estimated that full recovery of the advance to Phillips would occur no later than June 1981.

In support, El Paso referred to a recent letter from Atlantic Richfield advising that the Kavic reservoir is estimated to contain approximately 100 Bcf of proven reserves and some 232 Bcf of potential reserves, based on an analysis of the three wells drilled to date. However, commencement of production depends upon completion of an Alaskan natural gas transportation system, which is not estimated to be operative until at least 1983. Since delays incident to construction of the pipeline are beyond El Paso's control, El Paso contended that extension of rate base treatment for five years from commencement of deliveries from the Kavic prospect area is appropriate. The prospect area underlying the Phillips advance has not been determined to be productive of oil or gas, El Paso added, but continued rate base inclusion of this advance to the extent requested is nevertheless justified because, if gas had been discovered, full recoupment would occur pursuant to the

^{1/} By order dated 12/31/75, El Paso and three other pipelines who made Alaskan advance payments under contracts executed prior to Order No. 499 (issued 12/28/73) were directed to show cause why rate base treatment for these advances should not be terminated as of 12/31/75 and why refund of all carrying charges should not be required. The show cause order was issued at the same time as another order which terminated rate base inclusion of Alaskan advances covered by contracts executed after 12/28/73. The four pipelines filed responses to the show cause order in March 1976, and no further action has been taken by the Commission since that time.

backup provision due to the unavailability of a pipeline to transport North Slope gas until at least 1983. Assuming full recoupment under the backup provision by June 1981, El Paso said the Phillips advance will have been accorded rate base treatment for approximately seven years and nine months, which is well within the ten-year maximum period contemplated by Opinion Nos. 673 and 673-A if gas had been discovered in the funded area.

As further justification, El Paso argued that the subject advances were designed to benefit its customers in two respects. First, the advances served to accelerate exploration and development of nonassociated gas reserves necessary to support the implementation of a pipeline system to transport North Slope reserves. "Without the development of substantial dry gas reserves, a pipeline system would be totally dependent upon the associated gas reserves of the Prudhoe Bay Field." Second, the advance payment program gave El Paso a call on a portion of those reserves, thus insuring that gas from the North Slope would actually reach El Paso's customers by means of any pipeline project ultimately implemented. In short, El Paso declared, since the Alaskan advances represent investments made for the benefit of its customers, it would clearly be unfair to require the company's shareholders to bear the carrying costs thereof during any period of postponement in recoupment of the advances, particularly when that postponement results from delays in construction of a gas pipeline and other factors beyond El Paso's control. Moreover, El Paso added, denial of rate coverage of advance payment investments during a period of unavoidable delay in recovery would "operate as a disincentive to future efforts by El Paso, and by the industry generally, to undertake innovative gas supply projects. . . . [S]uch disincentive would be deleterious not only to the pipeline companies themselves, but also to their customers who would benefit from such projects."

If rate base treatment for its outstanding Alaskan advance payments is discontinued five years after the inclusion of each advance in Account 166, El Paso estimated that its total revenues would be reduced by approximately \$4.3 million over the next ten years.

El Paso also observed that all three of the producers here involved had rejected requests to consider expedited or alternative recoupment of the advances.

In conclusion, El Paso called attention to an FPC order of 7/29/77 conditionally granting a petition by Columbia Gas Transmission Corp. (RP76-159) to continue rate base treatment of a \$60 million advance to BP Oil Corp. for Alaskan North Slope gas beyond the initial five-year period approved in Opinion No. 674, issued 11/6/73. 1/ El Paso said the circumstances surrounding its advances are similar to those surrounding Columbia's advance, and hence similar treatment is warranted.

1/ More recently, on 6/28/78, the FERC conditionally authorized continued rate base treatment of advance payments made by Northern Natural Gas Co. (RP71-107, Phase II and RP72-127) for Alaskan gas under agreements executed prior to 12/28/73. (See REPORT NO. 1162, pp17-20.)

December 16, 1976

The Honorable John Rader
Alaska State Senator
P. O. Box 2068
Anchorage, Alaska 99501

Dear Senator Rader,

As you know, we are now entering the final, decisional phase of the North Slope gas pipeline controversy. The recently enacted Procedural Bill calls for an FPC recommendation by May 1, 1977, a decision by the President by September 1 and Congressional ratification within 60 days thereafter. Only two opportunities remain for input to the FPC by the applicants and other parties to the proceedings -- oral argument on the Judge's preliminary decision after January 15, and a "Brief on Exceptions" following his final recommendation (to be filed by March 1).

The State of Alaska will have one additional occasion to provide formal, direct input to the President. It is to be submitted by July 1, 1977.

Thus, the arena is shifting from the FPC regulatory phase to a purely political phase involving the federal administration and the Congress, and we and our allies are gearing up for increased promotional and lobbying efforts in behalf of the trans-Alaskan gas pipeline route.

An important influence on the ultimate success of these activities will be the State of Alaska's recent commitment of surplus Prudhoe Bay royalty gas to El Paso, Southern and Tenneco. We believe that such commitment is critical, because

- (i) it is a real expression of the State of Alaska's solid support for the trans-Alaska route,
- (ii) it brings Tenneco and Southern -- two substantial allies -- to the fight, and
- (iii) it will help create a national constituency in the 38 states that will be the beneficiaries of surplus royalty gas if the trans-Alaska route is approved.

December 16, 1976

We are advised by representatives of OMAR that you have been furnished a copy of the royalty gas contract. We hope that you have been able to read through it, and that you agree it is a fair and equitable arrangement for both the state and the purchasers. It has a 20-year term; it provides that the highest possible wellhead price will be paid to the state; and it allows the state to take back its gas in any amount and at any time in order to serve Alaskan markets as they develop.

It is also fortunate that the contracts were completed in time to allow the state to make them a part of the FPC record prior to its closing. In view of the suggested possibility that the Procedural Bill might be reconsidered by Congress next spring, we believe that placing the contracts before the FPC will provide additional assurances that the state will retain the right to recall its gas.

We hope that you will support early consideration and approval of the royalty gas contracts when the Legislature convenes next January. Since the decisional dates are now (essentially) firmly set, we have an excellent understanding of the time remaining for us to influence the final determination. Obviously, each day of delay in approval of the contracts is one less day that we can use their very meaningful leverage.

Turning briefly to another subject, you have probably heard that the FPC Staff recently endorsed the Arctic Gas route. Inasmuch as the Staff's position was developed on a strictly traditional basis, essentially ignoring the international ramifications of the two trans-Canadian proposals, we are not in any way discouraged by Arctic Gas' "winning" this first round. It was very disappointing that Staff would judge the competing proposals in this very unique case as they would any conventional pipeline in the lower 48. However, when other federal agencies, the President and the Congress become involved, the existence of Canada will no longer be ignored and the real disadvantages of Arctic Gas and Alcan will become known. When that occurs, the El Paso project should carry the day.

The FPC Staff position also reaffirmed the fact that our real competition is, and will continue to be Arctic Gas, since Staff harshly dismissed the concept, the costs and the schedule of Alcan as being "unrealistic and unreasonable."

We very much appreciate the support that the Legislature has given the trans-Alaskan gas pipeline route in the past, and we sincerely hope that our proposal will maintain its preferred position during the forthcoming legislative session.

Best regards.

Sincerely,

EL PASO ALASKA COMPANY



Michael C. Holland

Assistant to Vice President

John C. Bennett

Enclosures

AGO 667961

NORTH SLOPE NATURAL GAS TRANSPORTATION
FACTUAL COMPARISON OF PROJECTS IN ALASKA
 (December 1976)

	<u>TRANS-ALASKA PROJECT</u>	<u>ALCAN PIPELINE PROJECT</u>	<u>ARCTIC GAS PROJECT</u>
<u>Pipeline Mileage</u>	809 miles	731 miles	195 miles
<u>Capital Cost of Alaskan Facilities</u>	\$4.6 Billion	\$2.3 Billion	\$662 Million
<u>Employment</u>			
<u>Construction</u>	21,600 direct and induced jobs at peak of construction.	14,900 direct and induced jobs at peak of construction.	6,800 direct and induced jobs at peak of construction.
<u>Operation</u>	624 permanent employees.	108 permanent employees.	39 permanent employees.
<u>Construction Payroll</u>	\$840 Million	Unknown at present but expected to be about half that of the Trans-Alaska Project.	\$190 Million
<u>Ad Valorem and Income Taxes</u>	\$2.8 Billion	\$1.3 Billion	\$230 Million
<u>Future Industrial Development</u>	Offers greatest potential for future industrial development by offering shortest, most economical route to an ice-free, tidewater port (most economically attractive location for industrial development because of access to marine transportation of product).	To transport natural gas to tidewater requires 250 miles further transportation by pipeline, including a 150-mile lateral, resulting in increased cost of service. Therefore not as economically attractive as opportunities associated with the Trans-Alaska Project.	Route precludes use of state's royalty gas for industrial development.

****PLEASE NOTE****

THE ORIGINAL FILE CONTAINS AN OVERSIZED DOCUMENT THAT IS UNSUITABLE FOR FILMING. PLEASE REFER TO THE ALASKA STATE ARCHIVES TO VIEW THE ORIGINAL.

DESCRIPTION: MAP

TRANS-ALASKA GAS PROJECT

COMPARISON OF THE EL PASO PROJECT
WITH OTHER PROJECTS PROPOSING TO
TRANSPORT ALASKAN AND OR CANADIAN
NATURAL GAS DISCOVERIES

House Committee has held Dec 15 brief on same subject

UNITED STATES OF AMERICA

Before the

FEDERAL POWER COMMISSION

El Paso Alaska Company, et al.)

Docket Nos. CP75-96, et al.

BRIEF OF EL PASO ALASKA COMPANY
CONCERNING PROJECT FINANCING
AND REGULATORY ACTION

Paul R. Connolly, Esq.
Williams, Connolly & Califano
1000 Hill Building
Washington, D. C. 20006

G. Scott Cuming, Esq.
Vice-President
and General Counsel
Post Office Box 2185
Houston, Texas 77001

Counsel for
EL PASO ALASKA COMPANY

June 4, 1976

AGD 667964 4

BRIEF OF EL PASO ALASKA COMPANY CONCERNING
PROJECT FINANCING AND REGULATORY ACTION

I. INTRODUCTION TO THE PROBLEM

In these consolidated proceedings, proponents of two ^{1/} mutually-exclusive delivery systems are each seeking requisite Federal Power Commission ("FPC") authority to construct and operate facilities in interstate commerce to move natural gas from Alaska's North Slope to consumers in the lower 48 United States.

The El Paso Alaska Project proposes the construction of a new gas pipeline southward across Alaska to a site near Gravina Point in Prince William Sound on Alaska's south-central coast, a route within an established utility corridor closely paralleling the Alyeska oil pipeline. After liquefaction at a new facility at Gravina, the gas would be carried by ship to a regasification plant near Point Conception in southern California, regasified, and thereafter transported to markets throughout the country by utilizing idle capacity in existing pipeline systems.

The Arctic Gas Project proposes the construction of an entirely new pipeline system first extending eastward out of northern Alaska through the Arctic National Wildlife Range into Canada and then southward through Canada to a point of bifurcation near Caroline, Alberta. From there, an eastern leg would proceed to a United States border-point near Monchy, Saskatchewan and then traverse the north-central United States to a point near Kankakee, Illinois. At various points along this portion of the system within the lower 48 states, Alaskan gas would be

^{1/} Northwest Pipeline Corporation on May 10, 1976 announced plans to file an application to transport North Slope gas out of Alaska by a third route--along the course of the Alyeska oil line to Delta Junction and then eastward along the Alcan Highway to the Yukon border where three Canadian entities will in turn arrange for its transportation through Canada. Since no application has yet been filed, there has not been any Commission action to effect consolidation of that proposal with the two proposals which have been in comparative hearings for over a year.

delivered to existing pipelines for further movement and displacement to eastern and midwestern markets. A western leg of the Arctic Gas Project would use expanded pipelines in both the United States and Canada to move gas southward from Caroline across the International Boundary near Kingsgate, British Columbia to markets in the western states.

The capital requirements of these projects are enormous. The estimates of El Paso Alaska range between \$6.5 billion and \$7.9 billion; those of Arctic Gas range between \$8.3 billion and \$8.8 billion, each depending upon the amount of deliverability certificated. 2/

Recognizing that the unprecedented capital costs required for the construction of an Alaskan gas delivery system preclude any natural gas company or even a group of such companies from raising the necessary capital on the basis of their own credit, the financial advisors of El Paso Alaska--not unlike those of Arctic Gas--have recommended that the El Paso Alaska Project be project financed. Project financing involves the creation of a new enterprise whose own economic integrity is sufficient to finance itself independently to a significant degree. Stated in financial terms, this new enterprise is designed so that it generates sufficient revenues to pay its operating costs, to pay interest and principal on its debt and to pay a return on, and ultimately a return of, its equity.

The very nature of project financing identifies the principal financial risks inherent in it. The prospect that the project's revenues may be insufficient to permit it to make the necessary payments arises from three risks: (1) failure of governmental regulation to permit the project to generate sufficient revenues; (2) prolonged interruption of the project's operation without receipt of revenues; (3) non-completion of the project for economic, physical or other reasons.

El Paso Alaska's financial advisors have testified that neither the El Paso Alaska Project--nor any other comparable project--can be financed unless the investors can be

2/ These figures reflect July 1, 1975, costs based on assumptions each party has made in its filings and proposed testimony.

assured that these risks are significantly reduced. 3/ Since they expect that the project, once in operation, will be permitted to earn a fair return, they do not consider the first risk to be a serious deterrent to a potential investor. But as to the other risks, they state that lenders will require undertakings which provide, irrespective of project completion or project failure due to force majeure or otherwise, that they will recover their debt, principal and interest. Similarly, because the equity capital required will be so large, it is doubtful if a potential sponsor could be induced to contribute equity if no assurance could be given that at least the return of equity would be made upon project failure. The reasons for these positions are set out in Exhibit EP-254, which accompanies this Brief.

This risk assessment, therefore, is intrinsic to the reasoning of this Brief. Financing of the El Paso Alaska Project will require contractual and tariff provisions which, at a minimum, provide that, in the event of either prolonged service interruption or a failure to complete the project, debt principal and interest will be repaid to the lenders and that equity contributions will be recovered. This burden of unconditional repayment will be hereinafter called "Investment Recovery."

The financial advisors produced by Arctic Gas were also of the view that lenders would require assurances that their investment would be returned if the project failed either of completion or of operation for a prolonged period. Raymond B. Gary stated in pertinent part:

[Lenders] will require assurances a) that the project will be completed even if costs exceed those originally projected (or, if not completed, that the debt of the project will be repaid in full); b) that the project, once completed, will generate operating revenues sufficient to meet its expenses and service its debt; and c) that if for any reason, including force majeure, its operations are interrupted, suspended or terminated, its

3/ L. E. Katzenbach, Tr. 13,443-13,444; 13,689-13,698; 13,781-13,786; 13,801-13,804; Stanley Lewand, EP-100 (p. 6 of prepared direct testimony); Tr. 13,866-13,868; 13,886-13,900.

debt obligations will continue to be serviced either through continued receipt of revenues or otherwise. These assurances must take the form of binding contractual obligations. Tr. 17,801.

Stewart B. Clifford gave substantially the same testimony Tr. 17,818. The opinions of these U.S. financial advisors for Arctic Gas were also reaffirmed by their Canadian counterparts. 4/

L. E. Katzenbach, an El Paso Alaska financial witness, expressed the need for a series of agreements and tariffs. He thought that the tariffs of each of the shippers of Prudhoe Bay gas should contain a provision which would allow each to collect from its customers--in the event of the occurrence of either non-completion of the project or prolonged interruption of service--sufficient revenue to provide for Investment Recovery.

Katzenbach contemplated that all of the necessary agreements and tariff provisions would be submitted to this Commission as part of the totality of the financing package. The final approval of the El Paso Alaska Project by this Commission would include not only approval of the route and methodology for gas transport, but also approval of gas purchase contracts, approval of the necessary tariff provisions, approval of the overall financing plan and the issuance of certificates authorizing the construction and operation of jurisdictional facilities and for the sale and transportation of the gas. Each of the several elements would be approved as interdependent. "It would be a part of the whole closing arrangement." Tr. 13,725.

While the El Paso Alaska advisors thought that the assurances necessary to convince the lenders to advance funds would be supported by the approval of an all-events tariff and other contractual agreements, 5/ the advisors of Arctic Gas were of the opinion that the risk of prolonged interruption of service and non-completion could ultimately be met only by

4/ J. Ross LeMesurier, Tr. 17,814; Thomas S. Dobson, Tr. 17,824.

5/ Katzenbach, Tr. 13,676; Lewand, Tr. 13,886-13,892.

some form of guarantees from both the U.S. and Canadian governments and perhaps from state and provincial governments as well. 6/

Arctic Gas has identified two seemingly unresolvable roadblocks to satisfying the concerns of lenders by regulatory action alone. First, Arctic Gas contends that action by the FPC alone is not enough. Before lenders will be satisfied that gas consumers are backstopping the financing arrangements, satisfactory formal action must be unanimously forthcoming by state or local regulatory agencies in every state where Alaskan gas is destined. Having raised this hurdle, Arctic Gas then concedes the virtual impossibility of successfully attaining the required result in so many jurisdictions. 7/ Second, even assuming that satisfactory federal and local approvals could be obtained, Arctic Gas raises the specter of future regulatory change: "that in order for investors to have confidence in that tracking, that it would probably have to be legislatively mandated, so that future commissions could not upset or change the arrangements . . . wherein there is always the possibility that a politically constituted public utility commission could perhaps at a state level simply cancel the possibility of tracking." 8/

Treasury witnesses John M. Niehuss and Theodore M. Barnhill also recognized that lenders would require assurances of payment despite non-completion or prolonged interruption of service. They were of the opinion that it was possible to arrange financing without federal guarantees of financial assistance as long as appropriate regulatory actions were taken. Tr. 18,900; 18,908-18,912; 18,944-18,956.

It is, therefore, the purpose of this brief to address the means by which the investors in the El Paso Alaska Project might be assured that the risk of non-completion of the project and the risk of prolonged interruption of service--thereby creating a condition of non-revenue--would be covered. We believe that the approval by this Commission of an all-events

6/ Raymond B. Gary, Tr. 18,052-18,082; Stewart B. Clifford, Tr. 18,405-18,410; 18,424-18,427; J. Ross LeMesurier, Tr. 18,189-18,193; Thomas S. Dobson, 18,507-18,508.

7/ Gary, Tr. 18,080-18,081.

8/ Id. Tr. 18,080.

tariff for Alaska gas service and the approval of other contractual and rate clauses would reduce the financial risks perceived by investors to the degree needed to encourage a willingness on their part to advance the enormous sums necessary to the development of the El Paso Alaska Project.

II. THE MEANS BY WHICH REVENUE MAY BE GENERATED TO PROVIDE FOR INVESTMENT RECOVERY

El Paso Alaska proposes to provide against the risk of non-completion and the risk of prolonged interruption of service by means of contracts and tariff provisions which will assure investment recovery. The means by which these contracts and tariff provisions would operate are substantially the same for either service interruption or non-completion of the project, but since each risk would occur under different circumstances, each must be faced with slightly different procedural arrangements.

(a) Prolonged Interruption of Service

This condition would occur after the El Paso Alaska Project has been constructed and is in operation. Under these circumstances, the El Paso Alaska tariff, setting forth the terms and conditions under which gas would be transported for its shippers would be operative. ^{9/} That tariff, as presently proposed by El Paso Alaska, provides that a shipper must in all events pay a base monthly charge sufficient to pay operating expenses, debt service and a return of and on equity. Exh. EP-56, pp. 5-6, 26, 49. In the event of an outage, the return on equity is reduced to the point of elimination if the lack of service is substantial. ^{10/} However, there continues, even during prolonged outage, an obligation on the part of the shipper to pay a basic service charge adequate to provide for debt service and operating expenses ^{11/} and return of equity.

^{9/} The tariff as proposed is Exhibit EP-56. Its proposed effective date will occur when all segments of the El Paso Alaska Project have reached a stage of construction where El Paso Alaska stands ready to render initial transportation service to all shippers. Tr. 10,164-10,166.

^{10/} Exh. EP-56, pp. 56-57.

^{11/} Id.

As a consequence, any shipper of Alaskan gas having a service agreement with El Paso will be required to pay a basic service charge irrespective of its receipt of gas. 12/

(E) Non-completion of the Project

It is possible that the El Paso Project may never be completed either by reason of the enormity of cost overruns or by reason of insurmountable physical obstacles. If completion is not accomplished, a method must nevertheless be found to provide for Investment Recovery.

Since the assumption here is that the project is not completed, it necessarily follows that El Paso Alaska will have no operative tariff in place in order to generate monthly charges 13/. As a consequence, the tariff is not the operative instrument for generating the necessary revenues to provide for investment recovery. However, this obligation can be met by contractual arrangements with the various shippers of Alaskan gas. Each by contract will obligate itself to make monthly payments sufficient over time to service the amount of debt previously put in place and to return that equity which has been advanced. The discharge of this contractual duty by the shippers would provide El Paso Alaska with

12/ E.g., Exh. EP-56, p. 48-49 provides in pertinent part:

3. RATES AND CHARGES

3.1 . . . Shipper shall pay Company each month under this Rate Schedule, (1) Shipper's allocable share of Company's monthly cost of service . . . regardless of (i) the amount of natural gas received, transported, or delivered to shipper or its designee during the billing month involved . . . , and (ii) the non-delivery of natural gas to Shipper or its designee during the billing month for any reason.

13/ In our opinion only a "natural gas company" may have an effective tariff under Section 4 of the Natural Gas Act. Until El Paso Alaska transports gas in interstate commerce, it will not become a "natural gas company." See Section 2(6) of the Act.

the revenue required to provide for Investment Recovery.

While appropriate contracts and an all-events tariff will provide El Paso Alaska with revenue sufficient to provide for investment recovery in the event of either non-completion or prolonged outage, the shippers must be provided with a tariff mechanism by which timely to flow through these charges to their customers.

It is the submission of this Brief that the Commission, by the appropriate exercise of its certificate and rate authority, may provide sufficient assurances that once investments have been made in the El Paso Alaska Project, Investment Recovery can be accomplished in all-events and that neither supplementary legislation nor government backstopping is required.

III. NECESSARY ASSUMPTIONS

In order to put in place the various agreements, tariff provisions and regulatory actions necessary to provide the setting in which investment might be attracted to finance an Alaskan gas delivery system without increased burden to the federal Treasury, it is necessary to set out the assumptions which are critical to the legal conclusion which we reach-- that, by the appropriate exercise by the Commission of its certificate and rate authority, sufficient assurance may be given to the U.S. financial community that the economic risks inherent in a project of this type can be avoided. It is therefore, assumed that:

1. In order to maintain effective federal regulation and provide for uniform treatment of gas consumers, this Commission will not certificate sales of North Slope gas to other than interstate transmission companies presently subject to its jurisdiction and who are currently selling gas in interstate commerce under service agreements and tariffs subject to the authority of the Commission. ^{14/} These companies in turn

^{14/} An exception could be made in the case of the principal California distributors. See *infra*, p. 34. Historically, the two major California distributors have been regulated by the California Public Utilities Commission rather than the FPC. However, sales to California distributors should be certificated only if the CPUC were to agree to act with respect to the resale of Alaskan gas in the same manner as the FPC has been required to act to obtain the necessary financing commitments. Otherwise Alaskan gas should be delivered to the California markets under the existing service agreements with El Paso Natural Gas Company or other interstate carriers serving those markets.

will resell their Alaskan gas on a rolled-in basis under existing service agreements.

2. In order that each of the several certificate and rate authorizations may be considered interdependent and required as a totality by the present and future public convenience and necessity, the Commission will condition each grant of authority requested herein upon final approval of all interdependent events.

3. At the conclusion of the present phase of these consolidated proceedings, the Commission will issue a certificate of public convenience and necessity under § 7(c) of the Natural Gas Act authorizing El Paso Alaska to construct and operate facilities to transport gas from the North Slope to markets in the lower 48 states. Among other things, the certificate will be conditioned to require the submission of proposed financing arrangements within a reasonable period of time for the Commission's review and approval.

4. Before any financing plan is submitted to the Commission for approval, North Slope producers will have executed definitive contracts for the wellhead sale of their gas to interstate pipeline companies in the lower 48 states and will have sought certificates for such sales under Section 7(c) of the Natural Gas Act.

5. The purchasers of North Slope gas, having by reason thereof the greatest interest in a delivery system for that gas, will become the principal subscribers to the Project's equity, and their willingness to make such a contribution will be recognized in the course of the certification of the North Slope gas purchase contracts.

6. The equity participants will have reached preliminary agreement among themselves as to their respective degrees of equity participation and negotiation of the terms and conditions of short term and long term debt financing will have commenced with representatives of commercial banks and institutional lenders.

7. A financing plan tentatively acceptable to equity participants and lenders alike will be agreed upon and tendered to the Commission for its review and approval. As a part of these financing arrangements, shippers and sponsors will have conditionally executed or will have agreed to execute various documents, including:

(a) A service agreement, or a letter evidencing an intent to execute a service agreement, under the all-events cost of service transportation tariff of El Paso Alaska.

(b) An agreement by sponsors to make a specified dollar amount equity contribution to the El Paso Alaska Project.

(c) An agreement by sponsors, satisfactory to lenders, to contribute a pro rata share of a specified dollar amount of any additional funds needed during the construction period to provide for cost overruns.

(d) An agreement between shippers and El Paso Alaska, satisfactory to the Project's investors, by which the shippers, pro rata, will assure that sufficient funds will be made available to provide for Investment Recovery in the event the Project is aborted for any reason before completion.

8. Shippers of Alaskan Gas will have filed applications under Section 7(c) of the Act to add such facilities as are necessary in the lower 48 states to take delivery of their gas from the facilities available to the El Paso Alaska Project and each will have also filed applications with the FPC for appropriate Purchased Gas Adjustment Clause (PGAC) modifications sufficient to permit each to recoup in a timely manner all costs which may be incurred by reason of its agreement with El Paso Alaska to provide for Investment Recovery.

9. In connection with the applications specified in 8, supra, the shippers will each seek and obtain authority to treat its purchased supply of North Slope gas on a rolled-in basis as a part of its total system gas supply to be allocated and sold to its customers in accordance with existing contracts and the FPC curtailment plan prescribed for each.

10. Notice and opportunity to be heard shall have been afforded to all affected state regulatory commissions and to all affected distributor-customers of each shipper prior to the approval of the various tariff proposals.

11. The Commission will (i) issue final certificates to El Paso Alaska and each of the shippers; (ii) approve the financing plan submitted and recognize that its implementation is required by the present and future public convenience and necessity, and (iii) approve both the methods by which the shippers will wholesale their Alaskan gas and the tariff modifications proposed.

By virtue of the exercise of this final authority, all expenditures subsequently incurred by the shippers in the discharge of their respective obligations to El Paso Alaska, including specifically the obligation to make payment in the event of the failure of the project, will be reflected in the shipper's rates on file with the FPC and will be collected by each of them in its sales of natural gas to customers under existing sales contracts.

IV. THE FPC POSSESSES THE AUTHORITY TO ACCOMPLISH THE GOALS
NECESSARY TO ASSURE PRIVATE SECTOR FINANCING OF THE
EL PASO ALASKA PROJECT

So that the enormous sums necessary to finance the construction of the El Paso Alaska Project may be forthcoming from the private investment community, three purposes must be accomplished:

1. A mechanism must be put in place which will generate sufficient revenues adequate to provide for Investment Recovery even should the Project fail of completion or operation. Without the assurance of such revenue, investment counsellors are unanimous in stating that the project cannot be privately financed.
2. The mechanism once adopted by this Commission must be effective to assure the collection of revenue through to the ultimate consumer without fear of state regulatory interference.
3. Once investment is made in reliance upon the effectiveness of the mechanism for the collection of revenue, it must be inviolate to arbitrary change.

These ends are attained by the approval of changes in the presently filed tariffs of interstate transmission companies by which such companies, as shippers of Alaskan gas, would be permitted to flow through to their customers charges which arise as a result of their Alaskan gas agreements. These changes would be found at the time of the certification of the Project to be just and reasonable and required to enable the Alaskan gas delivery system to be built. The required tariff change would authorize a shipper to increase its rates for flowing gas to the extent necessary to provide for debt service and operating expenses in the event of outage, and to provide for Investment Recovery in the event of project abandonment.

1. The Natural Gas Act Contains a General Grant of Authority by Which the FPC May Accomplish Its Purposes

Section 1(b) of the Natural Gas Act is a grant to this Commission of jurisdiction over the "transportation of natural gas in interstate commerce" and "the sale in interstate commerce of natural gas for resale." Sections 4 and 5 of the Natural Gas Act grant exclusive jurisdiction to the Commission (a) to regulate charges for the transportation of gas in interstate commerce and (b) to fix the price at which gas may be sold in interstate commerce for resale. Section 16 grants the Commission "authority to perform any and all acts, and to prescribe, issue, make, and amend and rescind such orders, rules and regulations as it may find necessary or appropriate to carry out the provisions of this Act."

The Supreme Court has consistently accorded this Commission broad authority under the Natural Gas Act to deal with the jurisdictional transportation and sale of gas in an effective and comprehensive manner, and has emphasized the desirability and even the necessity for novel approaches, suited to the problems of the day, in the exercise of this authority. This generous interpretation of its authority has been particularly pronounced in recent instances where this Commission has acted out of a need to deal with the problems posed by the shortage of natural gas. Consistent with this need, the Supreme Court and the Courts of Appeal have approved a variety of FPC orders which, while only indirectly related to the actual transportation and sale of natural gas, are nonetheless appropriate measures to deal comprehensively with the problems posed by the delivery of gas from field to burner tip.

The use to which gas was put received the Supreme Court's attention in FPC v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1 (1961). The Commission had denied Transco's application to transport gas from Louisiana to Consolidated Edison in New York for use as boiler fuel. Transco had proposed to make a direct sale of the gas to ConEd and argued that as a direct sale the transportation was beyond all FPC jurisdiction including consideration of either end use or price. The Commission denied certification for two reasons: the end use of the gas was perceived as an inferior one considering the need to conserve natural gas and the inflated price paid by ConEd was seen as having an undesirable inflationary effect on future sales of both jurisdictional and non-jurisdictional gas. The Court upheld the Commission's judgment citing the FPC's "wide range of discretionary authority" which obligated it "to bring to bear upon the problem an

expert judgment and to determine from its analysis of the total situation on which side of the controversy the public interest lies." Id. at 7. The Court concluded that the Act, while leaving much authority over conservation to the states, did not preclude the Commission from acting in all matters of conservation, especially given the impracticality of uniform and effective state regulation.

In Permian Basin Area Rate Cases, 390 U.S. 747 (1968), the Court endorsed the Commission's experiment with area pricing designed to encourage exploration and prevent excessive producer profits. It reiterated that "the breadth and complexity of the Commission's responsibilities demand that it be given every reasonable opportunity to formulate methods of regulation appropriate to the solution of its intensely practical difficulties." Id. at 790. The Court reaffirmed Hope's teaching ^{15/} that the Court need not examine each detail of the Commission's order, but must only decide if the "total effect" of the order is "just and reasonable" under the Act. Id. at 767. It found no bar in the Act to the use of area rates, and in so doing held the Commission's authority to be co-extensive with the broad purposes of the Act:

The Act was intended to create, through the exercise of the national power over interstate commerce, "an agency for regulating the wholesale distribution to public service companies of natural gas moving interstate"; it was for this purpose expected to "balanc[e] ... the investor and the consumer interests." This Court has repeatedly held that the width of administrative authority must be measured in part by the purposes for which it was conferred. Surely the Commission's broad responsibilities therefore demand a generous construction of its statutory authority. Id. at 776 (citations omitted).

The Court derived "additional assistance" for its conclusion that the Commission was due a "generous construction of its statutory authority" from the Commission's "power [under § 16] to perform any and all acts, and to prescribe ... such orders,

^{15/} FPC v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944).

rules and regulations as it may find necessary or appropriate to carry out the provisions" of the Act. 16/

The Court continued that such "generous construction"

[I]s consistent with the view of administrative rate making uniformly taken by this Court [R]ate-making agencies are not bound to the service of any single regulatory formula; they are permitted, unless their statutory authority otherwise plainly indicates, "to make the pragmatic adjustments which may be called for by particular circumstances."

We are unwilling, in the circumstances now presented, to depart from these principles. The Commission has asserted, and the history of producer regulation has confirmed, that the ultimate achievement of the Commission's regulatory purposes may easily depend upon the contrivance of more expeditious administrative methods. The Commission believes that the elements of such methods may be found in area proceedings. "[C]onsiderations of feasibility and practicality are certainly germane" to the issues before us. We cannot, in these circumstances, conclude that Congress has given authority inadequate to achieve with reasonable effectiveness the purposes for which it has acted. Id. at 776-777 (citations omitted).

The unusual deference accorded to this Commission's expertise by the Court is illustrated by the fact that the rates were set in 1965 to encourage exploration but were applied

16/ Section 16 is not to be read simply as a means of arranging the Commission's procedural affairs. It authorizes the agency "to use means of regulation not spelled out in detail, provided the agency's action conforms with the purposes and policies of Congress and does not contravene any terms of the Act." Niagara Mohawk Power Corp. v. FPC, 379 F.2d 153, 158 (D.C. Cir. 1967); Mesa Petroleum Co. v. FPC, 441 F.2d 182, 187 (5th Cir. 1971); see also FPC v. Louisiana Power & Light Co., 406 U.S. 621 (1972).

retroactively to gas committed to interstate commerce since January 1, 1961. "It is difficult to see," the Court admitted, "how the higher rate could reasonably have been expected to encourage, retrospectively, exploration and production that had already occurred." *Id.* at 798. Nonetheless, the Court respected this Commission's belief that its initial statement of policy, issued as it began area rate hearings in 1960, "had created reasonable expectations among producers that higher rates would thereafter be permitted" and the Commission's conclusion that it would be unfair to disappoint the producers. This factor, and the need to preserve confidence in interstate prices, was sufficient to justify the Commission's retroactive application of area rates. *Id.* at 798-99. The Court has repeatedly shown its disinterest in setting aside parts of orders and expressed its concern only with the "total effect of the rate order." 390 U.S. at 767. As it said in *Permian*, "Although the Commission's position might at several places usefully be clarified, the producers have not satisfied the 'heavy burden' placed on those who would set aside its decisions." 390 U.S. at 812-13, quoting *Hope Natural Gas*, *supra*.

The Commission's authority to employ pricing mechanisms to encourage new production received approbation in *Mobil Oil Corp. v. FPC*, 417 U.S. 283 (1974). There the Commission fixed area rates for the southern Louisiana area, and set rates for "new" gas which were substantially higher than those set for "flowing" gas. The court rejected a challenge to these higher rates as being predicated on an "erroneously limited view of the permissible range of the Commission's authority to employ price to encourage exploration or production." 417 U.S. at 319. The Commission's decision to set higher prices for new gas was not based on any change in producing conditions, but rather on the need for new revenues to expand future production. The court ratified this approach.

Its justification here for increasing the price of flowing or first vintage gas was not that new evidence showed that the conditions of producing that gas differed from the conditions found in the 1968 opinion, but, as the Commission frankly acknowledged, new revenues were deemed necessary to expand future production. As between placing the burden of that expansion on new or second vintage gas alone or spreading it over both old and new gas, it judged the latter more equitable and

more likely to lead to the immediately increased capital necessary in the face of a crisis. We see nothing in New York's argument to suggest that the Commission could not--in view of its finding that increased revenues were necessary--place the burden of those payments on all users rather than on those alone who purchased gas in the future. Indeed, it is worth noting that the Commission's rate orders in Permian included in the cost components of gas a noncost price element for future expansion of exploratory effort.

In this situation, the Commission could reasonably choose its formula as an appropriate mechanism for protecting the public interest. And, against the background of a serious and growing domestic gas shortage, the Court of Appeals could certainly conclude that the Commission might reasonably decide that, as compared with adjustments in the rate ceilings for gas producers to induce more exploration and production, its responsibility to maintain adequate supplies at the lowest reasonable rate could better be discharged by means of the contingent escalation and refund credit provisions. We therefore agree with the Court of Appeals' holding that "these periodic escalations were a proper subject for the exercise of administrative discretion and clearly fall within that 'zone of reasonableness' which we allow FPC on review." Id. at 320-321.

In FPC v. Texaco, Inc., 417 U.S. 380 (1974), the court endorsed yet another FPC concept for ensuring an adequate gas supply by encouraging the exploratory efforts of small producers. In this instance, the Commission proposed to allow small producers to sell at the price the market would bear, with the Commission regulating those prices only indirectly in the course of regulating the rates of pipelines and of the large producers who purchase gas from small producers. Though sending the actual order back to the FPC for clarification, the court approved the plan in principle after concluding simply that there was "nothing in the Act which requires the Commission to fix the rates chargeable by small producers by orders directly addressed to them or which proscribes the kind of indirect regulation undertaken here." Id. at 387. While all rates must be just

and reasonable, the Act "does not specify the means by which that regulatory prescription is to be attained." Id. Most recently, the Court reversed the District of Columbia Circuit and, reiterating Permian's language of "generous statutory authority," upheld the FPC's power to pre-grant abandonment at the time it certifies sales under § 7. FPC v. Moss, 44 U.S.L.W. 4278 (3/3/76).

The foregoing cases sketch at least in outline the expansive scope of FPC authority in certification and rate-setting proceedings. They demonstrate the disinclination of the Supreme Court to fragment complex FPC decisions into permissible and impermissible facets and, show moreover, the readiness of the Court to find support in the Act for FPC inventiveness necessary to deal with current gas shortage problems.

Section 4 of the Natural Gas Act provides that all rates and charges made, demanded or received by a natural gas company "for or in connection with" the transportation or sale of jurisdictional gas shall be just and reasonable, and that, upon the filing of a new schedule with the Commission, the Commission is authorized, after hearing, to "make such orders with reference thereto as would be proper in a proceeding initiated after it [i.e., the new schedule] had become effective." Section 5 of the Act authorizes the Commission to "determine the just and reasonable rate, charge, classification, rule, regulation, practice or contract to be thereafter observed and in force, and [to] fix the same by order."

Because the shippers' proposed tariff revisions will permit the flow-through of charges imposed by reason of interruptions of service or abandonment of the Alaska Project, such charges will be "in connection with" the jurisdictional transportation and sale of natural gas, and thus authorized under the Act. The power to regulate transportation necessarily includes, in any "comprehensive and effective regulatory scheme," ^{17/} the power to deal with the consequences of failure of that transportation. In order to fulfill its statutory duty to ensure

^{17/} Panhandle Eastern Pipe Line Co. v. PSC, 332 U.S. 507, 520 (1947).

effective transportation the Commission may and indeed must provide for abandonment and interruption of service. 18/

The concept that failure of transportation must be a necessary aspect of the FPC's transportation jurisdiction is not a novel one, nor without judicial approval. As early as 1947, the Supreme Court explicitly recognized the nexus. In Panhandle Eastern Pipe Line Co. v. PSC of Indiana, 332 U.S. 507 (1947), the Court upheld state authority under the Act to regulate rates of direct sales in interstate commerce. To the pipeline's protest that this would bring about conflicting state regulations and conflicting state-federal actions "particularly in relation to curtailment of service when weather conditions or others require it," the Court answered that in the event of such conflict, "The matter of interrupting service is one largely related, as appellees say, to transportation and thus within the jurisdiction of the Federal Power Commission to control, in accommodation of any conflicting interests among various states." Id. at 523. See FPC v. Transcontinental Gas Pipe Line Corp., supra, at 27-28.

The Supreme Court reiterated its view that the Commission has pervasive authority over the transportation of natural gas in FPC v. Louisiana Power & Light Co., 406 U.S. 621 (1972). The question presented was whether the Commission had jurisdiction to curtail direct-sale deliveries in times of natural gas shortage. Since curtailment is a pro tanto non-delivery, and thus by extension a "non-transportation" and "non-sale" of gas, the Court's decision that direct-sale curtailments came under the aegis of the Commission's transportation jurisdiction is directly applicable here. The Court, reversing the Fifth Circuit, rejected the argument of Louisiana Power & Light, a direct-sale customer of a jurisdictional pipeline, that the direct-sale exemption in § 1(b) of the Act "creates a complete exemption of direct sales from curtailment regulations." "The answer," said the Court,

18/ The rate mechanism proposed is nothing more than the conventional and familiar "demand charge" long recognized as an appropriate component of rate-making to reflect "costs which occur by reason of required plant and equipment capacity [which] must be available whether or not it is being used at any particular moment." Mississippi River Fuel Corp. v. FPC, 163 F.2d 433, 438 (D.C. Cir 1947).

[I]s that the prohibition of the proviso of § 1 (b) withheld from FPC only rate-setting authority with respect to direct sales. Curtailment regulations are not rate-setting regulations but regulations of the "transportation" of natural gas and this within FPC jurisdiction under the opening sentence of § 1 (b) that "[t]he provisions of this Act shall apply to the transportation of natural gas in interstate commerce. . . ." 406 U.S. at 637-638 (emphasis in original)

* * *

Since curtailment programs fall within the FPC's responsibilities under the head of its "transportation" jurisdiction, the Commission must possess broad powers to devise effective means to meet these responsibilities. FPC and other agencies created to protect the public interest must be free, "within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances." FPC v Natural Gas Pipeline Co., 315 U.S. 575, 586 (1942). Section 16 of the Act assures the FPC the necessary degree of flexibility in providing that:

"The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this Act. . . ." 15 U.S.C. § 717o.

In applying this section, we have held that "the width of administrative authority must be measured in part by the purposes for which it was conferred Surely the Commission's broad responsibilities therefore demand a generous construction of its statutory authority." Permian Basin Area Rate Cases, 390 U.S. 747, 776 (1968); see United Gas Pipe Line Co. v. FPC, 385 U.S. 83, 89-90 (1966). Id. at 642

The Commission had seen fit to use the provisions of Section 4 of the Act to effectuate its curtailment authority. It had required all pipelines facing supply shortages to file reasonable curtailment schemes as amendments to their existing tariffs. The Court approved this unusual usage of Section 4 authority and answering the argument that only Section 7(b) abandonment jurisdiction was available to the Commission, said, "Since § 4(b) deals with 'service,' the FPC may invoke it to deal with curtailment programs, whether or not it could also invoke § 7 for the purpose." Id. at 646.

The commodious grant of transportation jurisdiction which Louisiana Power affords the Commission fully encompasses the exercise of the authority which we seek--the authorization to amend existing tariffs in the exercise of Section 7 and Section 4 jurisdiction to permit the flow-through of charges necessary to finance an Alaskan gas transportation system.

2. The Authority to Track, Through Existing Tariffs, the Service Charges Which Might be Necessitated if the Alaskan Project Fails Is Clear

Since this Commission possesses wide authority to prescribe rules and rates for the transportation and sale of gas in interstate commerce, it clearly possesses as an incidental right the power to allow for the collection of service charges in the event the transportation system fails--if that collection is a necessary condition for providing for the financing of the transportation system in the first instance. This is the teaching of the opinions dealing with permission to rate base advance payments made by a pipeline to producers for gas to be delivered in the future from new exploration and development. See Public Service Comm'n of New York v. FPC, 467 F.2d 361 (D.C. Cir. 1972); Public Service Comm'n of New York v. FPC, 511 F.2d 33 (D.C. Cir. 1975). The Court of Appeals said of the advance payment program, 467 F.2d at 369-370:

[W]e are convinced that the "total effect of the rate order" is a reasonable attempt to increase the available capital for development of gas production, which, under the circumstances of the present gas shortage, we find to be a valid exercise of the discretion of the FPC.

By analogy, this Commission could authorize a present surcharge to the expected consumers of Prudhoe Bay gas for the purpose of creating a sinking fund sufficient to pay off investors in an Alaskan gas delivery system, if it found that such a fund was necessary to attract the capital necessary to construct the project. If it possesses such authority, as clearly it does under the "advance payments" cases, no reason suggests itself as to why it could not adopt the proposal we put forth, which has a lesser impact on the consumer--the allowance of tariff modifications which would permit Alaskan gas shippers to track through their rates the increased costs which they must bear only in the unlikely event of project interruption or non-completion.

3. The Several States Are Bound to Allow for the Collection From Consumers of Service Charges Required for Alaskan Gas Service

Both the distributing companies that may be subject to a shipper's additional charge on account of the failure of Alaskan gas service and state regulatory commissions having jurisdiction over such companies are precluded from attacking in any other forum the justness and reasonableness of this service charge.

Subject only to the judicial review afforded by the Natural Gas Act, 19/ rates fixed by this Commission for the transportation or sale of gas under its jurisdiction are conclusively presumed to be just and reasonable. Their justness and reasonableness may not be collaterally attacked in any other forum. Montana-Dakota Utilities Co. v. Northwestern Public Service Co., 341 U.S. 246 (1951). The holding of that case which was decided under the Federal Power Act 20/ is a critical underpinning to the position we espouse.

19/ See Section 19(b).

20/ "The pertinent provisions of the Federal Power Act 'are in all material respects' substantially identical to the equivalent provisions of the Natural Gas Act." Permian Basin Area Rate Cases, 390 U.S. 747, 821 (1968), quoting FPC v. Sierra Pacific Power Co., 350 U.S. 348, 353 (1956).

In that case an interstate electric utility sued another utility with whom the plaintiff had exchanged electric energy over a period of years. During the period of exchange the companies had a director interlock. Upon termination of the interlock the former subservient corporation sued the dominant, claiming that the rates it had been forced to pay the dominant, and the payments it had received from the dominant were unreasonable and resulted from the impermissible interlock. In sum, it contended that the Commission's approval of the rates paid and collected was the result of fraud practiced upon the plaintiff. The Supreme Court found that no cognizable cause of action was stated. The Court said of the subservient utility:

It cannot litigate in a judicial forum its general right to a reasonable rate, ignoring the qualification that it shall be made specific only by exercise of the Commission's judgment, in which there is some considerable element of discretion. It can claim no rate as a legal right that is other than the filed rate, whether fixed or merely accepted by the Commission, and not even a court can authorize commerce in the commodity on other terms.

We hold that the right to a reasonable rate is the right to the rate which the Commission files or fixes, and that, except for review of the Commission's orders, the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one. 341 U.S. at 251-252. 21/

Clearly, then, the states are barred from questioning in subsequent proceedings rates which utilities under their jurisdiction must pay for their interstate purchases of gas. This

21/ This concept, that rates once fixed by federal regulatory agencies are conclusively presumed just and reasonable and cannot otherwise be challenged, is an old, firmly entrenched and necessary doctrine. See Texas and Pacific R.R. Co. v. Abilene Cotton Oil Co., 204 U.S. 426 (1907); Keogh v. Chicago and Northwestern Ry. Co., 260 U.S. 156 (1922); Georgia v. Pennsylvania R. Co., 324 U.S. 439 (1945); McLeran v. El Paso Natural Gas Co., 357 F. Supp. 329 (S.D. Tex. 1972).

is an area in which the states may not interfere. The law was plainly stated by a three-judge court in FPC v. Corporation Comm'n of Oklahoma, 362 F. Supp. 522, 538 (W.D. Okla. 1973), affirmed, 415 U.S. 961 (1974).

The State has no authority, either directly or indirectly, to fix the price at which natural gas is sold in interstate commerce.

Quoting from Northern Natural Gas Co. v. State Corporation Comm'n of Kansas, 372 U.S. 84, 91 (1963), the opinion went on to state:

The federal regulatory scheme leaves no room either for direct state regulation of the prices or interstate wholesales of natural gas, Natural Gas Pipeline Co. v. Panoma Corp., 349 U.S. 44 or for state regulations which would indirectly achieve the same result.

This principle arises from the doctrine of federal supremacy. 22/

A state order which "affect(s) the ability of the Federal Power Commission to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act. . . . invalidly invade(s) the federal agency's exclusive domain." Northern Natural Gas Co. v. State Corporation Comm'n of Kansas, supra at 91-92.

State orders which might impair the effective implementation of federal regulatory purposes "must be declared a nullity in order to assure the effectuation of the comprehensive federal regulation ordained by Congress." Id. at 92.

22/ "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby; any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. Art. VI, cl. 2.

As we have previously set out, 23/ filed tariffs approved by this Commission are conclusively presumed just and reasonable in other forums. As a consequence, the collection by a shipper of its filed rate from its customers is beyond the challenge of any state regulatory commission.

When the inquiry shifts from whether a state may regulate what a distributor pays, to whether the state may regulate what the distributor charges when reselling the gas to its customers, different considerations come into play, but the result is the same. Under the due process clause, the states must allow the distributor to pass on to its customers the charges imposed by the tariff of its interstate supplier.

Although Section 1(b) of the Natural Gas Act states that the FPC's authority shall not extend to "local distribution of natural gas", 15 U.S.C. § 717b, the states are nevertheless bound by the Constitution's due process clause 24/ to allow regulated utilities to pass legitimate operating expenses on to their consumers.

The Alaskan gas service charge which the distributor would be required to pay to its pipeline supplier on account of the latter's filed rates is plainly an operating expense for that utility, and past practice and the law developed in this area lead one to the conclusion that allowance of flow-through can be expected.

The disallowance by a regulatory body of a legitimate expense is a violation of the due process clause of the Fourteenth Amendment to the Constitution. West Ohio Gas Co. v. Public Utilities Comm'n of Ohio, 294 U.S. 63 (1935). In that case the Ohio Public Utilities Commission disallowed a \$12,000 advertising expense incurred by a utility to procure new business and allowed only \$5,000 on the ground that the excess was "unnecessary and wasteful" and could not be passed

23/ See discussion, supra, at pp. 21-22, concerning Montana-Dakota Utilities Co. v. Northwestern Public Service Co., 341 U.S. 246 (1951).

24/ ". . . nor shall any State deprive any person of . . . property, without due process of law U.S. Const. Amend. XIV.

on to consumers. The Supreme Court found no evidence to support such a conclusion and restored the original amount, holding that good faith on the part of management is to be presumed: "In the absence of a showing of inefficiency or improvidence, a court will not substitute its judgment for (management's) as to the measure of a prudent outlay." Id. at 72. The Court held that the state commission's rate "must give heed to all legitimate expenses that will be charged upon income during the term of regulation." Id. at 74. Similarly, the utility claimed as an expense the loss of 9 percent of its gas as a result of leakage. The state commission allowed for only a 7 percent loss. The Supreme Court found no evidence of fault or inefficiency to justify the modification. Such a modification in the absence of such evidence was held to be arbitrary and a denial of due process. Id. at 68-69. See also 294 U.S. at 77 (Stone, C. J., concurring).

As the District of Columbia Circuit said in setting aside a FPC disallowance of costs,

Expenses (using that term in its broad sense to include not only operating expenses but depreciation and taxes) are facts. They are to be ascertained, not created, by the regulatory authorities. If properly incurred, they must be allowed as part of the composition of rates. Otherwise, the so-called allowance of a return upon the investment, being an amount over and above expenses, would be a farce.

[It is an] obvious basic premise [that a] rate order which does not provide for proper allowable expenses, taxes, depreciation and return, is unfair, unreasonable and confiscatory. Mississippi River Fuel Corp. v. FPC, 163 F.2d 433, 437, 451 (D.C. Cir. 1947).

Only expenses which are attributable to "inefficiency" or "improvidence", Alabama PSC v. Southern Bell Tel. & Tel. Co., 42 So.2d 655, 84 P.U.R. (n.s.) 221 (Ala. 1949); waste or negligence, West Ohio Gas Co. v. PUC, 294 U.S. 63 (1935); or resulting from an abuse of managerial discretion, Re New England Tel. & Tel. Co., 66 A.2d 135, 79 P.U.R. (n.s.) 508 (Vt. 1949), are disallowed.

There can be no challenge to the legitimacy and propriety of an Alaskan gas service charge. If the charge is authorized in a tariff approved by this Commission, it is conclusively established as just and reasonable. Montana-Dakota Utilities Co. v. Northwestern Public Service Co. supra. Rates established by a state regulatory body for utilities under its jurisdiction must allow for such an expense. The service charge in these circumstances resembles the treatment which must be accorded a federal tax imposed upon the utility. "Normally included as a cost of service is a proper allowance for taxes, including Federal income taxes." FPC v. United Gas Pipeline Co. 386 U.S. 237, 243 (1971).

In Galveston Electric Co. v. City of Galveston, 258 U.S. 388 (1922) and in Georgia Ry. and Power Co. v. Railroad Comm'n, 262 U.S. 625 (1923), the Supreme Court reinstated as an allowed expense federal income taxes which lower courts had disallowed on grounds that Congress had intended the expense of income taxes to be borne by the taxpayer utility, and not to be shifted to alternate consumers. The Supreme Court held simply that all taxes, state or federal, income or otherwise, "which would be payable if a fair return were earned are appropriate deductions." Galveston Electric Co. v. City of Galveston, supra at 399.

Just recently in City of Cleveland v. FPC, 525 F.2d 845 (D.C. Cir. 1976), the court rejected the city's contention that a state gross receipts tax levied against certain portions of the utility's operations was not properly allowable as an expense. The applicability of the tax to the utility was then being litigated in Ohio courts. The utility was paying the tax and was required to continue until Ohio authority ruled to the contrary. The court held that the amount of tax paid was properly allowable as an expense. Id. at 850. Cf. Driscoll v. Edison Light & Power Co., 307 U.S. 104 (1939) (expenses incurred in unsuccessful defense of existing rate structure before a public utilities commission are allowable expenses).

A distributor customer of an Alaskan gas shipper, required to pay that shipper's Alaskan service charge, must be permitted to pass this charge along to its own customers. A state regulatory body cannot disallow such payments except under pain of being found to have acted arbitrarily. Any other treatment, by "not provid[ing] for proper allowable expenses" would be "unfair, unreasonable and confiscatory." Mississippi River Fuel Corp. v. FPC, supra. "[U]nder the due process clause of the Constitution no public utility could be compelled to absorb its own costs and not pass them on to the consumer." PSC of New York v. FPC, 467 F.2d 361, 370 (D.C. Cir. 1972).

4. The Commission is Bound to Continue for the Duration of the Risk the Approved Tariff Provisions

"The skepticism with which investors regard regulatory authorities" ^{25/} has prompted financial advisors for Arctic Gas to suggest that the risk of non-completion and prolonged interruption be guaranteed by some form of governmental insurance. The skepticism which is expressed is that the approval by this Commission of tariffs containing provisions assuring investors of a return of their investment in the event of the failure of the project will not be long observed but that the issue of the fairness of the provision will be revisited by some subsequent Commission. The Arctic Gas advisors fear there can be no guarantee that the required tariff provisions will remain effective.

It is our submission that this Commission has the statutory authority permanently to adopt such tariff provisions and that, absent changed circumstances, that approval cannot later be withdrawn. So to do would violate Section 5 of the Natural Gas Act and the due process clause of the United States Constitution. The recent opinion in Pacific Gas Transmission Co. v. FPC, No. 74-2046 (D.C. Cir. 4/9/76) does not in our opinion alter this submission. The court in that case specifically noted the Administrative Law Judge's finding that there had been since the approval of the Pacific Gas Transmission's cost of service tariff "a 'change of considerable significance and unquestionable certainty in the ground rules' under which the tariff had originally been approved." This change was the four-fold price increase ordered by Canadian authorities for Canadian export gas sold to Pacific Gas Transmission Company.

Once it is found by the Commission as a fact, in the course of its consideration of the Project's financing, that the funds necessary to provide for the construction of the El Paso Alaska Project will not be available unless investors can be assured that Commission approval is given for tariff provisions which would permit the collection of the necessary revenue to provide for Investment Recovery in the event of the failure of the project, the logic of the solution is readily apparent. The Commission, under that predicate, would be enabled to view the required tariff provisions as an integral

^{25/} Testimony of Raymond B. Gary, Tr. 18,054.

part of the application for a certificate and as a necessary assurance to the issuance of the certificate. The Commission would then be enabled to authorize the construction and operation of the project only if it also found that the necessary tariff provisions were required by the overall present and future public convenience and necessity. ^{26/} Charges for service are a proper subject for consideration in a certificate proceeding. See Atlantic Refining Co. v. Public Service Comm'n, 360 U.S. 378 (1959); Henry v. FPC, No. 73-2090 (D. C. Cir. 7/28/75).

The issuance of a final certificate to El Paso would contain the clear expression that the proposed tariff provision is required not only by the present but also by future public convenience and necessity.

Although this Commission may be of the opinion that it is unable to bind a future Commission not to invoke the prospective operation of Section 5 of the Natural Gas Act, ^{27/} we do not believe that Section 5 poses any real threat to the permanence of approval given to the requested tariff provisions. Section 5 does not authorize the Commission arbitrarily to change any filed tariff theretofore found to be just and reasonable. Any change to be worked under Section 5 must be based on a hearing record and supported by substantial evidence. The Commission's authority under Section 5 requires a "two-step adjudicatory process."

^{26/} Section 7(e) of the Natural Gas Act permits certification of a project such as that proposed by El Paso Alaska only if the Commission finds that it "is or will be required by the present or future public convenience and necessity."

^{27/} See Order No. 455, 48 FPC 218, 223:

We cannot bind a future commission not to invoke the prospective operation of Section 5, nor do we attempt to do so. We do, however, announce our policy to examine the justness and reasonableness of proposed rates in Section 7 proceedings instituted under this Section, thus avoiding the uncertainty of reserving rate determinations for subsequent Section 4 or Section 5 action.

First, the Commission must find that an existing condition is unjust or discriminatory; second, the Commission must prescribe the remedy for that condition. Each step requires the Commission to draw a legal conclusion, viz: illegality of an existing condition and the justness and reasonableness of the remedy. American Smelting & Refining Co. v FPC, 494 F.2d 925, 940-41 (D.C. Cir. 1974).

Once a just and reasonable rate has been established, the Commission is not at liberty to allow change in that rate "without changes in circumstance." Southern Louisiana Area Rate Cases v. FPC, 428 F.2d 407, 429 (5th Cir. 1970), cert. denied, 400 U.S. 950 (1970).

While the Commission has considerable discretion under Section 5 to initiate inquiries into existing rates, once a judgment has been made as to the reasonableness of a particular tariff provision and especially when large sums of money have been committed to a project in reliance upon those provisions, that decision may not be reversed -- absent some new circumstance -- without offending traditional considerations of equity and due process.

[A] decision may not be repudiated for the sole purpose of applying some quirk or change in administrative policy, particularly where, as here, considerable funds have been expended in justifiable reliance upon the earlier ruling. Chapman v. El Paso Natural Gas Co., 204 F.2d 46, 53-54 (D.C. Cir. 1953).

While we cannot dismiss out of hand the threat which the exercise of Section 5 authority would give to the Commission to change its mind concerning the approval of the required tariff provisions, it poses no practical threat to the guarantee of permanence required by the investors in the El Paso Alaska Project. The required tariff provisions are designed to repay investment in the event of project failure. If the condition occurs against which the tariff provision was designed, it cannot be argued logically that this is a change of circumstance. It is not possible presently to imagine any change in circumstance which would justify abrogation of a tariff provision found to be essential to

cert. denied, 419 U.S. 834 (1974). 29/ See also Consumers Union of U.S. Inc. v. FPC, 510 F.2d 656, 659 (D.C. Cir. 1974).

We propose, therefore, that the certificate orders themselves contain express provisions approving the necessary tariff provisions as essential conditions to implementation of the transportation and sales authorized.

Under these circumstances, tariff provisions necessarily required in order to finance a transportation system which are found to be reasonable and in the public interest and expressly recognized as integral to the certifying process could not be abrogated without in effect abrogating the certificate itself--a power which the Commission does not possess. No express power is reserved to the Commission in the Natural Gas Act to amend or alter a final certificate once issued. Cf. United States v. Seatrail Lines, Inc., 329 U.S. 424, 432 (1947). See also, CAB v. Delta Air Lines, Inc., 367 U.S. 316 (1961).

Moreover, the abrogation of the required tariff provisions without evidence of changed circumstances and thus changed equities would be an exercise of arbitrary conduct forbidden by the due process clause of the United States Constitution. In City of Chicago v. FPC, 385 F.2d 629, 637 (D.C. Cir. 1967), the court put the proposition clearly:

29/ The Court in Distrigas said:

Thus should the Commission eventually decide that those facilities and sales proposed in Distrigas' original application do not now merit Section 7 certification, it would, in our view, be under some burden to justify its decision, on the basis of altered circumstances or otherwise. Moreover, in denying Distrigas' application for rehearing, the Commission acknowledged "the problems and equities associated with application of a change of [jurisdictional] policy." Given this acknowledgment, we cannot now assume that the Commission would, in applying Section 7 requirements to Distrigas, fail to abide the principles of fairness implicit in all standards governing exercise of regulatory power. See Amalgamated Meat Cutters v. Connally, 337 F. Supp. 737, 755-58 (D.D.C. 1971) (three-judge court) (opinion by Leventhal, Circuit Judge).

financing and determined by the Commission to be in the present and future public interest. 28/

The ability of this Commission to bind a future Commission in a determination of what benefits the future public convenience and necessity has been established by the Supreme Court's opinion in FPC v. Moss, 44 U.S.L.W. 4278, (3/3/76). That case gave final judicial approval to all aspects of the Commission's Order No. 455 and in particular, approved the pre-granting of abandonment authorization as an integral part of a Section 7(c) certification proceeding. The procedure which was authorized by Order No. 455 permitted this Commission to "determine in a single proceeding whether the 'public convenience and necessity' under § 7(c) of the Act, 15 U.S.C. § 717f(c) warrants the issuance of a certificate authorizing the sale and whether the rates called for by the contract are 'just and reasonable' under § 4(a), 15 U.S.C. § 717c(a)." 44 U.S.L.W. at 4279.

We envision a similar one-step procedure -- the exercise by this Commission of its certification authority under Section 7(c) and its rate-making authority under Section 4. The final certificates and the necessary tariff provisions for El Paso Alaska and the shippers would be approved together upon consideration of the total financing plans submitted by El Paso and the shippers. The Section 7(c) certificates of El Paso and of the shippers would issue upon an express finding that the tariff provisions were necessary to ensure construction of the project and that the project was required by the present and future public convenience and necessity. The Commission's order would acknowledge that funds would be advanced in reliance upon the continued effectiveness of the required tariff provisions in each of the shippers' tariffs and in that of El Paso Alaska. Under these circumstances, no change in policy or change of mind by a future Commission would be adequate grounds for disturbing this finding, absent evidence of a change in the nature of the problem or a change of circumstances so considerable as to make it inequitable to adhere to the filed tariff. See Distrigas Corp. v. FPC, 495 F.2d 1057, 1065 (D.C. Cir. 1974),

28/ This is not to say that the Commission would be without authority to institute, upon project failure, a Section 5 proceeding to disallow costs imprudently incurred. The standards for such disallowance are rigorous. See cases cited at p. 25, supra. This problem should be avoided by the adoption of audit procedures during the course of construction--a Staff recommendation which El Paso Alaska has endorsed.

The Rule of Law does not forbid an agency from modifying its regulatory policy, and the courts have upheld policy revision many times. Indeed one of the signal attributes of the administrative process is flexibility in reconsidering and reforming of policy. What is required by the Rule of Law is that agency policies and standards, whether or not modifications of previous policies, be reasonable and non-discriminatory, and flow rationally from findings that are reasonable inferences from substantial evidence.

There is perhaps one additional requirement inserted in case of change in policy, that the agency give due consideration to the equities, if any, arising out of commitments based on previous rulings. (Citations omitted)

Consequently, if the equities remain the same, one can confidently expect a court to reach the conclusion that the Commission would be estopped 'to change its position.' Presumably, if the equities change, the reason for the tariff provision would have also changed. As long as the risk which the tariff provisions were designed to avoid remain, it follows that there can be no change in the operative equities.

While the doctrine of estoppel has been historically held, as a general rule, not to be applicable to the United States or its agencies in their exercise of governmental power, there has been a significant shift in recent years toward the adoption of the principle of estoppel against the government in situations where the equities require its application. 30/ It has now been recognized that

[E]stoppel is available as a defense against the government if the government's wrongful conduct threatens to work a serious injustice

30/ See Emergence of an Equitable Doctrine of Estoppel Against The Government-The Oil Shale Cases, 46 U. Colo. L. Rev. 433 (1975).

and if the public's interest would not be unduly damaged by the imposition of estoppel. United States v. Lazy FC Ranch, 481 F.2d 985, 989 (9th Cir. 1973).

See also United States v. Wharton, 514 F.2d 406 (9th Cir. 1975); United States v. Georgia Pacific Co., 421 F.2d 92 (9th Cir. 1970). 31/

The ultimate and practical effect of the three concepts just examined is that (i) if the risk of non-payment to the investors remains over the years and (ii) if the investors have advanced moneys for the completion of the Alaska Project upon the express approval by the Commission of the service charge provisions in the applicable tariffs, designed as the means to provide for investment recovery, these provisions have a permanence guaranteed by the Natural Gas Act, the Federal Constitution and general principles of equity.

V. APPLICABILITY TO THE ARCTIC GAS PROJECT

We are not convinced that our proposed theory will materially assist Arctic Gas in its financing. The absence of constitutional principles in Canadian law equivalent to the supremacy clause and the due process clause of the U.S. Constitution and the lack of confidence in the legal restraints upon Canadian governmental bodies preclude any sanguine judgment that the necessary tariffs could be put into place and maintained in Canada. Arctic Gas might well require other procedures to assure its financeability.

VI. APPLICABILITY TO CALIFORNIA STATE REGULATION

Should Southern California Gas Company or Pacific Gas and Electric Company become purchasers of North Slope gas and shippers over the facilities of the El Paso Alaska Project, it will be necessary to the financing of the project to involve the California Public Utilities Commission. Investors as a condi-

31/ Should overriding considerations of public interest prevent the operation of the equitable doctrine of estoppel against the FPC in the circumstances, the investors would possess a substantial claim that there has been a "taking" within the meaning of the Fifth Amendment's obligation to pay appropriate compensation. See Union Oil Co. of California v. Morton, 512 F.2d 743, 750-52 (9th Cir. 1975).

tion to financing would undoubtedly require that Commission to approve the same tariff provisions as would be submitted to this Commission. If the CPUC should refuse, it is doubtful that any large percentage of North Slope gas could be sold to Southern California or Pacific Gas and Electric except as a resale from a transmission company under FPC jurisdiction. 32/

If the CPUC were to approve the necessary service charge provisions, the investors should feel assured that a subsequent Commission, differently constituted, would not be free to abrogate the approved tariff provisions. Under California law the equitable doctrine of estoppel applies to the state to the same extent as to a private person. City of Long Beach v. Mansell, 3 Cal. 3d 462, 476 P.2d 423 (1970). See also U.S. Fidelity & Guaranty Co. v. State Board of Equalization, 47 Cal. 2d 384, 303 P.2d 1034 (1956); Strong v. County of Santa Cruz, 15 Cal. 3d 720, 543 P.2d 264 (1975).

In addition, concepts of due process, including the right to appropriate compensation for a public taking, bind the state no less than the Federal Government. See West Ohio Gas Co. v. Public Utilities Comm'n of Ohio, *supra*; Miller v. Railroad Comm'n, 9 Cal. 2d 190, 70 P.2d 164 (1937).

VII. CONCLUSION

It is in the interest of United States fiscal policy that an Alaskan gas delivery system be financed in the private sector. Treasury witnesses have urged this Commission to develop techniques to accomplish this end. Tr. 18,897-18,900.

Once it is perceived that private financing to construct such a transportation system will not be forthcoming unless the investor can be assured that he will recover his investment in any event and that it is in the interest of the gas consumer that Alaskan gas be brought to market as soon as possible, the logic of the plan which El Paso Alaska sponsors is compelling.

This Commission clearly possesses the necessary statutory authority to permit the imposition of a charge on

32/ In this manner, this Commission's approval of an Alaskan gas service charge would control.

flowing gas to pay for the financing of an Alaskan gas delivery system if the condition requiring such a charge arises.

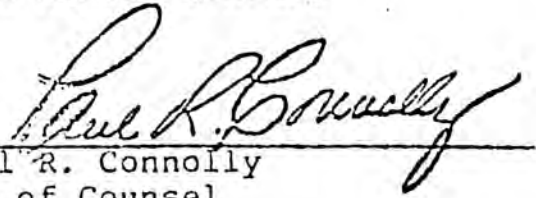
If such a charge is found to be just and reasonable, it will be and must be passed along to the ultimate customer without the need for further state regulatory approval.

Once authorized, and once financing has been put in place in reliance upon the charge, it may not be abrogated while the risk which it was designed to avoid remains to threaten the investor with the non-recovery of his investment.

Respectfully submitted,

EL PASO ALASKA COMPANY

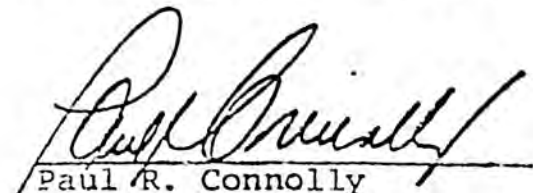
By


Paul R. Connolly
One of Counsel

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused a copy of the foregoing to be served upon each state regulatory commission in accordance with instructions of the Presiding Administrative Law Judge and upon each person designated on the restricted service list compiled by the Commission Secretary in the proceedings consolidated at Docket Nos. CP75-96, et al., in accordance with the requirements of Section 1.17 of the Rules of Practice and Procedure.

Dated at Washington, D. C. this 4th day of June, 1976.


Paul R. Connolly
One of Counsel

Prepared by El Paso

EL PASO NATURAL GAS COMPANY
NATURAL GAS CONSUMPTION FOR THOSE
STATES SERVED WHOLLY OR IN PART
Calendar Year 1975

<u>STATE</u>	<u>EPNG SALES</u>	<u>TOTAL CONSUMPTION</u>	<u>EPNG PERCENT OF TOTAL CONSUMPTION</u>
Arizona	164,704 MMCF ¹	164,704 MMCF	100.0%
California	1,008,158 MMCF	1,807,604 MMCF	55.8%
Colorado	120 MMCF	290,798 MMCF	<1%
Nevada	28,590 MMCF	60,446 MMCF	47.3%
New Mexico	43,336 MMCF	167,220 MMCF	25.9%
Oklahoma	11 MMCF	639,575 MMCF	<1%
Texas	34,627 MMCF	3,911,026 MMCF	<1%
Utah	19 MMCF	123,098 MMCF	<1%

¹ MMCF = millions of cubic feet

NATURAL GAS CURTAILMENT IN 1976
AND ESTIMATED CURTAILMENT IN 1981
1976

	<u>VOLUME</u>	<u>% OF REQUIREMENT</u>
P 1	0	0
P 2	1,731 MMCF	1%
P 3	35,666 MMCF	16%
P 4	2,862 MMCF	21%
P 5	219,809 MMCF	65%
TOTAL	<u>260,068 MMCF</u>	<u>19%</u>

1981

	<u>VOLUME</u>	<u>% OF REQUIREMENT</u>
P 1	83,071 MMCF	15%
P 2	143,261 MMCF	52%
P 3	254,693 MMCF	100%
P 4	11,440 MMCF	100%
P 5	348,723 MMCF	100%
TOTAL	<u>841,188 MMCF</u>	<u>58%</u>

December 23, 1975

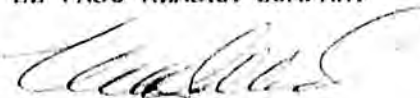
Dear Senator Rader,

John Bennett has asked that I send you the enclosed presentation by Mr. E. C. Phillips, President of Westcoast Transmission Company Limited. It was given recently before the Canadian House of Commons Standing Committee on National Resources and Public Works.

The major theme of Mr. Phillips' talk is that Canada must not act in haste on the matter of frontier gas transportation systems. He briefly discusses a forecasted shortage of natural gas in eastern Canada (by the winter of 1979-80) and projected curtailments of U. S. exports. Most importantly, however, Mr. Phillips suggests a nine-point program which would provide for the prudent development of Canada's frontier gas resources and at the same time satisfy both Canada's growing demands for natural gas and U. S. export contracts. The salient point endorses a recently announced offer by the Province of Alberta to provide interim supplies of natural gas from existing, proven Alberta reserves in order to meet immediate requirements, and thereby lessen the urgency of any decision on the Arctic Gas or Foothills projects. Such interim supplies would ultimately be repaid with frontier gas developed at a later time.

Very truly yours,

EL PASO ALASKA COMPANY



Michael C. Holland
Assistant to the Vice President

Enclosure

The Honorable John L. Rader
Box 2068
Anchorage, AK 99501

WESTCOAST TRANSMISSION COMPANY LIMITED

PRESENTATION TO
HOUSE OF COMMONS STANDING COMMITTEE
ON NATIONAL RESOURCES AND PUBLIC WORKS

Ottawa, December 9, 1975

As representatives of Westcoast Transmission Company Limited, we are delighted, Mr. Chairman, to have this opportunity to discuss the subject of frontier natural gas. It is not overly dramatic to say this is the most complex and important project our regulators and legislators have considered in this century. As one of the three major Canadian gas pipelines, we are anxious to make whatever contribution we can to this great national undertaking. Our formal presentation will be very brief in order to permit sufficient time for questions from your committee.

With me today is our Senior Vice President, John Anderson. His principal responsibility is regulatory affairs, together with other legal matters and gas supply.

Merely as a word of qualification on this subject, Westcoast Transmission operates 2,242 miles of gas pipeline reaching from the U.S.A. border, through British Columbia into the Yukon and Northwest Territories. This system traverses residential areas, rich farmland, plains, foothills, mountains, Indian reserves, major rivers, muskeg and permafrost - the most challenging and varied pipeline operation in North America. We are the only pipeline in Canada operating gas processing plants. The one in Fort Nelson is the largest of its type in the world and the most northerly-situated in Canada, just 80 miles south of the Northwest Territories border.

With Alberta Gas Trunk Line, we are a sponsoring partner in Foothills Pipe Lines Ltd., familiarly known as the Maple Leaf Project to move Mackenzie Delta gas to southern Canada.

The thrust of our presentation today definitely will run counter to some popularly accepted views on the subject of frontier natural gas. We will develop the thesis that undue haste is both unnecessary and imprudent in this vital matter. There is a process by which interim arrangements can be made to supply gas, for both domestic and export requirements, while regulatory proceedings follow a cautious and deliberate pace. Our greatest concern in this matter is the extent to which the public and many in

the industry have under-estimated the time required for all the complex regulatory, legislative, economic, contractual and physical factors to be harmonized in a fashion that will not impose serious social or economic hardship or injustice on any geographical region of Canada, or on any segment of its population. Consequently, it could be an unkindness, bordering on unintentional deception to leave the impression with the U.S.A. that they can safely defer their plans while waiting for Canada to select the best frontier pipeline route in this country's own public interest.

Unlike the detailed geological knowledge Westcoast has developed concerning natural gas reserves in British Columbia and Alberta, we do not have our own calculations of the frontier reserves. However, our examination of the submissions of others leads us to the conclusion that there are abundant reserves to be found both in the Mackenzie Delta and the High Arctic regions. There is no question that these reserves will be required in southern Canada, and the technology will be developed to permit their transport. The same applies to Alaska gas reserves and their movement to the lower 48 states.

Based on that confident expectation, Westcoast, with four U.S.A. partners, acquired Mountain Pacific Pipeline Ltd. in 1969 as a corporate vehicle for the purpose of moving Alaska gas to the Pacific coast of the U.S.A. Because of an abrupt change in the gas supply situation, we were compelled to change our priorities and consider moving Canadian frontier gas to Canadian consumers first.

To accomplish this new priority, we joined Foothills Pipe Lines Ltd. rather than its competitor, Canadian Arctic Gas Pipeline Limited. Our many reasons for that choice have been given in evidence before the National Energy Board. If we had to identify our most compelling reason, we would say it was the decision of CAGPL to bypass the existing gas transportation system in Alberta, which reaches within 80 miles of the Northwest Territories border, and to build 1,000 miles of all new right-of-way and pipeline through that province; and another 105 miles through southeastern British Columbia. In our view, as pipeliners and citizens, that departure from practical engineering and the easily avoidable duplication of services would impose a perpetual social and economic cost on Canadians that should be rejected by this nation.

Having earlier offered a word of caution regarding improvident haste in this matter, we should emphasize this advice is not indicative of any insensitivity to the urgent natural gas needs of either eastern Canada or our export customers in the United States.

Our own studies forecast a shortage in eastern Canada by the winter of 1979-80. As to U.S.A. requirements, our own system in British Columbia will curtail our export customers in the Pacific Northwest about 300 million cubic feet per day this winter, almost 40 percent of their contract. And we believe it was quite significant that the Minister of Energy, Mines and Resources recently limited his assurance of no curtailment of exports from other locations in Canada to just this winter. The gas export prospect for subsequent winters is not encouraging.

We recognize that the need to meet the imminent gas shortage in eastern Canada is of national importance. Similarly, we maintain it is in the Canadian public interest to remove the curtailment in the Pacific Northwest and to prevent the commencement of any curtailment of NEB approved gas exports to the mid-western and eastern United States. Without labouring the point, we cannot accept that tampering with Canada's gas export contracts worth about \$1.6 billion per year will not be injurious to relations with Canada's most important trading partner, not to mention the negative effect on our balance of payments.

Fortunately, the U.S.A. has more than one possible long-term alternative to their proposed Mackenzie Valley pipeline. At least two of the alternatives have different but demonstrable economic benefits to the U.S.A. when compared to the Mackenzie Valley route. The Federal Power Commission staff and the Department of the Interior have both indicated interest in a possible alternative to the two contesting applications now being heard by the FPC. And reference will be made in a moment to a method of short-term relief for U.S.A. gas requirements.

Our position that frontier gas must ultimately flow to southern Canada is not inconsistent with our publicly expressed sensitivity to the question of native land claims. Indeed, this is why we are urging that there not be even the slightest appearance of using a gas supply emergency as an excuse to proceed with a pipeline without resolving the land dispute. As far as Westcoast is concerned, we would not start construction of a pipeline through lands of clearly contestable ownership or control.

In order to make a constructive contribution to your committee's consideration of this great national debate, I will itemize a sequence of events that could satisfy the reasonable aspirations of all, with discrimination and hardship for none. Further, these events could be acceptable to the principal ministries involved - Energy, Indian Affairs, External Affairs and Finance.

The following sequence is clearly idealistic but still attainable with prudent and determined regulatory, legislative and industry effort:

1. Continue the current NEB Hearing and Berger Inquiry without the burden of injudicious deadlines for decisions.
2. Meantime, exploit the offer of the Honorable Donald Getty to provide an interim supply of "swap" gas from Alberta's reserves.
3. Use these interim supplies to reduce the Pacific Northwest curtailments and to eliminate the need for any export curtailments to the mid-western and eastern United States. Retention of their present importation from Canada of one trillion cubic feet per year should be a higher U.S.A. priority than locating an all new remote source of a trillion cubic feet per annum with availability many years in the future.
4. Polar Gas should be encouraged to come forward formally, with its proposal to move gas from the Arctic Islands, in sufficient time to be heard by the National Energy Board as a concurrent or sequential project to the Mackenzie Valley applications.
5. U.S.A. can exploit the interim assistance by using the time afforded to examine thoroughly the pipeline alternative to their Mackenzie Valley plan, namely a pipeline through Alaska and Canada carrying only Alaska gas.
6. Canada can exploit the interim Alberta supply by using the extra time to resolve native land claims in an atmosphere unclouded by impending gas shortages in eastern Canada.

7. U.S.A. can finally adopt an Alaska-gas-only project designed to fit their specific requirements, more time having been provided to negotiate an international transportation treaty if required.
8. Canada could finally achieve, if warranted, a sequential melding of Mackenzie Valley and Arctic Islands projects in a profitably and practically phased all-Canadian undertaking.
9. Commence replacement of Alberta "swap" gas with frontier gas.

In summary, we are advocating unhurried and thorough consideration by all involved in this vital matter. Although we have been identified as a partner in the proposal with the descriptive nickname Maple Leaf Project, we submit that although Westcoast's position is thoroughly responsive to Canadian needs, it is at the same time pro-American. We cannot agree that the suggested cancellation of export licences is an acceptable solution.

The willingness of your committee to travel extensively in the frontier areas and its policy of inviting presentations such as this, give us assurance that the legislative processes are keenly tuned to this complex subject. And, in closing, I would like to record the complete confidence Westcoast has in the National Energy Board - its Chairman Marshall Crowe, the Board Members, the executives and staff. The NEB is unquestionably capable of submitting to government an objective recommendation at an appropriate time. We only hope that industry will assist the Board with sound and imaginative proposals and that the Canadian public will be understanding and patient concerning the amount of time all of this will take.

E. C. Phillips, President

John Anderson, Senior Vice President

**EL PASO NATURAL GAS COMPANY
NATURAL GAS CONSUMPTION FOR THOSE
STATES SERVED WHOLLY OR IN PART
Calendar Year 1975**

<u>STATE</u>	<u>EPNG SALES</u>	<u>TOTAL CONSUMPTION</u>	<u>EPNG PERCENT OF TOTAL CONSUMPTION</u>
Arizona	164,704 MMCF ¹	164,704 MMCF	100.0%
California	1,008,158 MMCF	1,807,604 MMCF	55.8%
Colorado	120 MMCF	290,798 MMCF	<1%
Nevada	28,590 MMCF	60,446 MMCF	47.3%
New Mexico	43,336 MMCF	167,220 MMCF	25.9%
Oklahoma	11 MMCF	639,575 MMCF	<1%
Texas	34,627 MMCF	3,911,026 MMCF	<1%
Utah	19 MMCF	123,098 MMCF	<1%

¹ MMCF = millions of cubic feet

**NATURAL GAS CURTAILMENT IN 1976
AND ESTIMATED CURTAILMENT IN 1981**

	<u>VOLUME</u>	<u>% OF REQUIREMENT</u>
P 1	0	0
P 2	1,731 MMCF	1%
P 3	35,666 MMCF	16%
P 4	2,862 MMCF	21%
P 5	219,809 MMCF	65%
TOTAL	260,068 MMCF	19%

1981

	<u>VOLUME</u>	<u>% OF REQUIREMENT</u>
P 1	83,071 MMCF	15%
P 2	143,261 MMCF	52%
P 3	254,693 MMCF	100%
P 4	11,440 MMCF	100%
P 5	348,723 MMCF	100%
TOTAL	841,188 MMCF	58%

STATEMENT OF JOHN C. BENNETT
VICE PRESIDENT, EL PASO ALASKA COMPANY
BEFORE THE JOINT LEGISLATIVE GAS REVIEW COMMITTEE
FEBRUARY 1977

Mr. Chairman, members of the Joint Legislative Gas Review Committee, we are grateful for this opportunity to meet with you today and to discuss both the purpose and the effects of the state's commitment of surplus Prudhoe Bay royalty gas.

I want to say at the outset that the arrangements which are the subject of these deliberations represent one of the most significant actions by any participant in the lengthy decisional process for the North Slope gas pipeline route. I can assure you that the support of the State of Alaska, as expressed by this commitment of surplus royalty gas, is having a profound positive influence on the ultimate success of our proposal. Conversely, we can just as confidently predict that defeat of these contracts by the Legislature will have an equally profound negative effect. Any inordinate delay in their approval would produce identical negative results.

So, our hope, ladies and gentlemen, is that these contracts will be approved in their present form at the earliest possible date.

I would like to take a few moments to emphasize some of the reasons for our belief that these contracts are the best attainable for both the state and the buyers.

1. They are the product of intensive, arms-length negotiations.

Neither the state nor the buyers are completely happy with all of

the provisions in the contracts, but, for our part, we are satisfied that we can neither give up anything more than we already have, nor can we ask anything further from the state. As a result, the contracts represent a true bargained arrangement, arrived at in good-faith negotiations.

2. We are obviously pleased with the provision calling for active support of the trans-Alaska route for the gas pipeline by both the state and the buyers. From the state's standpoint, there has never been a Governor, a Legislature or any state agency, task force, or committee which has studied the alternative proposals and reached any conclusion other than that the trans-Alaska route is best for the state. The citizens and institutions of Alaska are overwhelmingly in favor of our line. A number of state entities, from political subdivisions to special interest groups, have joined the Hammond Administration in intervening in behalf of the project before the Federal Power Commission. Indeed, Alaska's commitment to a trans-Alaska line is perhaps best expressed by a statement in the November 1976 Gas Pipeline Task Force Report, which said,

".....the Alaska public is more united on this question than on any other present major public issue."

3. As to the buyers' support for the trans-Alaska route, you need have no fears about my company's sincere dedication to its own proposal. Since 1970, when we first looked at this proposition (at the request of a group of Alaskan businessmen), we have expended approximately

\$20 million in the design and promotion of the trans-Alaska route. This is more than four times the amount spent by any individual company sponsoring a competing proposal, and it is 100% risk money.

Tenneco and Southern are the other two purchasers of the state's surplus royalty gas. In spite of the fact that the contracts are not yet final, both companies have played large parts in the progress we have made recently on the Hill and elsewhere in the lower 48. They have done far more than any of us have had a right to expect, and we are extremely pleased with the results of their efforts. They have shown us that they can and will produce, and I believe that the best is yet to come.

4. Both Tenneco and Southern bring to this project considerable talent and experience. While we jealously guard our own company's reputation as the leader in the field of large scale, base-load LNG technology, Tenneco and Southern are also recognized experts.

Southern is part of El Paso's initial Algerian LNG project and is currently constructing LNG receiving facilities at Savannah, Georgia. Tenneco has recently filed for its own base-load LNG project to supply Algerian gas to the United States. The addition of these two respected companies to the trans-Alaska project will strengthen the available resource base to ensure the development of the most efficient and environmentally acceptable project possible.

5. From the state's standpoint, these contracts provide for the highest possible price for its surplus gas; rights to the LPG's in the gas

stream are reserved; flexibility in recalling gas to meet in-state gas needs is total; and resources surplus to Alaska's needs are used as a lever to help obtain approval of a project which will undoubtedly provide the greatest possible benefits for its citizens.

During the three months that this commitment of surplus royalty gas has been public, we have heard and read of several concerns about these contracts which have been expressed by responsible citizens who, we have no doubt, have had the best interests of the state in mind.

Some have suggested that the trans-Alaska route might not be best for the state. We ask only that those people look at the record of support for our project by the citizens of Alaska. We challenge either of our competitors to show that they will provide more jobs, more taxes, lower transportation cost or more spin-off development opportunities than we can.

We have heard some suggest that the timing of this sale is bad. From the standpoint of its support for the trans-Alaska route, this is probably true. It would have produced far greater positive results had it been made a year ago. To those who feel it is too soon, we point out that the contract contains every conceivable flexibility for the state to recall its gas as in-state markets develop -- even to the point where virtually all of the gas could be recalled on the day the pipeline begins operation. In fact, under the lease agreements with the Prudhoe Bay producers, the state does not acquire title to its royalty gas until it arrives at the wellhead. So it must be produced in order to exist as royalty gas per se. As a physical matter, the state's royalty gas could be gathered up and then reinjected into the Prudhoe Bay reservoir. But as a practical matter, who can explain to the citizens of Alaska that they have a

valuable, marketable resource which they are paying to have withheld from market, and which is diminishing by between 5 and 8 percent each production/reinjection cycle. We have firm assurances from the Prudhoe Bay producers that between 2 and 2.4 billion cubic feet of gas per day can be produced without adversely affecting oil production. So protection of oil production is no reason for reinjection, nor is economics, nor is conservation. In our view, reinjecting the gas gains nothing for the state, and therefore makes no sense at all.

We have heard some ask for guarantees that the state's right to recall its royalty gas from our pipeline for in-state use will be fully protected. This is a guarantee that we as a private company simply cannot provide. The United States Congress, however, can and has. Under the Alaska Natural Gas Transportation Act of 1976, the State of Alaska has been given unique authority to take its gas back from interstate transportation to satisfy its own needs. Additionally, these contracts were submitted to the FPC -- on the last afternoon of the hearings -- and once their approval is granted, another layer of protection of the recall right will be obtained. Finally, under the provisions of the contract itself, if the state's access to its royalty gas is not guaranteed, the contracts self-destruct. There simply is no other way that we can think of to protect this right.

A final point that we hear made in detraction of this surplus royalty gas sale is that the state should not commit its resources to gain political leverage. Obviously, this is a philosophical question, but as a practical matter, natural gas is no different a resource than money from the State's Treasury. Those who suggest that the Legislature should appropriate several million dollars of state

funds for lobbying and promotional activities ignore the fact that the royalty gas contracts achieve this same objective without the expenditure of a single tax dollar. In fact, the influence gained in behalf of the trans-Alaska route from the contracts is far more substantial than that which could be gained from almost any amount of money spent for lobbying or similar efforts. The commitment of surplus royalty gas will allow Tenneco, Southern and El Paso to develop a constituency in almost 40 of the lower 48 states. When we visit our market areas and point out that more gas will be available if and only if the trans-Alaska route is approved, we expect that considerable support for our project will result, particularly in the face of the critical gas situation and cold weather of this winter.

Ladies and gentlemen, that concludes my prepared remarks. If you wish, I will now respond to any questions you might have.

Thank you.

STATEMENT

By

ROBERT C. THOMAS

BEFORE THE

JOINT SPECIAL ROYALTY GAS REVIEW COMMITTEE

My name is Robert C. Thomas. I am a Senior Vice President of Tennessee Gas Transmission Company with responsibility for energy supply for all of Tenneco's Interstate Transmission Companies. I am also a Vice President of Tenneco Alaska, an Alaskan Corporation, which has entered into a royalty gas agreement with the State on behalf of Tenneco.

My purposes today are to urge your early approval of the Royalty Gas Sales Agreements, to explain why we believe these agreements are in the best interests of Tenneco and the State, and to answer your questions.

The State has presented to you the terms of this agreement and the benefits accruing to the State. I would like to start with the reasons Tenneco has signed this agreement.