

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

1016 SCOMM 28: JOINT GAS PIPELINE COMMITTEE. 1981-82

The overall proposed reduction by FERC is \$2.1 billion. The major differences reflect judgment about labor staffing and productivity. Williams Brothers believes that the FLUOR cost estimate is extremely conservative, i.e., on the high side. It should be noted that the higher the cost Certification, the higher the potential rate of return for the Sponsor. This is because of the incentive tariff schedule which penalizes the Sponsors for overruns.

In addition to the Pipeline itself, the preliminary design and funding cost estimate for the Conditioning Plant is \$3,503-million in 1980 dollars. This estimate was prepared by R. M. Parsons Company and includes an overall contingency factor of 30%.

Background Marketability of Gas

A special marketability report was prepared by Jensen Associates entitled "The Market Outlook for Alaska Natural Gas". The study was made for Northwest Alaskan Pipeline Company. A copy of their summary is attached in Exhibit B.

They conclude: "We believe that Alaskan gas is marketable not only under the rising long-term price increase scenario-- which we term our "least unlikely" forecast-- but also under a more conservative price projection which we have utilized in this study to test market response".

Jensen does warn, however, that full deregulation of gas pricing may squeeze the marketability of Alaskan gas, particularly in the early years of the pipeline operation.

Reaction of the Financial Community

The reaction of the financial community, as expressed by several major commercial banks and insurance companies, was generally favorable, although guarded. The key economic concern of the prospective lenders related to the billing commencement date.

Under present regulations, billing cannot commence until all four ANGTS segments are completed, tested and proved capable of operations. The certificate of such completion would be performed by the Federal Inspector. Thus, the costs of any delay in the completion of the line could not be charged to end-users and funds for debt service would not be available except as a burden on the sponsors of the line.

The financial institutions are concerned, and have been from the outset, by the costs of delay and the possibility that the delays may be very extended or indefinite. Although early billing cannot be a perfect substitute for a completion guarantee, early billing does reduce the adverse economic consequence of delay and/or non-completion. The financial community does understand that completion guarantees will not be available either from the project sponsors, producers or the Federal Government. Without committing themselves, the financial community, however, did make it clear that some form of early billing commitment would be essential to private financing.

Other concerns of the private financial community relate to governmental attitudes (Federal and State), particularly with respect to price deregulation, environmental regulations and with the Federal Energy Regulatory Commission's (FERC's) ability to modify prior rulings.

Price deregulation is viewed by many as a threat to the marketability of Alaskan gas. Since 1978, the accepted formula for the pricing of Alaska gas provides for roll-in pricing whereby utilities would charge its customers on the basis of its average cost for gas rather than on the basis of its incremental cost for gas. Roll-in pricing works best when the original price for base gas already is low. Thus, the average cost is modest. If the base price for gas is high, the highest price new gas may outprice itself in the market.

At the present time under the Natural Gas Policy Act of 1978, most new gas will be deregulated by 1985. See Exhibit C for details of present status of deregulation. There is no provision for the deregulation of old interstate gas at the present time.

If the law were changed and all gas were deregulated, the initial cost for Alaskan gas may be perceived by the financial community as being too high for the marketplace. This perception may change either way depending upon the world price of oil.

This is a problem the financial community is well aware of, but without any specific solution proposed, or required, at this time.

Another concern of the financial community relates to the environmental and regulatory climate. The financial community believes that the greatest risk, both for the completion of the project and for its costs, are possible delays as a consequence of changes in regulation or inordinate controversy regarding regulation.

In June, 1981, four major commercial banks wrote to North Alaskan partners (see Exhibit D) outlining these concerns. On balance, however, the consensus reaction of the financial community is that the project is economically viable and adequate funds from the private sector could be made available provided that the proper safeguards, such as early billing commencement and supportive regulatory climate, are available.

Political Negotiations

Subsequent to the receipt of the letter from the four banks, outlined above, the ANGTS sponsors submitted to the White House a request for a "number of waivers" of present regulations. Certain of these waivers relating to billing commencement date, regulation and rolled-in pricing which were felt to be essential to the private lenders. Other items, such as permission of the producers to own equity and the treatment of the conditioning plant costs, are an integral part of the financing package worked out between the sponsors and producers. (A summary of the request to the White House is attached in Exhibit E).

The White House staff has, for several weeks, been discussing a proposed waiver package with key members of the Senate and the House. At the present time, there has been no resolution. The most controversial issue is the billing commencement date. It is not felt that the Congress will allow all of the requests of the sponsors for early commencement, but it is believed the Congress will eventually permit much of the request. (The Senate proposal and the House response to the Senate may be found in Exhibits F and G).

The reaction of the financial community is expected to be hard-headed with respect to the billing commencement date, particularly as lenders do not expect to receive completion guarantees.

Conclusion

Over the past twelve months, considerable progress has been made toward developing a viable financial plan for the Alaska segment of the ANGTS:

- (1) Detailed cost estimates satisfactory to the Sponsors and Producers have been made.

- (2) A consensus has been reached between Sponsors and Producers including minority ownership of the pipeline by the Producers and inclusive of the gas conditioning plant (and costs) in the ANGTS.
- (3) An overrun pool has been created satisfactory to the Sponsors and Producers.
- (4) The financial community appears at the moment to be satisfied with the marketability of the gas.
- (5) The financial community has eased its requirement for ironclad completion guarantees.

Much remains to be done, however, to satisfy the financial community. Foremost of the problems is early billing commencement date which is the cornerstone of the lenders' protection against non-completion and/or delays.

Negotiations in the Congress will continue after the summer recess regarding the waiver package.

If pressure mounts for full deregulation of gas, special protectionist measures for Alaskan gas may well be required by the lending institutions. It should be noted, however, that the Reagan Administration's National Energy Policy Plan issued in July, 1981, makes no recommendation to alter the present deregulation schedule.

ANGST FINANCING PLAN

S U M M A R Y

The Financial Plan will address only the Alaskan portion of the project. The financing of the other three (3) segments; i.e. The Western U.S. Leg; The Eastern U.S. Leg, and the Canadian Section have their individual and separate financing plans which are not included herein.

* * *

(1) Capital for the Alaskan Segment will be raised on a project financing basis. This means that debt service and equity returns will be covered only by the cash flow generated by the project's operations.

(2) 25% of the financial requirement will come from equity financing and 75% from debt financing.

(3) The Plan assumes a dollar cost of \$21 billion for the Alaska Pipeline Segment; \$6 billion for the conditional plant and a completion assurance "pool" of \$3 billion. These estimates are based on "as spent dollars".

(4) The responsibility for financing will be as follows:

(a) Producers

- (i) Equity not to exceed \$2.25 billion.
- (ii) Producers to be responsible for arranging \$6.75 billion in debt.

(b) Pipeline Sponsor/Partners

- (i) Equity not to exceed \$5.25 billion.
- (ii) Pipeline Sponsor/Partners to be responsible for arranging \$15.75 billion in project debt.

GRAND TOTAL: \$30 BILLION

All debt financing will be upon the same terms and conditions. The sources of such debt will include U.S. and foreign banks and U.S. financial institutions; i.e., insurance companies, pension funds and suppliers.

The debt financing plan specifically points out that the PRESIDENT'S DECISION in 1977 envisaged the possibility of participation in the project by the State of Alaska. The Plan states (but does not elaborate) that any debt financing provided by the State of Alaska or other Alaskan governmental bodies, would act to reduce the funding required from other sources.

In describing the Plan, the Sponsors further comment that in their opinion the U.S. banking system, foreign banks and U.S. insurance companies, will have the funds available within their lending limits to meet these capital requirements.

The Sponsors further comment that in arranging the required overrun funding, the engineers (FLUOR) added an engineering contingency factor of 12% plus a 28% factor (or approximately \$4 billion) to cover "abnormal" events. The Sponsors, therefore, take the position that because of these built-in overrun funding provisions and completion assurances "it appears that a Completion Assurance Pool of \$3 billion will be adequate."

Because of the magnitude of the project in projecting cash requirements, various inflation and interest rates as well as rates of equity and debt ratios were used. The Sponsors point out that the cash requirements ranged, in fact, from \$17.7 billion to \$27.4 billion. Construction cost inflation rates vary in these projections from 7% to 11%, while interest rates varied from 8% to 14%.

* * * *

MARKETABILITY/JENSEN REPORT

Jensen Associates, Inc. was engaged to prepare a study of "The Market Outlook for Alaskan Natural Gas" for Northwest Alaskan Pipeline Company. This study has been recently updated and the following summarizes the results.

Introduction

We have been asked by Northwest Alaskan Pipeline Company to review the marketability of Alaskan natural gas in greater detail and to update our conclusions in the light of events which have transpired since the first report. This study--like the previous one--was commissioned to review the purely commercial outlook for Alaskan gas rather than to deal with the many aspects of national energy policy which necessarily influenced the decision to proceed with the pipeline. In focusing on the commercial marketability, the emphasis has been upon the likely gas market environment during the construction and early operation of the pipeline. Thus, its time frame is the decade of the 1980s.

Summary and Conclusions

The market environment for natural gas in the United States continues to undergo profound changes, as demand, supply, price and the prospects for competitive energy sources all respond to the upheavals in energy markets which were set in motion throughout the world during the 1970s. By 1987, when Alaskan gas will be available, we expect that the decline of conventional lower 48 gas supplies will have created a strong demand for supplementary gas volumes, if

gas is not to lose market share to imported oil. In an environment of rising real prices for oil--which we believe is the most likely expectation for long-term price trends--the price structure for Alaskan gas will look increasingly favorable compared both to oil and to those alternative gas supplies whose prices escalate with oil.

We believe that Alaskan gas is marketable, not only under the rising long-term price increase scenario--which we term our "least unlikely" forecast--but also under a more conservative price projection which we have utilized in this study to test market response.

The underlying driving force which will be most influential in creating increased demand for gas in general and a market for Alaskan supplies in particular, is an increase in real world oil prices. A major portion of existing U.S. industrial and power generation plant is not readily convertible from oil and gas firing to coal or other fuels thus, rising oil prices quickly shift demand to gas. In addition, most supplementary gas supplies--such as Canadian, Mexican or LNG--are being linked in price to oil. Rising real prices for oil thus makes Alaskan gas--without such linkage--increasingly attractive relative to alternate supplies.

Our "least unlikely" crude price forecast calls for a 60 percent increase in real crude oil prices between early 1981 and 1987 when the Alaskan gas is scheduled to flow. Under such an oil price scenario, Alaskan gas--priced in the middle of its expected range--would be cheaper than oil-indexed imports from Canada, Mexico and Algeria by 1989.

Early 1981 has seen a marked shift in the outlook for world oil supplies and prices. The successful weathering by world oil markets of the Iraq-Iran crisis, together with unexpectedly high reductions in world oil--and OPEC oil--demand has forced many oil economists to moderate their projections. Most forecasters have lowered their near-term oil price estimates and some have substantially lowered their long-term estimates as well. We at Jensen Associates have also reduced our price expectations for the near-term and adjusted our longer-term "lower bound price scenario." But we are not convinced that the conditions necessary for the lower bound forecast--continuing overhang of surplus oil supply within OPEC, and an absence of disruptive military or political events in the Middle East--will persist throughout the 1980s. We thus continue to regard the lower bound case as more unlikely. We view a continuation of the world oil pricing patterns which prevailed during the 1970s as less unlikely. These call for at least one disruptive event-induced upward price increase between now and the time the Alaskan gas flows.

Roughly two-thirds of the elapsed time since early 1973 has been marked by balanced or surplus world oil supply, with a tendency toward stable or declining real oil prices. Yet, 80 percent of the oil price increase during the period occurred during those times when events in the Middle East upset world oil balances. The majority of the time, therefore, there may be a natural tendency to ignore the dominant "crisis" element in world oil price formation.

Our "least unlikely" price projection, together with our more unlikely "lower bound" case, are shown in Table 1. The less unlikely forecast is, of necessity, illustrative since one cannot predict the timing of disruptive events; for purposes of this forecast we have arbitrarily projected a disruption in 1984, with price formation before and after analogous to the 1973/1974 and 1979/1980 disruptions. Our more unlikely lower bound case has weakening real prices until the end of 1982, followed by the operation of the OPEC long-range strategy formula thereafter.

Much of our marketability analysis has been focused on the interaction of upper-bound Alaskan gas price estimates, with lower-bound world oil price projections in order to test the market under the least favorable combination of circumstances. World oil prices have already risen substantially since the passage of the Natural Gas Policy Act in November 1978 and crude oil price deregulation in January 1981 placed further upward price pressures on competitive oil prices.

While oil prices have risen, gas pricing, under the terms of the Natural Gas Policy Act of 1978, is to be controlled until new gas deregulation in 1985, thus creating strong pressures to drive dual-fueled demand to gas and create incentives for new customer growth and gas conversions. Thus, we see a growing demand for gas, despite major conservation-induced energy savings.

We do not see as easy an expansion of gas supply. Lower 48 production should continue to decline despite accelerated drilling

activity. The addition of supplementary sources will be required to attempt to maintain supply levels. The supplements to maintain supply levels are apt to be costly as increasingly, prices for gas imports from Canada, Mexico and LNG projects will be indexed to rising world oil prices.

The outlook for demand until 1985 is likely to be for a return of some of the excess demand conditions which first faced the gas industry from 1971-1977. New gas deregulation in 1985 will cause some price correction, and some loss of load, but a market will still remain for rolled-in Alaskan gas when it comes on line in 1987. Our estimates of gas demand together with supply (in the most severe lower bound oil price case) is shown in Table 2.

In the Natural Gas Policy Act, Congress granted Alaskan gas the right to rolled-in treatment for ratemaking purposes. This was designed to permit price-controlled old gas (which will continue long after 1985 new gas deregulation) to cross subsidize any portion of the price of Alaskan gas over and above market clearing price levels. In a higher oil price scenario, Alaskan gas becomes competitive on the margin, as real oil prices gradually overtake the initially higher-priced Alaskan gas. In our least unlikely combination of oil and gas prices, Alaskan gas requires roll-in treatment during the early years to be marketable.

However, utilizing the upper-bound Alaska gas price and the lower-bound oil price, Alaskan gas must increasingly rely--in the early years, at least--on the rolled-in treatment which Congress

granted it in the NGPA. In the relatively unfavorable combination of higher-bound Alaskan gas prices and lower-bound oil prices, we estimate that the 1987 market will have 25 percent of total U.S. gas supply still regulated below market clearing levels, amounting to a roll-in capacity of \$11.7 billion. This is illustrated in Figure 1. Other supplementary gas supplies, priced above clearing levels, will utilize a portion of this capacity, but most of it remains to accomodate the Alaskan gas and to provide a potential for "fly up"--the rapid market and contractual escalation of deregulated new gas prices in 1985.

It is possible that the gas pipeline industry, through its contracting practices between now and 1985 can lock in enough deregulated gas price escalation to absorb the roll-in capacity in this lower-bound case and make it difficult to accomodate the Alaskan gas. We sense a growing awareness of this problem in the industry with greater emphasis on market protection contract clauses. We therefore believe the problem is manageable if dealt with in time.

In summary, we believe that the commercial market for Alaskan gas will exist in 1987 and in our least unlikely world oil price scenario will increasingly be competitive with alternate gas supplies, which will be largely linked to oil. A combination of the upper-bound Alaskan case and lowered oil price case will require reliance on roll-in capacity, but enough capacity should exist to accomodate it.

TABLE 1

FORECASTS OF REFINERS' ACQUISITION COST OF CRUDE OIL
(1980 \$/Barrel)

	<u>1981</u>	<u>1985</u>	<u>1987</u>	<u>1990</u>
Least Unlikely Case	\$35.21	\$59.30	\$57.60	\$66.42
Lower Bound Case	\$35.21	\$36.19	\$38.43	\$42.01

Source: Jensen Associates, Inc.

TABLE 2

SUPPLY AND DEMAND FOR U.S. NATURAL GAS

1980 - 1990

(Trillion Cubic Feet)

	Estimated <u>1980</u>	<u>Forecast</u>	
		<u>1985</u>	<u>1990*</u>
Total Demand	20.5	22.5	18.4
Total Expected Supply (Excluding Alaska)	20.5	18.8	17.7
<u>Shortfall</u>			
Without Alaska	--	-3.8	-0.7
With Alaska	--	-3.8	0

* The 1990 demand forecast is based on a cleared market for natural gas.

Source: Jensen Associates, Inc.

U. S. Department of Energy

1987 ROLL-IN CAPACITY OF U.S. NATURAL GAS MARKETS

(Based on Lower Bound Crude Price
and
Upper Bound Alaskan Price)

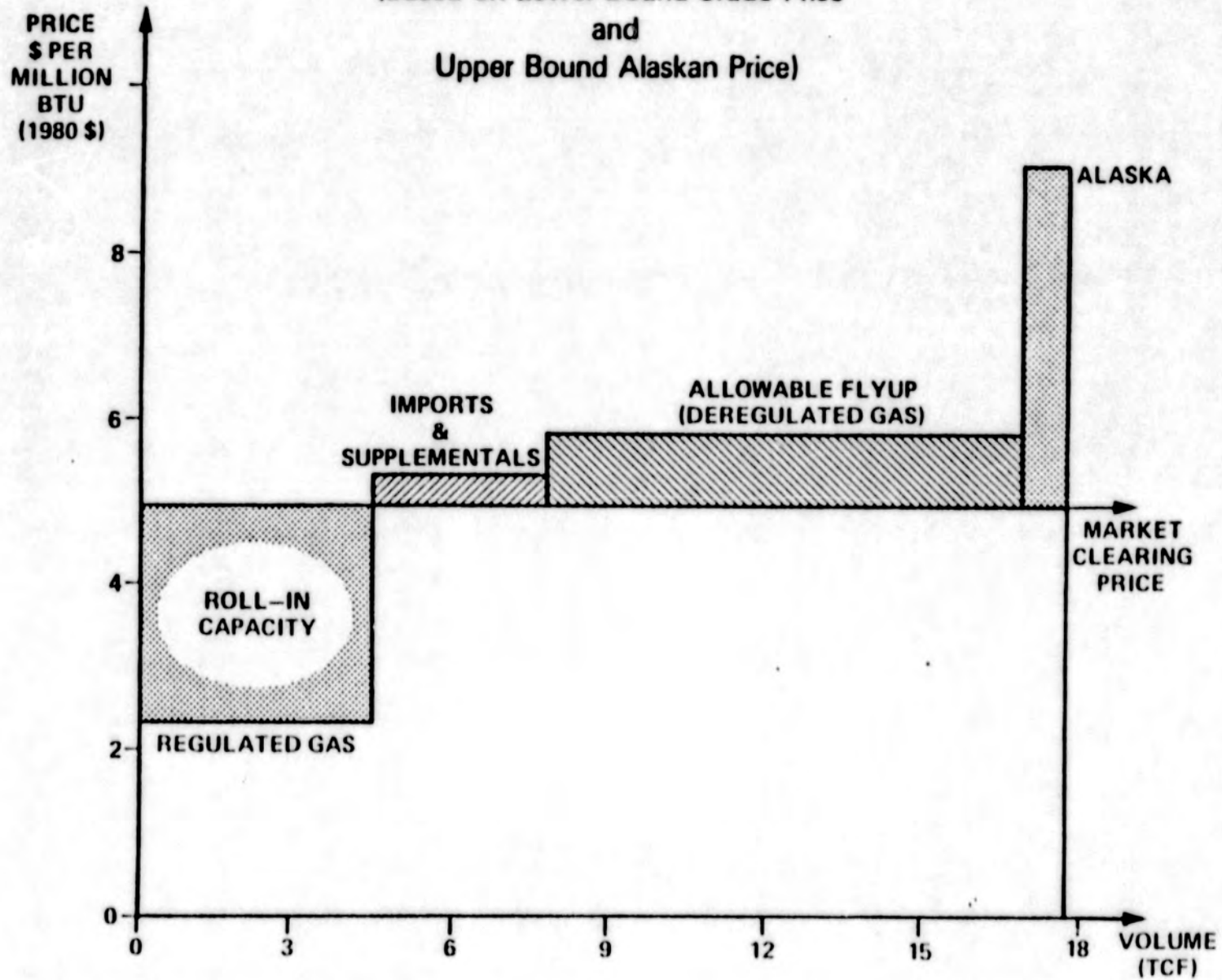


FIGURE 1

Dates of Deregulation

Exhibit C

<u>Section of the Act</u>	<u>Category of Gas</u>	<u>Date of Deregulation</u>	<u>Section of the Act</u>	<u>Category of Gas</u>	<u>Date of Deregulation</u>
102	New Natural Gas - new Outer Continental Shelf leases (on or after Apr. 20, 1977) - new onshore wells 1) 2.5 miles from nearest marker well 2) if closer than 2.5 miles to marker well, 1,000 ft. deeper than deepest completion location of each marker well within 2.5 miles - new onshore reservoirs Gas from reservoirs discovered after July 27, 1976 on old (pre-Apr. 20, 1977) OCS	Jan. 1, 1985 Not Deregulated	106	Sales of Gas Made Under "Rollover" Contracts (an expired contract which has been renegotiated) - interstate - intrastate	Not Deregulated Jan. 1, 1985, if more than \$1
103	New Onshore Production Wells (the surface drilling of which began after Feb. 19, 1977, that are within 2.5 miles of a marker well and not 1,000 ft. deeper than deepest completion location in each marker well within 2.5 miles) - gas produced above 5,000 ft. depth - gas produced from below 5,000' depth	July 1, 1987, Jan. 1, 1985	107	High Cost Natural Gas - production from below 15,000 ft. from wells drilled after Feb. 19, 1977 - gas produced from geopressured brine, coal seams, Devonian shale - gas produced under other conditions the FERC determines to present "extraordinary risks or costs"	deregulated on effective date of FERC incremental pricing rule called for by the Act (approximately 1 year after enactment) Not Deregulated
104	Gas Dedicated to Interstate Commerce Before Date of Enactment (rates previously set by FPC) - from wells commenced from 1/1/752/18/77 - from wells commenced from 1/1/73 to 12/31/74 - from wells commenced prior to 1/1/73 - other gas (gas produced by small producers, gas qualifying for special relief rates, etc.)	Not Deregulated	108	Stripper Well Natural Gas (natural gas not produced in association with crude oil, which is produced at an cfd over a 90-day period)	Not Deregulated
105	Gas Sold Under Existing Intrastate Contracts - if contract price is less than Sec. 102 price, it may escalate, as called for by contract, up to Sec. 102 price - if contract exceeds Sec. 102 price, then contract price plus annual escalation applies, whichever is higher.	Jan. 1, 1985, if unescalated contract price exceeds \$1 by Dec. 31, 1984 If lower, not Deregulated	109	Other Categories of Natural Gas - any natural gas not covered under any other section of the bill - natural gas produced from the Prudhoe Bay area of Alaska	Not Deregulated

June 3, 1981

Mr. John G. McMillian
Chairman and Chief Executive Officer
Northwest Alaskan Pipeline Company
1120 20th Street, N.W.
Suite S-700
Washington, D.C. 20036

Dear John:

During the past two days, representatives of Bank of America National Trust & Savings Association, The Chase Manhattan Bank (National Association), Citibank, N.A. and Morgan Guaranty Trust Company of New York (the "Banks") met to discuss the Alaskan Northwest Natural Gas Transportation Company ("Alaskan Northwest") legislative waiver proposal forwarded to the Banks last week by Rush Moody, Jr. We understand that Alaskan Northwest intends to request that the President submit a legislative waiver proposal to Congress under Section 8(g) of the Alaska Natural Gas Transportation Act of 1976, which authorizes the President to request the waivers of certain provisions of law "in order to permit expeditious construction and initial operation" of the Alaska Natural Gas Transportation System ("ANGTS").

You have asked us for our preliminary views on legislative waivers by the middle of this week. Because of the limited amount of time available to us, we have not had an opportunity to review your proposal with regulatory counsel. Moreover, any consideration in depth of the general question of whether waivers additional to those identified and discussed generally herein may be necessary or advisable in order to finance the Alaskan portion of ANGTS privately must await further development of the detailed structure of a financing plan through negotiations among the project's sponsors and the lenders. Rather we have sought at this early stage to give you our views on the waivers presently identified to us which are of particular concern to lenders.

1. Commencement of Billing Under the Tariff. We agree that it is necessary for billing to commence under the tariff for the Alaskan segments of ANGTS prior to the "completion and commissioning" of the entire ANGTS. Moreover, we feel that the waiver request should leave open for now the

question of whether the Alaskan segment should be treated as one or divided into segments for purposes of commencement of billing, or whether there is some other basis on which to establish earlier billing commencement as to some or all charges. This revision could provide flexibility in developing an acceptable financing plan for the Alaskan portion of ANGTS. Different approaches which might be used in the financing plan include designating individual segments of the Alaskan portion on the basis of area covered, difficulty of construction or cost of construction.

2. Producer Participation. We endorse the equity participation in the project by producers of Alaskan gas. We believe that producer participation in the project will be a significant, constructive step in enhancing the project's financeability.

3. Regulatory Consistency. In the view of the Banks, a necessary component in any successful financing plan for ANGTS is the proposition that, once made, regulatory decisions on which the project's lenders have relied will not subsequently be rescinded or modified to their detriment. Accordingly, the Banks support the requested waiver of Sections 4, 5 and 16 of the Natural Gas Act (the "NGA") as those sections and applicable rules, regulations and orders may affect regulatory decisions made in connection with ANGTS or the shipper tracking mechanism referred to below in 4. The Banks also support the proposed waiver of Sections 1(b) and 2(6) of the NGA in order to confirm that Alaskan Northwest will be a "natural gas company" for all purposes under the NGA when "completion and commissioning" occurs for a segment of the pipeline, whether or not gas is actually flowing.

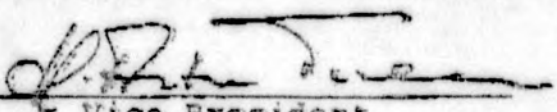
4. Shipper Tracking and Pricing. Since the debt financing for the construction of the various segments of ANGTS is expected to be amortized principally through transportation charges paid by shippers, it seems to us to be important that tracking provisions be in place at the outset of the financing which permit the shippers to recover these charges from their customers. In addition, to the extent that any statutory provision, rule, regulation or order could be construed to require incremental, rather than rolled-in, pricing in connection with gas delivered through a segment of ANGTS, such provision or regulation should be waived.

In the time frame and prior to the development of a detailed financing plan we cannot be more definitive in our comments. However, we hope that it is helpful to you to have our views at this time. As you know, key issues in the formulation of a financing plan still remain unresolved and may well require additional legislative waivers or other legislative or regulatory action. We look forward to working with you in resolving these issues.

Please let us know if you have any questions or comments on this letter.

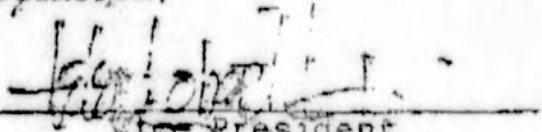
Very truly yours,

BANK OF AMERICA NATIONAL TRUST
& SAVINGS ASSOCIATION

By 

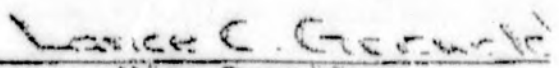
Vice President

THE CHASE MANHATTAN BANK (NATIONAL
ASSOCIATION)

By 

Vice President

CITIBANK, N.A.

By 

Vice President

MORGAN GUARANTY TRUST COMPANY OF
NEW YORK

By 

Vice President

ALASKA NATURAL GAS TRANSPORTATION SYSTEM
REQUIRED WAIVER OF LAW CONCEPTS FOR PRIVATE FINANCING
(Submitted to White House Officials by ANGTS sponsors)

I. Billing Commencement

The Alaska system transportation tariff approved by FERC provides that billing from gas consumers cannot start until the entire ANGTS is completed and commissioned as being capable of delivering gas even though gas deliveries may not have actually commenced. The transportation tariff approved by the Canadian National Energy Board (NEB) provides that the full cost of service may be billed when the Canadian segment of the system is completed and commissioned even though gas deliveries may not have commenced.

Canadian companies, financial advisors and government officials indicate that the billing commencement authorized by the NEB is absolutely essential to finance the Canadian facilities.

U.S. companies and banks state that the Alaska facilities cannot be privately financed unless a minimum bill covering debt service and out-of-pocket costs (similar to the minimum bill now provided when the whole ANGTS is completed) can be billed when the Alaska facilities are completed and commissioned. In addition, until the financing plan is completed, the opportunity should be retained to divide the Alaska facilities for billing commencement purposes into limited and logically defined sections consistent with sound construction practices.

The detailed billing commencement procedures must be submitted to FERC for approval.

2. Producer Equity

Private financing requires some producer investment in debt and equity in the Alaska facilities. In order to assure that producers will not control the partnership which owns the Alaska facilities, the producer equity interest will be less than 50 percent, initially and throughout the life of the project. The Producers will not be allowed to limit access to the transportation system, nor restrict its expansion.

3. Conditioning Plant

The conditioning plant should be an integral part of the ANGTS, however, the incentive rate of return mechanism now required for most of the pipeline system is neither necessary nor desirable for the plant and if applied would result in substantial delay of the project.

4. Regulatory Consistency

The final non-appealable orders issued by FERC covering all remaining regulatory actions necessary to commence construction must be effective when accepted with no further action required and must not be altered during the life of the project in any manner that would impair service of debt.

5. Regulatory Reform to Achieve Expedition

Regulatory procedures should be structured to provide an adequate record to satisfy all parties at interest but should be streamlined to assure that all required approvals are final and non-appealable by February 1, 1981.

6. Rolled-in Pricing

U.S. shippers and lenders must have assurances that those shippers who contract for the purchase of Alaska gas and for transportation service in the U.S. and Canada will be allowed to roll-in or average Alaska gas costs with other gas acquisition costs.

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Exhibit F

Draft Waiver Language on Senate Billing Commencement Date Proposal
(July 16, 1981)

Waive Section V, Conditions IV-3, of the President's Decision to the extent necessary for the (Federal Energy Regulatory Commission), in issuing a final certificate for the approved transportation system, to approve tariffs which authorize billing to commence and collection of rates and charges to begin -

- (a) to permit recovery of the full cost of service for the pipeline in Canada to commence
 - (1) upon completion and testing of the system, and
 - (2) not before a date certain, as determined by the Commission in consultation with the Federal Inspector, to be the most likely date for the Alaska portion of the approved transportation system to begin operation; and
- (b) to permit recovery of the actual operation and maintenance expenses, current taxes and amounts necessary to service debt, including interest and scheduled retirement of debt to commence -
 - (1) upon completion and testing of -
 - (A) the Alaska pipeline segment, or
 - (B) the conditioning plant segment, and
 - (2) not before a date certain, as determined by the Commission in consultation with the Federal Inspector, to be the most likely date for the Alaska portion of the approved transportation system to begin operation.

Draft Waiver Package
(July 10, 1981 Senate Proposal)

1. Producer Ownership Participation

Waiver Section V, Conditions IV-4 and V-1, of the President's Decision to the extent that producers of Alaska natural gas are permitted to participate in the ownership of the Alaska segment of the approved transportation system but only to the extent that such producer participation does not (a) create or maintain a situation inconsistent with the antitrust laws, or (b) in and of itself create restrictions on access to the Alaska segment of the approved transportation system for non-owner shippers or restrictions on capacity expansion.

2. Conditioning Plant

Waiver Section 7, Paragraph 3, First Sentence, of the President's Decision to include the gas conditioning plant in the approved transportation system and in the final certificate to be issued for the system, waive the application of Section V, Condition IV-2, to the gas conditioning plant.

3. Evidentiary Hearing Requirement

Waive Section 7(c)(1)(B) of the Natural Gas Act to the extent that it applies to applications for certificates of public convenience and necessity authorizing the construction or operation of any segment of the Alaska segment of the approved transportation system to the extent that it can be construed to require the use of formal evidentiary hearings, provided, however, that the waiver shall not be construed to preclude the use of formal evidentiary hearing(s) whenever the FERC determines, in its discretion, that such hearing is necessary.

4. Authority to Modify or Rescind Orders

Waive Sections 4, 5, 7 and 16 of the Natural Gas Act to the extent that such sections would allow the Commission to change the provisions of any final rule or order approving (a) any tariff in any manner that would impair the recovery of the actual operation and maintenance expenses, actual current taxes, and amounts necessary to service debt, including interest and scheduled retirement of debt, for the approved transportation system; or (b) the recovery by shippers of Alaska gas of (1) all costs related to the purchase of such gas at just and reasonable rates, and (2) transportation of such gas pursuant to an approved tariff.

5. Regulatory Status as a "Natural Gas Company"

Waive Sections 1(b) and 2(6) of the Natural Gas Act to the extent necessary to ensure that the Alaskan Northwest Natural Gas Transportation Company or its successor and any shipper of Alaska natural gas through the Alaska segment of the approved transportation system may be deemed to be a "natural gas company" within the meaning of the Act at such time as it accepts a final certificate of public convenience and necessity authorizing it to construct or operate the Alaska segment of the approved transportation system or to ship or sell gas that is to be transported through the approved transportation system.

6. Import and Export Authority

Waive Section 3 of the Natural Gas Act and Section 103 of the Energy Policy and Conservation Act as they would apply to natural gas transported through the Alaska segment of the approved transportation system to the extent that any authorization would otherwise be required for -

- (a) the exportation of Alaska natural gas to Canada (to the extent that such natural gas is replaced by Canada downstream from the export);
- (b) for the importation of natural gas from Canada (to the extent that such natural gas replaced Alaska natural gas exported to Canada); and
- (c) for the exportation from Alaska into Canada and the importation from Canada into the Lower 48 States of the United States of Alaska natural gas.

Congress of the United States

House of Representatives

Washington, D.C. 20515

Exhibit G

July 22, 1981

The Honorable James A. McClure
United States Senate
3121 Dirksen Building
Washington, D.C. 20510

Dear Senator McClure:

We deeply appreciate the efforts you have made, and those of your staff, in working with us and our staff on the difficult issues embodied in the proposed waivers of law related to the Alaska Natural Gas Transportation Systems (ANGTS). In the few short weeks during which these proposals have been before us, we have made significant progress. We have been able jointly to solve or avoid many of the serious public policy problems posed by the original proposal without undercutting the viability of the project. This process has brought us to the point that only a few major issues remain. As might be expected, however, these few issues still include those that are the most significant and troublesome. We stand ready to continue to work to resolve these issues.

It must be remembered that in 1977 the President provided in his decision and the Congress affirmed by joint resolution terms and conditions that the sponsors of the ANGTS indicated would be sufficient to allow for private financing and construction. We continue to stand by our decision of that time that under those terms this project is clearly in the national interest. We have affirmed that judgment several times, most recently in a concurrent resolution passed during 1980.

The current waiver proposal, however, fundamentally alters the original nature of the project. Particularly by the proposal that advance billing be permitted for completed sections of the pipeline, but also by the regulatory certainty waivers and others, the agreement that we reached with the sponsors of this project on behalf of American gas consumers would be importantly modified. Significant portions of the risk of non-completion of the project and significant financing costs would be shifted onto those gas consumers. In addition, the ability of their regulators to protect their interests would be simultaneously reduced.

Nonetheless, we stand ready to consider altering the original agreement to make such major changes. Some would use the occasion of the request for these waivers to reject the project altogether--we do not number ourselves among them. To the contrary, it is our desire that the process which has brought us the progress we have already achieved be permitted to continue. Indeed, it should be expanded to include those who would raise the fundamental questions of whether this project remains in the national interest as it would be modified by the waiver proposals.

Such processes take time, of course, and there is the legitimate question as to whether there is sufficient time remaining in this session to bring such a process to the point of success in order not to delay the construction schedule for the project. It is our opinion that there is time, and that, whether or not the time is sufficient, waivers cannot succeed in the House of Representatives unless such a process has taken place. We believe that the surest way to doom the waiver proposals to defeat would be for us to encourage them to be sent forward by the President before the Congress at large has had the opportunity to weigh the difficult questions of whether the value to the nation of this project still makes the cost it now involves worth paying.

We cannot, of course, speak to the procedural or substantive situation concerning these waivers in the Senate, and it may in fact be necessary to their success in the Senate that the waivers be sent forward as soon as possible, although the opposite situation is true in the House. If you and the President decide that he should submit the waivers in their present form, we will certainly take them up in good faith and will support those which give us no trouble.

The Honorable James A. McClure
July 22, 1981

3

Members of our Committee and others have raised several minor but still significant concerns with the waivers beyond those mentioned above. Not all of use are equally concerned by all of them, but these questions must be answered in the House in some fashion before full support could be assured.

We remain determined to seek a resolution of the issues raised by these waivers, and hope to continue consulting with you and the Administration on them. With time, solutions may be found. For example, a billing commencement proposal featuring an escrow account might offer a possible solution to the billing commencement issue. It is our judgment that the current form of the proposal cannot succeed in the House now, but that is not to say that a varied proposal cannot succeed nor that given time, the troubling questions raised by this proposal cannot be satisfactorily dealt with. Thank you again for your patience and cooperation, and we look forward to further efforts.

Sincerely,

John D. Dingell
Chairman
Energy and Commerce Committee

James T. Broyhill
Ranking Minority Member
Energy and Commerce Committee

Philip R. Sharp
Chairman
Fossil and Synthetic Fuels
Subcommittee

Clarence J. Brown
Ranking Minority Member
Fossil and Synthetic Fuels
Subcommittee

Morris K. Udall
Chairman
Interior and Insular Affairs
Committee

Manuel Lujan, Jr.
Ranking Minority Member
Interior and Insular Affairs
Committee

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AS A UNIT IN THE ORIGINAL DOCUMENT.**

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TESTIMONY OF JOSEPH M. CHOMSKI

Legal Counsel to the

JOINT NATURAL GAS PIPELINE COMMITTEE

March 11, 1981

Testimony of Joseph M. Chomski

March 11, 1981

Distinguished members of the Committee, I am Joseph M. Chomski of the Alaska law firm of BIRCH, HORTON, BITTNER AND MONROE. I have been asked to testify before the Committee today on the current status of the Alaska Gas Pipeline as seen from the federal statutory, regulatory and political perspective. I have also been asked to discuss the outlook for the Pipeline, including the problems the project must confront and the implications for the State of Alaska.

Since this Committee is newly reconstituted, Chairman Gardiner has suggested that I spend a moment describing my background and our firm's history with the Pipeline Committee. I am the resident partner in our firm's Washington, D.C. office. At my side is Bruce Monroe, the managing partner of our Juneau office. We began working for the Pipeline Committee in October, 1978, and have been under contract to it since then. We have produced eight separate written reports for the Committee during this period. The reports have included

(1) a comprehensive history of the federal perception of State's financing commitment to the Gas Line and the methods by which the federal government can exercise leverage over the State to force financial participation,

(2) an analysis of federal financial assistance options,

(3) a report on Federal Energy Regulatory Commission and court decisions attempting to expand federal control of natural gas into gathering and production,

(4) an extensive report in April, 1980, covering the statutory obstacles to the Pipeline's construction as well as corollary matters such as the construction schedule and the State's prospective financial role.

(5) Our most recent report was presented to the Committee in December, dissecting Northwest's FERC Certificate Application and the FERC procedural structure as it relates to Pipeline approval.

We have also provided answers to all questions posed by Committee members and staff on a regular basis and have generally kept the Committee current on all federal aspects regarding the Gas Pipeline, and in particular those affecting Alaska's interests in the project. In other words, we have sought to be the Committee's "eyes and ears" in Washington and to serve as an early warning system for problems that appear on the horizon.

As to my personal background, I am a member of the Alaska Bar, and the vast majority of my practice in D.C. concerns Alaskan's or Alaska's problems with the federal government. Much of my work is in the energy area. Prior to joining our firm, I spent five years as an investment analyst with a large Wall Street brokerage company, primarily covering the energy industry.

Before getting into the current and future aspects of the Pipeline, I would like to point out certain findings in two of these previous reports because of their relevance to the current posture of the project.

In our 1979 historical perspective's report, we determined that the State of Alaska never made any financial commitment to participate in the Alaska Northwest Gas Pipeline Project. In fact, the concept of Alaska participation in the funding for the Gas Pipeline was solely a creature of the Treasury Department under President Carter. The only financial commitment of any sort made by the State of Alaska was a promise to participate in the All-Alaska line, also known as the El Paso Project.

In our April, 1980, report to the Committee on legal impediments to the line's construction, we concluded that under no reasonable circumstances could the Gas Pipeline be built, given current law. This conclusion remains intact today. We will later describe the prospects for legislative amendment of the statutory restrictions governing the Gas Pipeline. We also suggested that if the Gas Pipeline cannot be privately financed, a major revision of the statutory framework and treaties governing it would be necessary and a long delay certain. Third, we enumerated the legal, regulatory, financial and other considerations that had to be met before pipeline construction could commence in Alaska. We stated that only the most optimistic scenario would produce Pipeline construction in Alaska by 1983, and that a 1984 commencement date is most likely. We believe this is still the case.

Finally, one last historical perspective. The Alaska Gas Pipeline project has had its problems, as all will admit. It still faces many tough ones, but the events of the last year cast an undeniable aura of optimism. In no year has progress been greater than the last one.

CURRENT STATUS - 1981 EVENTS

At present, most of the governmental bodies in Washington, D.C., involved with the Alaska Gas Pipeline are in a "watching and waiting" posture. Congress, the Federal Energy Regulatory Commission, the Administration, the Department of Energy, and the Office of the Federal Inspector are all awaiting the outcome of the ongoing producer-sponsor financing negotiations. This is not to say that no work is being done, but the event of preeminent importance in the immediate future is the agreement, or lack thereof, that these negotiations will produce.

On the assumption that the negotiations will reach some conclusion, I would characterize the calendar for 1981 as having three tracks.

The first track, obviously, revolves around the producer-sponsor negotiations and the sequence of events that will follow them. The stated objective of the negotiations is to develop a private financing plan involving significant producer participation. There is a general expectation that an announcement will be forthcoming at the end of these negotiations, and that announcement may be issued within the next month. Once the producer-sponsor agreement in principle is reached, it will be presented to the financial community for review and comment.

Once the lenders have assessed the proposal, it is expected that their response will be something like: "It may be possible to raise the monies involved if certain nonnegotiable conditions are met."

The nonnegotiable conditions will include changes in the law, and regulation governing the Line, to permit the producers to participate in the Pipeline as owners, to provide a tracking mechanism to insure repayment to the lenders, perhaps to provide a billing commencement date assurance for Canadian lenders, and several lesser points. It is also almost certain that the producer-sponsor agreement in principle will include the sales gas conditioning plant in the Pipeline, contrary to existing law.

At this juncture, the focus will turn to Congress. The producers and sponsors will submit a proposal for altering the 1977 President's Decision and Report, using an expedited procedure. Assuming Congress does not balk at the changes, the statute could be changed to enable the project to go ahead by September or October. I will discuss Congressional attitudes and the expedited procedure in a few minutes.

The second concurrent track on which the Gas Line is progressing centers around the Federal Energy Regulatory Commission, formerly known as the Federal Power Commission. This is the process of reviewing and approving the application filed by Alaska Northwest for a final Certificate of Public Convenience

and Necessity to construct and operate the Alaska Gas Pipeline. Our December, 1980, report to the Committee details the process at some length, so I will not restate it. However, I will highlight the some key 1981 events.

The first benchmark may occur today and certainly will occur within the next few days, if not today. FERC's director of the Alaska Gas Pipeline Office will issue his draft report to the Commission containing approval or disapproval recommendations for the segments of the certificate application that Northwest has filed. The most important of these recommendations will involve a cost estimate for the Pipeline and the proposed centerpoint -- really cost overrun allowance -- around which the incentive rate of return mechanism will function. Once this report is issued, there will be a short period for comments dealing solely with mathematical rather than policy matters, and then a final report recommending approval or disapproval of partial certification will go to the Commission. If approval is recommended, agreement by the Commissioners in fairly short order is expected.

FERC will then await submission by Northwest of the remainder of its Certificate Application. The unfiled portions are pivotal to the project, since they include the financing plan, marketability projections, a national economic benefit section (this requires Northwest to demonstrate that the project costs do not "materially and unilaterally exceed the comparable

cost estimate filed by Northwest on April, 1977. FERC may not issue a final certificate if Northwest fails this test.)*, and Northwest's cost of service data. There is no firm date when Northwest is expected to complete its application, but sometime this summer might not be a bad guess. Obviously, completion of the application depends on the outcome of the current negotiations.

Presumably, FERC will do little other than limited staff work on the final segments of the Certificate Application until Congress sanctions the changes in the Alaska Gas Pipeline law that will be assumed in Northwest's submission. Therefore, work in earnest on the final segments of the application cannot be expected until the latter part of this year. Presumably, FERC will use the same abbreviated procedures they use on the first part of the certificate review process.

Ultimately, we think the FERC Pipeline Office may be able to produce a draft report with recommendations on final certification by the end of the year or more likely, early 1982. If the recommendations and the Commission's actions are both favorable, final certification of the Alaska Gas Pipeline will at long last occur.

*There is no legislative history to define material and unreasonable cost excess. The cost comparisons FERC will have to weigh is \$3.3 billion versus \$8.5 - \$9.0 billion, or more than a 250% increase in four years.

The third and last track on which the Line is progressing might be considered the operational track. Construction is moving ahead swiftly on the Western leg of the project. The highly publicized ceremony commemorating construction commencement recently took place in Spokane. At present, construction is on schedule or ahead of schedule and throughput is anticipated by October of this year.

The Eastern leg of the pipeline, also known as the Northern Border Pipeline, is scheduled for construction commencement in May and completion in the fall of 1982. While Northern Border has its financing together, there are certain regulatory and legal problems that remain. Primarily, the State of North Dakota is balking at providing a right of way and its objections are now in litigation. The North Dakota suit is of great importance to the Pipeline since it will set precedents on such matters as federal preemption of State's rights regarding the Alaska Gas Pipeline. A decision on this suit is expected sometime this year. There is also a problem of assessing cultural resources in the Pipeline's route. Some major excavations may be necessary before trenching of the line can begin and an emergency salvage plan is now being put together.

With regard to the Alaska segment, the critical operational event this year involves procurement for the North Slope conditioning plant. In order to maintain the Gas Line's current construction and completion schedule, significant progress on the conditioning plant must occur this year. Northwest states that purchase orders must be made by this summer or a year will be lost.

REAGAN ADMINISTRATION POSITION

We have been requested to describe the Reagan Administration's position regarding the Alaska Gas Pipeline. I will do the best we can at this early juncture. What is clear is that no truly firm, detailed position has been reached, nor has the Administration's lead person on the Pipeline been designated. We know of no campaign statements or other public commitments made by the President prior to inauguration. Despite these caveats, there are many things that can be said.

The Administration will take a strongly positive, but purposely vague position on the Pipeline during the President's meetings this week with Canadian Prime Minister Trudeau. It is doubtful that any specific detailed commitments will be made during this meeting. It is clear from overall Administration policy that the Gas Pipeline presents many important benefits, including: Substantially increased domestic energy supplies, a balance of payments benefit, and improved national security. It is also likely that the Administration will work hard to eliminate the regulatory and statutory obstructions that the Pipeline's promoters and prospective lenders cite as obstacles to financing. Elimination of many of these obstructions will, however, raise the price to consumers of North Slope gas, once delivered.

In distinguishing the Carter position from the Reagan position, it is often postulated that President Carter was for more regulatory restrictions on the Line, but that he might have been more willing to accept federal financial support or guarantees if they were needed to make the Line a reality. The Reagan Administration is more opposed to those regulatory restrictions, but no one can yet possibly speculate whether he will break from his philosophical commitment of keeping government out of the hair of private business -- as well as his budget austerity program -- to provide financial support if that is essential to make the Line occur. It would be hard for the President to sanction federal participation, but it would also be difficult to stand by and watch the project abandoned.

One final indication of the Reagan position may come from the Transition Report on the Gas Line prepared for the Administration. We provide a warning here: these reports often perfectly reflect Administration thinking, but in some cases are completely out of step and are ignored. The Transition Paper on the Gas Pipeline reached made only general recommendations: "That the project should go forward as planned, assuming an acceptable financing plan can be developed." The report also states that the Alaska Natural Gas Transportation System is in

the national interest if private financing can be found. Finally, it concludes that the Office of the Federal Inspector should be maintained because its presence would make acquisition of financing easier.

There is one other factor that bears mention. The Reagan Administration posture on the Gas Pipeline is particularly important because our new President will have the opportunity in 1981 to appoint four of the five Commissioners of the Federal Energy Regulatory Commission. Therefore, he can be as sure as any President can be about an independent agency carrying out his wishes, if he chooses to make concurrence with his Gas Pipeline position a prerequisite for appointment to FERC.

CONGRESSIONAL ACTION

It is quite clear that the critical path for Gas Pipeline development will soon point to Congress. A little background information is necessary to explain the Congressional procedure.

In 1976, Congress enacted the Alaska Natural Gas Transportation Act, which was legislation essentially expediting the federal government's decision-making process for choosing the desired Gas Pipeline applicant and route and then expediting construction and initial operation of the Pipeline. ANGTA provided for the President to recommend to Congress an applicant and route in a document including terms and conditions entitled, "The President's Decision and Report." Once Congress approved the President's Decision and Report, its terms and conditions became federal law, the equivalent of conventional federal legislation.

In September, 1977, President Carter submitted his Decision to Congress which soon approved it. As we stated in our April, 1980, report to this Committee, the Decision and its terms and conditions were hopelessly flawed. Fortunately, ANGTA contained a provision at § 8(g), which allowed the President's Decision to be amended within 60 calendar days of continuous session of Congress if approved by enactment of a joint resolution.

The realities of Pipeline development now make amendment of the President's Decision an apparent necessity for the Pipeline to proceed. The waiver provision at § 8(g) is expected to be the mechanism used. Assuming that the producers, sponsors and financiers agree on what it takes to finance the Pipeline, we anticipate that a proposal for waiving several of the provisions of the President's Decision will be presented to the House and Senate this summer. We anticipate that the waivers will do at least the following things: (1) permit North Slope producers to hold an equity position in the project; (2) add the conditioning plant to the Pipeline project; (3) provide that U.S. consumers can be billed for debt service and perhaps return on investment to pay for Canadian segments of the Line, should they be completed before the entire Pipeline is ready for commissioning.

We believe there is little opposition to producer equity participation and probably little opposition to adding the conditioning plant to the project. There may be some consumer opposition to the waiver of the existing protection that U.S. consumers have against being billed for gas they do not receive. Additionally, this latter waiver might be considered the first step toward permitting an all-events tariff which would put the onus of a Pipeline completion guarantee directly on the U.S. consumer. Such a provision, which could conceivably be addressed by a future Congress, would be highly controversial.

We believe that the above legislation will probably be approved by Congress, largely because of the national interest in the Pipeline project and the dissolution of much of the consumer protection sentiment in the House of Representatives that originally fought for these provisions.

While enactment of the above legislation will certainly help move the Pipeline along, it will leave certain other critical elements undecided. For example, addition of the conditioning plant to the Pipeline project does not, in and of itself, switch the burden of paying conditioning costs to the consumer and away from North Slope producers. While the intent of the producers is to effect this substitution, it cannot be provided by a waiver of the President's Decision, since the President's Decision was silent on the conditioning costs issue. The Natural Gas Policy Act and FERC Order 45 are responsible for the conditioning cost treatment, and one or both must be altered to solve this difficulty.

Finally, in our opinion, the issue of federal participation in financing the Gas Line will not be presented to Congress this year, unless producer-sponsor negotiations fall apart or unless Wall Street adamantly turns thumbs down on the proposal that may be made to them by the producers and sponsors.

CANADA

One of the strongest reasons the Gas Line will almost certainly become reality some day is the commitment made to it by Canada, the U.S.-Canada Treaty, and our country's desire to maintain strong relations with our Northern neighbor. The Canadians do not want to be embarrassed by trusting the United States, then not having the Alaska segment built, thus ending up with a Canadian gas export system and no more.

The Canadians also do not want the United States portion of the Line to be built with government money, because that would not only violate our treaties with them, but it would endanger their financing. Gaining approval for revised treaties and statutes may not be easy in Canada. Moreover, the Canadians believe that the same major North American financial institutions will be involved with financing the Line on both sides of the border. Therefore, if one side has government guarantees and the other does not, the lenders will flow their money to the guaranteed side.

As to legal obstacles facing the Canadian segment of the Pipeline, two stand out. To date, British Columbia has been unwilling to sign a nondiscriminatory tax agreement for the section of the Pipeline traversing its borders. If B.C. chooses not to, litigation will ensue and will certainly end up in Canada's

highest court. The second obstacle is the lack of a treaty with the Canadian Yukon Indians to settle their land claims. I am told that some progress is being made, but that it is a long way from complete.

The Canadians have one significant regulatory/legal problem that Congress or FERC must solve. They are concerned that the President's Decision and Report will prohibit U.S. consumers from paying any tariff until the entire Pipeline is finished. Should the Canadian side be completed before the U.S. side, the Canadians, without an alteration in the President's Decision language, could receive no debt service or return on their investment until the U.S. line is finished. Obviously, that puts them at risk in a manner they wish to avoid. It would appear that either via Congress, will have to solve this problem.

Finally, there is a great deal of misinformation regarding the nature of Canada's foremost interest in the Alaska Gas Pipeline project. Canada's principal interest stems from the project's providing the least expensive access to McKenzie Delta and Beaufort Sea gas. But for this benefit, Canadian involvement would probably be far less aggressive.

NATURAL GAS PRICE DECONTROL AND NORTH SLOPE GAS MARKETABILITY

Natural gas decontrol as it effects the Alaska Natural Gas Transportation System is difficult to analyze because the Reagan Administration has introduced no gas deregulation legislation. This puts all of us in the position of trying to grab hold of a cloud, there is just nothing solid to latch onto yet. The Administration has, however, made a public commitment to ask Congress to accelerate deregulation of the price of natural gas. In fact, David Stockman recently announced that the Administration will launch a two-pronged effort to accelerate decontrol. FEPC can deregulate prices on certain types of gas administratively, while Congress will be requested to change the deregulation schedule in the 1978 Natural Gas Policy Act.

The Congressional effort is where the impact lies is for the Gas Pipeline. The Natural Gas Policy Act provided one pricing structure for North Slope gas¹ and a separate one for most U.S. natural gas. North Slope gas was priced at \$1.45 per Mcf, plus inflation from April, 1977. More importantly, Congress provided that the wellhead price and the transportation costs of this gas shall be rolled into the other gas purchased by interstate pipelines.

¹As well as some other defined classes of gas not relevant to the Gas Line's future.

The Natural Gas Policy Act provides that new gas -- defined as natural gas discovered after April, 1977 -- and several other categories of natural gas will be deregulated in 1985. Prudhoe gas would not be. It is this 1985 deregulation schedule that the Administration presumably proposes to accelerate. Whether deregulating Alaska North Slope gas is also on their agenda is not known, but it may be irrelevant if the price of other gas is highly competitive.

Deregulation is cited as a threat to the Gas Pipeline is that it may mean because there is no low priced gas to roll Alaska gas prices into, or that there may be no mechanism existent to force roll-in of Alaskan gas prices. Obviously, such uncertainty is the stuff that makes lenders nervous.

It is interesting to note that in President Carter's 1977 Decision on the Gas Pipeline, he stated the following regarding deregulation: "If, on the other hand, proposals to deregulate natural gas prevail, serious uncertainties and delays concerning the development of any Alaskan natural gas transportation system could result." He then went on to question the saleability of the gas and the financibility of the project under a deregulation scenario.

Whether deregulation will in fact occur is an open question. The gas producers want it, but the gas pipeline companies strongly oppose it. President Reagan committed himself to it

during the campaign, but the Republican leadership in the Senate Energy Committee has asked him not to introduce it this year. The issue for the Gas Line is not whether deregulation legislation will pass soon, but whether deregulation will occur before the Gas Line is commissioned, whether it will be deregulation in toto, and whether some mechanism will be left or created to insure North Slope gas marketability.

If there is fairly complete deregulation, an extremely serious problem for the State of Alaska could arise. It is quite possible that North Slope gas will be higher priced than competitive gas and that state public utility commissions will not sanction rates including the high priced Alaskan gas if cheaper gas can be purchased. In this event, North Slope gas will have to be discounted to be sold. Notably, the California Public Utility Commission has recently refused to permit a rate high including expensive Canadian gas because cheaper gas was available.

In essence, a net back pricing system, not unlike that applying to crude oil, may be created. Since North Slope gas costs is made up of the wellhead price and the transportation increment, one or both would have to be shaved. Our research indicates that the wellhead price is the more vulnerable for several reasons. First, the Pipeline is so tough to finance already, that any thought of a discounted tariff in early years would go over poorly with Pipeline participants and lenders.

Second, while levelled or end-loaded tariffs are possible, they may not be as practicable from a regulatory standpoint as a standard declining pipeline tariff.

Where does this leave Alaska? In great jeopardy of having to sell a couple of year's worth of royalty gas at a great discount or perhaps almost no wellhead price at all. It also augurs poorly for State severance tax revenue in early years. A recent Department of Energy memorandum concurs with the conclusion that a severely discounted wellhead price might be necessary to market North Slope gas in the first year of throughput, under a deregulation scenario.

The producers, who will presumably be Gas Line owners also, will be able to spread their risk of suffering a low wellhead price by getting a full return on their Pipeline investment and by reducing their tax burden. Alaska, unless it chooses to be an equity owner in the Line, has no such insulation. Moreover, the producers as private corporations can more easily justify early year losses by focusing on the profits generated during the life of the field. The State seems to be less in a position to justify, legally or otherwise, short term losses in natural resource sales for potential long term benefits.

This potential problem might be solved if the State can do one of several things, such as trade its royalty gas for gas liquids, enter into an underlifting agreement with North Slope producers, store its royalty gas until the wellhead price rises to satisfactory levels, invest in the Gas Pipeline to dilute its risks, or somehow maximize in-state use of royalty gas during the early years of production.

ALASKA'S FINANCIAL ROLE

Perhaps the ultimate question this Legislature may at some time face is whether to invest Alaskan assets in the Gas Pipeline. It would be pointless to testify before you today and not address this issue. I cannot offer any hard and fast answers, but some principles are clear, and some options are beginning to surface.

As I stated at the outset, Alaska is not -- legally or historically -- committed to financial participation in the Northwest Alaskan Pipeline. However, the administrative record is clear and a general consensus exists that the State of Alaska probably has much to gain if the Gas Line is built. This makes Alaska the only major U.S. Gas Line benefactor that has not offered to financially participate to date.

There are two exogenous forces militating for Alaska's financial participation. Prospective lenders want Alaska involved in the financing to placate their fears that the State will impose unduly harsh regulations and taxes if it is not a participant. The second force is the sheer magnitude of the funding needed, perhaps \$35 billion. This sum makes it imperative for every substantial source of funding to be explored.

Alaska is an obvious source. Most recently, the Wall Street Journal's Alaska Gas Pipeline article, so widely circulated here this week, noted that over and above producer funding, "Pipeline companies would have to raise as much as \$28 billion from their own resources, the United States and Canadian investment community, and the State of Alaska."

In contrast, the public posture of the producers and sponsors over the last six to twelve months has been that an Alaskan financial role is largely irrelevant. Given the current mood of uneasiness regarding the participants' ability to finance the Line privately, it seems likely to me that any meaningful effort to raise the needed funds without federal involvement will include a serious overture to Alaska for significant financial participation.

If the producer-sponsor negotiations reach a successful conclusion soon and the 1981 schedule I sketched out before hold up, the most probable date when the Legislature will face such a funding proposal would be next year's session.

As to the exact nature of the financial participation that might be requested of Alaska, or the possible alternatives, I will leave that for the State's financial consultants. What I

can say is that debt rather than equity is purportedly the consortium's greatest need. Finally, with regard to the oft-discussed proposal for the State to finance the conditioning plant, it would appear to me that rolling the conditioning plant into the Pipeline, which the producers still require, might make it more difficult for the State to finance the conditioning plant alone, but probably not preclude it.

Thank you for this opportunity to testify here today. I welcome any questions.

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ALASKA

STATE LEGISLATURE

MEMORANDUM

May 14, 1981

To: Members of the Jt. Gas Pipeline Committee

From: Mark Wittow, Staff (465-4844)

MW

Attached are two items prepared by Joe Chomski for the committee. The first is a brief outline of the major federal decisions affecting the natural gas pipeline during the coming year. The second item is a detailed analysis of the FERC/Federal Inspector draft report on gas pipeline costs and related issues.

LAW OFFICES

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A PROFESSIONAL CORPORATION

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SUITE 1100

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(202) 659-5800

MEMORANDUM

To: Joint Natural Gas Pipeline Committee
Mark Wittow - Professional Staff Member

From: Joseph M. Chomski
May 7, 1981

Re: Outline of Major Events in Washington Affecting the Alaska Natural Gas Pipeline in the Coming Year

Per your request, I have listed below the most important regulatory, legal or legislative actions expected during the next 6-12 months in Washington. I believe that all of these should be closely monitored by the Committee and analysis made: of their impacts on Alaska's interest in the Gas Pipeline; as to whether Alaska's participation in the Washington decision-making process is necessary; as to what impact these events will have on future decisions by the Legislature regarding investment in the Gasline. The events, in general chronological order, are as follows:

1. The Federal Energy Regulatory Commission (FERC) Report on "tracking" the shipper tariff through to consumers is expected in June or July. Comments will be received by the Commission and a decision on tracking issues may be expected 90 days or more thereafter. These issues impact Alaska in many ways, particularly if it invests in the line.

2. The final Report covering the FERC/OFI cost estimate and incentive rate of return should be made this summer, after which 60-75 days of public comments will be elicited. This is one of the most critical documents for Alaska regarding the Gas Pipeline's future, regarding investment in the Gas Pipeline, regarding wellhead values, etc. It also affects such things as reimbursement of state costs to monitor the Pipeline and for Pipeline impacts on the state. A Commission decision on the Report's recommendations will be made around November, so the critical period stretches from perhaps July to November. The Legislature may well want to file comments or reply to the comments of others, especially if assumptions are being included regarding Legislature-approved financing.

3. The remainder of Northwest's certificate application, including its plans for the North Slope conditioning plant, inclusion of North Slope producers, a possible financing role for the State of Alaska, and other financial matters should be submitted to FERC in multiple volumes sometime in the late summer

PAGE TWO

or fall. This is an equally critical document, which should, if all goes well, lead to final granting of the Pipeline certificate to Northwest in the first half of 1982. This document will make many assumptions as to the future of Alaska's role and Alaska's interest.

4. Legislation changing Alaska Gas Pipeline law is expected to be introduced in Congress this summer, to do such things as permit producer equity, allow a billing commencement date acceptable to the Canadians, resolve certain difficult tariff issues, and perhaps even affect the right of states to regulate the Gas Pipeline. Needless to say, the Alaska Delegation will be actively involved and the interest of the State will be at stake. It is possible the Congressional battle will carry over into early 1982.

5. During the next several months, the United States Congress will probably hold hearings on state severance taxes, particularly as they relate to energy extraction. These hearings should be followed and analyzed since they have such a dramatic impact on the value of North Slope gas, the value of North Slope oil, the economic viability of the Gas Pipeline, as well as other major state economic matters.

6. The formulation and introduction of the Reagan Administration's natural gas deregulation position and/or legislation will occur this year, probably with special provisions or treatment included for North Slope natural gas. As we all know, deregulation can, if postured poorly, impose a tremendous economic setback on the Gas Pipeline.

The issues listed above are by no means inclusive of all the Washington, D.C. matters that should be analyzed. They are, however, the six pre-eminent ones, in my opinion. The next 6-12 months will be as active and as pivotal to the future of the Gas Pipeline as we will see in Washington at any time.

If you have any questions, please feel free to call. I hope the Committee finds this outline useful in planning future activities.

JMC:skp

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rec'd
5/14/81

MEMORANDUM

To: Joint Pipeline Commission

From: Joseph M. Chomski
C. Floyd Mathews

**ANALYSIS OF FERC/FEDERAL INSPECTOR DRAFT
REPORT ON GAS PIPELINE COSTS AND RATE OF RETURN CENTER POINT;
RELATED ISSUES AND PROJECT SCHEDULE REASSESSMENT**

INTRODUCTION

Since our testimony before the Committee on March 12, several events affecting the future of the Gas Pipeline have occurred, highlighted by the issuance of the long awaited Federal Energy Regulatory Commission-Office of Federal Inspector Draft Report on Gas Pipeline Costs and rate of return center point. More importantly, the unexpected withdrawal for reconsideration of that report, coupled with continued silence from the financial negotiations between the sponsors and North Slope producers, constitute grounds for setting back the proposed schedule for pipeline regulatory approval, pipeline financing and ultimately pipeline construction and completion. On the plus side, a favorable decision from a federal district court has set aside the obstruction to the Northern Border segment of the Gas Pipeline placed by the State of North Dakota.

This report will briefly analyze the FERC-OFI (also known as the Adger-Berman) Report as well as the FERC procedure to follow it. Before doing so, we would like to comment on certain other pertinent events and non-events.

The single most significant problem facing the pipeline is, as all are aware, financing. The ongoing producer-sponsor negotiations toward reaching an acceptable financing plan have produced no overt results in the last two months. There is some consolation in the fact that the talks have not broken off. Our best guess at this point is that the negotiations can not be expected to conclude with the issuance of a financing plan until June, at the earliest.

It is also worth noting that Federal Inspector John Rhett testified on April 21, 1981 before the Interior Appropriations Subcommittee of the United States Senate regarding the Gas Pipeline Project. OFI has been the most optimistic of all government or disinterested private parties regarding projections of pipeline construction commencement and completion. To our knowledge, OFI was the last

entity to continue projecting pipeline completion by late 1985. In his testimony, Mr. Rhett stated that if Alaska Northwest had not produced a definite plan for financing the Alaska Leg and a plan for financing the non-jurisdictional sales gas conditioning facility at Prudhoe Bay by June, the construction schedule that OFI espouses would have to be ratcheted backward. The sense of the hearing and the lack of announcement since then made it quite clear that the deadline suggested by Mr. Rhett will not be met, or that if an announcement is made by June it will not be sufficiently definite to avoid another postponement.

We will describe the Adger-Berman Report below and the FERC review process as it is now set out. We should, however, note that there has been substantial change in the review schedule for the Report in the last two months. The revision adds many months to the regulatory approval process at FERC. Before the Report was issued, it was the intention of FERC to entertain only revisions based on mathematical rather than substantive errors before the report was issued in final form to the Commission in April. The severity of Northwest's opposition to the conclusions in the report has caused the Alaska Gas Pipeline Office of FERC and the Office of the Federal Inspector to agree to reconsider their conclusions and reissue the Report after evaluating additional data provided by Northwest (in four volumes). The reconsidered Draft Report is expected to be issued in mid-July or so. Not only does this impose an additional regulatory delay, but raises the serious question as to whether the Report's and then FERC's final cost and center point determination will still be too low for Northwest, its partners and the producers to privately finance the project.

The Adger-Berman Report

On March 12, 1981, the Federal Energy Regulatory Commission and the Office of the Federal Inspector jointly issued the draft "Report to the Commission on the Certification Cost Estimate and Related Incentive Rate of Return Issues for the Alaska Segment of the Alaska Natural Gas Transportation System". This draft was prepared by Mr. John D. Adger, the FERC Alaskan Delegate, and Mr. J. Richard Berman, Director, Office of Audit and Cost Analysis, of the Office of the Federal Inspector, in FERC Docket No. CP80-435. There are several attachments to the Report, including four separate volumes prepared by Williams Brothers Engineering Company. We will attempt to summarize the major recommendations to the Commission contained in the draft Report. In brief, the draft Report recommends a combined center point value and certificate cost estimate which is \$2 billion below what Alaskan Northwest Natural Gas Transportation Company (Alaskan Northwest) had requested.

The Commission's initial order of August 1, 1980 in Docket No. CP80-435 directed the FERC Alaskan Delegate (FERC Delegate) and the Director of the Office of the Federal Inspector (OFI) to consider, recommend and report to the Commission regarding the following three major issues:

1. Alaskan Northwest's original certificate cost estimate of \$7.9 billion in 1980 dollars;
2. Alaskan Northwest's original proposed center point of 1.292; and

3. related incentive rate of return issues.

The Commission's August 1, 1980 order noted that Alaskan Northwest's application omitted much critical information such as final design, proposed financing, cost of service analysis, shipper tariffs, etc. The August 1, 1980 order contemplated that the Commission would consider and resolve expeditiously the above three issues pending submission of further information by Alaskan Northwest.

The Draft Report recommends as follows:

1. The certificate cost estimate should be fixed at \$6.8 billion in 1980 dollars; further hearings should consider an additional \$278.6 million of costs requested by Alaskan Northwest. This is a reduction of \$1.1 billion from the figure requested by Alaskan Northwest (page 5).
2. The Delegate and the OFI disagree regarding when the center point should be set. However, if the Commission does set a center point at this stage of the proceeding, both the Delegate and the OFI recommend a center point of 1.185 (pages 5-6). The dollar value of this reduction in Alaskan Northwest's requested center point roughly approximates \$800 million.
3. Although Alaskan Northwest has not yet completed a final design, the effect on the certificate cost estimate of any future design changes (with minor exceptions) should be handled by the OFI pursuant to condition 9 of the FERC's Orders Nos. 31 and 31-B (pages 6-7).

The Last Estimate

Alaskan Northwest had filed originally a certificate cost estimate of \$7.9 billion, which was subsequently amended to \$8.2 billion (Report page 5).*/ Even though the final design has not been decided, the draft Report recommends that the design for the pipeline is sufficiently advanced to provide a basis for fixing the certificate cost estimate for most items, with a few exceptions. The Report recommends a certificate cost figure of \$6.8 billion (Report, page 5). The report recommends further hearings for consideration of an additional \$278.6 million of

*/ Alaskan Northwest initially requested a center point of 1.292, but subsequently amended this request downward to 1.249. Some confusion has resulted from the fact that the center point may be expressed either as a multiplier to be applied to the base certificate estimate, or the center point can be expressed as a dollar figure to be added to the base cost estimate. For example, an article in the April 7, 1981 Wall Street Journal referred to the requested cost estimate of "\$10.4 billion", and it appears that the author of this article added the base cost estimate to the dollar value of the center point in order to arrive at the higher estimate figure of \$10.4 billion. For the purposes of this report, the base cost estimate and the center point will be considered separately.

costs which Alaskan Northwest has requested for the following items: \$53.6 million for right-of-way monitoring by Federal agencies, \$21.6 million for monitoring by the State of Alaska, and \$204.4 million for socioeconomic payments to the State of Alaska. (Report pages V-4 to V-9).

The delegate and OFI utilized Williams Brothers Engineering Company to examine in detail Alaskan Northwest's certificate cost estimate. Williams Brothers Engineering Company (WBEC) prepared a four volume study (considered to be part of Adger's Report) evaluating in detail the various items in Alaskan Northwest's cost estimate. The Report concludes that Alaskan Northwest's estimate and WBEC's evaluation are close enough to corroborate one another (Report page 5), but for construction cost estimate purposes Alaskan Northwest built in too many contingency costs (stated otherwise, their estimate had a greater degree of assurance than FERC contemplated).

WBEC was retained because of the highly technical nature of the filing. There is no easy way to summarize the numerous cost and center point value adjustments comprising WBEC's recommended total reduction of \$2 billion. However, the Report notes that the incentive rate of return (IROR) mechanism was intended as a major control on construction costs. The President's Report initially suggested the use of an IROR mechanism to curb construction costs, and the Commission's IROR orders (Orders Nos. 31 and 31-B) established the IROR formula. The IROR uses the certificate cost estimate as a base estimate against which the actual construction cost will be measured. The Report concludes that Alaskan Northwest's filed certificate cost estimate reflects a greater degree of cost assurance than previously contemplated. Thus, the cost estimate and center point requests submitted by Northwest must be lowered. (Report page II-6).

As indicated above, the Report recommends further hearings to determine the validity of Alaskan Northwest's request for \$278.6 million for Federal and State right-of-way monitoring and socioeconomic payments to the State of Alaska (Report V-4 to V-9). The report notes that on February 13, 1981 the State of Alaska finally resubmitted its estimate of reimburseable costs: the State requested \$51.3 million for "surveillance" and nearly \$19.8 million for socioeconomic expenditures. This is of course is a substantial reduction from the original \$226 million requested by Alaskan Northwest and the State. The Commission staff has consistently opposed any inclusion of payment of socioeconomic costs to the State of Alaska in the certificate cost estimate. The Report also notes that there are many complex legal and factual issues which must be resolved before the inclusion of these costs can be authorized. Further, any decision of this issue here would have precedential value in other Commission proceedings. Therefore the Report recommends further Commission proceedings to fully develop the factual and legal bases for these costs. Such a proceeding could commence immediately, and need not delay the main proceeding. The Report also notes that the State's estimates do not include "highway indemnification costs". The Report states that should Alaskan Northwest desire to include the costs of repairing highway damage in the certificate cost estimate, an estimate of such costs should be filed for Commission review in the socioeconomic phase of this proceeding. (Report page V-9).

The Center Point

The Delegate and the OFI could not agree on a single recommendation for the appropriate center point value. The OFI concluded that, although the methodology underlying Alaskan Northwest's analysis is not definitive, it is adequate to provide a valid basis for fixing the center point now. The Alaskan Delegate, in a separate conclusion, stated that Alaskan Northwest's analysis is probably not the best basis for resolution of the center point issue; however, the Delegate suggests that, should Alaskan Northwest provide better evidence in support of its analysis, the center point might possibly be set at this stage of the proceeding. However, both the OFI and the Delegate agreed that, if the Commission does decide to fix the center point at this time, the center point should be fixed at 1.185 (Report pages III-1 to III-6). This is substantially less than the center point of 1.249 most recently requested by Alaskan Northwest.

All cost estimates (including both Alaskan Northwest's and WBEC's) usually include contingencies for cost overruns due to certain events. The center point value, however, represents cost overruns due to abnormal events. It is expected that in any project of the difficulty and scale of the Alaska Gas Pipeline, inevitably cost overruns due to abnormal events will occur. The dollar value of the center point represents a relationship between the basic cost estimate plus an allowance for abnormal cost overruns. Therefore, the final center point dollar value cannot be fixed until the certificate cost estimate is fixed. Since the Report recommends further proceedings to resolve certain minor items of the cost estimate (for the communications system, affirmative action training, payments to the State of Alaska, etc.), it will not be possible to ascertain an exact final center point value until the full certificate cost estimate is fixed. (Report page 6 note 13).

The Report's recommendation to reduce the center point to 1.185 is based on WBEC's evaluation of Alaskan Northwest's requested cost allowance for abnormal events, which is sometimes referred to in the Report as the "center point allowance". WBEC recommends the transfer of \$303 million of Alaskan Northwest's proposed center point allowance to a special assigned contingency account, and the adjustment of other values used by Alaskan Northwest in determining the center point allowance. The net effect of all of WBEC's recommendations is a reduction in the proposed center point dollar allowance from \$2.266 billion (requested by Alaskan Northwest in its most recent submission) to \$1.464 billion; this reduces the center point to the recommended 1.185 (Report page III-1).

Chapter Three of the Report and Section 8 of Volume IV of the WBEC evaluation describe in detail the numerous adjustments and reductions in support of the recommended center point of 1.185. It is impractical to summarize these numerous items in a short space. However, the Report notes that Alaskan Northwest's methodology for calculating the center point errs in two major respects:

1. As with its certificate cost estimate, Alaskan Northwest utilized values with a very high degree of risk assurance in calculating its center point allowance;
2. Alaskan Northwest partially or wholly misclassified certain center point events. The Report concludes that many of these events should be classified as estimating errors or cost contingencies instead of abnormal events. These latter misclassifications relate to the costs which WBEC recommended be reclassified into a new category, the special assigned contingency account. (Report pages III-3 to III-4).

Related IROR Issues

The Commission's IROR orders contemplated that all major design issues would be resolved before fixing the certificate cost estimate and center point. However, when it became apparent in the summer of 1980 that Alaskan Northwest had not yet finalized its design for the Alaska segment, the Commission's August 1, 1980 order directed the Delegate to identify completely all of the major outstanding design issues and to address the cost consequences of alternative resolutions of those issues, particularly as they would affect the IROR mechanism. The Report recommends that although the design is not complete, any subsequent design changes can be handled effectively by the OFI pursuant to condition 9 of the IROR orders (there are a few exceptions to this recommendation, which are discussed below).

Chapter Four identifies certain design issues yet to be resolved and also sets forth considerations which the OFI may take into account in the future in applying condition 9 of Order No. 31-B to any future resolution of these design issues.

The Report notes that Alaskan Northwest's filing contains no specific design for a communications system for the Alaskan segment. Instead, the communications system portion is based on the average of four bids. The Report identifies a number of potentially cheaper alternatives. All parties have agreed to leave the filed figure in the certificate cost estimate, subject to the condition that it will be replaced by actual cost once a system is ultimately chosen and approved by the OFI. (Report pages IV-3 to IV-4).

Additionally, Alaskan Northwest did not include in its filed estimate any cost attributable to its affirmative action training necessary to meet affirmative action requirements. Alaskan Northwest stated that these costs cannot be estimated because the OFI has not yet approved Alaskan Northwest's proposed affirmative action training program. Alaskan Northwest proposed to submit the cost of these programs to the OFI for approval as a future design change. The FERC staff urged that Alaskan Northwest be required to file the estimated cost of the training programs for inclusion in the certificate cost estimate within 30 days of OFI approval of the affirmative action plan, with a future separate subproceeding to examine that estimate. The Report adopts the staff recommendation. (Report pages IV-4 to IV-6).

Chapter Four of the Report also identifies issues for which the design is sufficiently developed to now set the certificate cost estimate, and which should not be eligible for future certificate cost alterations by the OFI under condition 9 of Order 31-B. The Report specifies pipeline and pump station camps and

precertification costs (Report pages IV-5 to IV-11). The Report identifies a second category of design issues which are sufficiently developed to now fix the certificate cost estimate, but which may be eligible for certificate cost estimate alterations by the OFI as bona fide design changes are made. As examples, the report cites the Yukon River Crossing, work pad design, borrow quantities, refrigeration capacity for compressor stations, use of pipeline insulation for frost heat mitigation, etc. (Report pages IV-11 to IV-20).

The Response

Subsequent to issuance of the Report, a technical conference was held in Tulsa, Oklahoma by FERC with the interested parties. At that conference, Alaskan Northwest angrily responded, stating that the draft's \$2 billion cut was far too deep. Alaskan Northwest filed four volumes of comments on the draft Report in early April, 1981, which in essence argued against the draft report's \$2 billion reductions.

The Alaskan Northwest "Comments . . . on the Draft Report" begin with a quotation that is an unqualified threat from all the sponsors and from the producers to abandon the project. It is based on the seriousness they attach to the FERC/OFI cost and center point estimates. The filing states that the added material should justify "major modifications" in the Draft Reports and that:

The eleven partners of the Alaskan Northwest and the three major producers of Prudhoe Bay gas who will provide the necessary equity for the pipeline system and conditioning plant have unanimously concluded that they could not provide such equity if the Commission adopted the recommendations of the Draft Report. (Emphasis added).

Soon thereafter, FERC's Alaska Delegate Adger issued a second interim report to the Commission, agreeing to consider making revisions in the Draft Report after analyzing the additional material submitted by Northwest. He also stated that his team and OFI would need substantial additional time to consider Alaskan Northwest's additional filings.

At present, it appears that a reconsidered draft Adger-Berman Report may be expected sometime in July. Assuming that it does not also spawn a significant reconsideration period, it should be finalized after another technical conference and submitted to the Commissioners before September 1. The Commission will then receive comments and reply comments during the following 60-75 days. Sometime thereafter, FERC can be expected to approve a final cost estimate and center point. We seriously doubt that this final FERC decision will be issued before November 1.*

Conclusion

The substantial cost and center point reductions in the Adger-Berman Report and the blatant abandonment threat response from Alaskan Northwest,

*/ Contrast this with the schedule FERC was on before the violent Alaskan Northwest reaction, when a final report to the Commission was expected by mid-April and a final decision by the Commission was possible by early July.

its fellow pipeline sponsors and the North Slope producers cannot be dismissed as just another bump in the road to project fruition. At the very least, the FERC regulatory process has been set back three-four months, carrying with it a generalized ripple effect through the scheduling of the entire project. More importantly, the cost and center point reductions will be difficult for FERC/OFI to cast aside in toto, since so much work went into reaching those conclusions. A compromised position between the Alaskan Northwest request and the draft conclusions will not help pipeline financeability. If FERC/OFI reaffirm the Draft Report's conclusions, the abandonment threat will be called and - if it is to be believed - withdrawal from the project by its participants could follow.

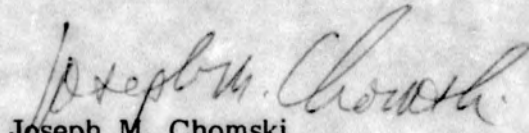
In general, most applications to Federal regulatory agencies for cost estimate approvals, rate of return decisions, and other similar economic adjudications contain some exaggerated or nonessential items. This is done to allow the Federal regulatory agency to fulfill its mandate by making certain cuts, yet leaves the applicant enough to permit the project to go ahead. It is possible that Alaskan Northwest can suffer some reduction in its request without materially impacting financeability ^{*/}, although we have no concrete evidence one way or the other on this point. The \$2 billion cut may be far more than an immaterial trimming, however. If no fat exists in the application and some cuts are made, or if a compromise cuts beyond Alaskan Northwest's true needs, or if the next draft report reasserts the initial FERC/OFI conclusions, a major project financing crisis may be triggered.

On top of the FERC/OFI problem is the painful silence coming from the producer-sponsor financing negotiations. While the general pronouncements from the participants indicate positive movement, one cannot overlook the inability of the parties to reach a successful conclusion. Many informally estimated deadlines for completing the talks have passed with nothing to show for them. There is, however, some solace in the fact that the talks are continuing.

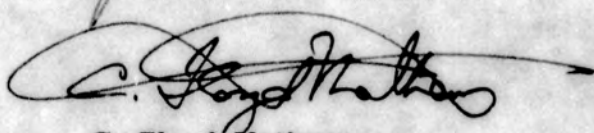
The recent delays in the regulatory process and in concluding the financing talks makes it more difficult to acquire Congressional approval this year for any necessary changes to the statutory framework under which the Alaska Gas Pipeline is administered. As we have stated to the Committee before, the Pipeline cannot be built under existing law. No meaningful efforts to effect changes in the President's Decision and Report via legislation have been introduced or previewed to date. If the process has not begun by June or early July, it will be difficult to achieve enactment this year, although not impossible. Should Congress abide by the recess and adjournment schedule it has announced, it may also be difficult to streamline the amendment process via use of the waiver provision in ANGTA unless a legislative package is introduced soon.

^{*/} Whether the project would be privately financeable if FERC approved the center point and cost estimates submitted by Northwest remains an open question. As the Committee is aware, many experts believe that private financing is not possible even with FERC approval of the Northwest application as submitted, while others hold out hope that such financing can be acquired. We make no judgment on this point.

While the favorable decision in the North Dakota suit clears away one obstacle previously deterring the Northern Border section, the decision was not unexpected. Finally, it is noteworthy that no firm procurement commitments for the North Slope gas conditioning plant have been made in the last two months. Since this the pacing item for the Pipeline, the lack of action vis-a-vis procurement further indicates schedule slippage.



Joseph M. Chomski



C. Floyd Mathews

JMC:skp

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**SUPPLEMENT TO MAY 8 REPORT TO JOINT
NATURAL GAS PIPELINE COMMITTEE**

In the last day or so, reports of a near agreement between the producers and sponsors covering a financing plan for the Alaska Natural Gas Transportation System have surfaced from several sources. Essentially, the report states that a 70% sponsor, 30% producer split of equity, presumably debt, and cost overrun pool has been agreed to, and the conditioning plant would be part of the Line. There is no official announcement or confirmation regarding this purported agreement, but it has been cited in the Energy Daily, and in Federal Inspector Jack Rhett's testimony before the House Interior Appropriations Committee. There is speculation that an official announcement may be made within two weeks.

This rumored development in no way changes our conclusion regarding the seriousness of the threat to the project posed by the FERC/OFI draft report on cost and center point described in our May 8 memorandum. In fact, in that memorandum we alluded to favorable reports from the negotiations, though we expressed concern that the parties were silent as to possible successful completion of the talks. Most significantly, the producer sponsor threat to abandon the project if FERC accepts the conclusions in the Draft Report (the conclusions are being reconsidered) remains in tact regardless of the negotiations' end.

Assuming that a financing agreement is announced shortly, two positive impacts stand out. First, the longstanding frustrations of the producer sponsor negotiations will be largely behind us and the major hurdle these negotiations posed will have been leaped. Second, conclusion of the negotiations at this juncture should give Congress sufficient time to consider legislative proposals to alter existing Alaska Natural Gas Pipeline law. If approved, these changes would enable the project to go forward as conceived by the producers and sponsors. If the proposals to Congress (issued by the President) are received no later than June 11, the 60 day expedited waiver provision for altering the President's Decision and Report can be fully utilized.

Respectfully submitted,


Joseph M. Chomski

JMC:skp

rec'd
4:30 pm
5/14/81

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*ADMITTED IN D.C.

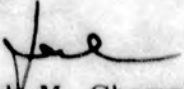
Mr. Mark Wittow
Professional Staff Member Natural Gas Pipeline Committee
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Mark:

Per your request, attached is an outline of upcoming events that should be actively followed and analyzed by the Alaska Legislature in order to protect the State's interests and advance the Gas Pipeline project in a manner most beneficial to Alaskans. Please distribute this outline to all the members of the Gas Pipeline Committee who would be interested in it.

With best regards,

BIRCH, HORTON, BITTNER AND MONROE


Joseph M. Chomski

JMC:skp
Attachment

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Mr. Mark Wittow
Joint Pipeline Commission
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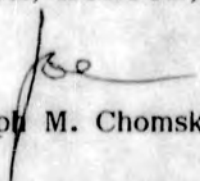
Dear Mark:

Attached is the memorandum we promised you regarding the Adger-Berman Report and related events. I have also attached cover letters we sent to Senator Kerttula and Representative Gardiner with copies of the report. Under separate cover, I am sending you the outline you requested of future events that the Committee should follow.

I hope all is well with you and look forward to seeing you in the near future. I may be in Alaska in late May. If I am, I'll call.

With best regards,

BIRCH, HORTON, BITTNER AND MONROE


Joseph M. Chomski

JMC:skp
Enclosures

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*ADMITTED IN D.C.

The Honorable Terry Gardiner
Alaska State House of Representatives
Pouch V
Juneau, Alaska 99811
(Mail Stop 3100)

Dear Terry:

After discussions with Joint Gas Pipeline Committee staff, we have prepared the attached report on the major regulatory development since my testimony before the Committee, and some related events. As a result of the added regulatory delay described in the report, plus continued silence from the financial negotiations, we must conclude that yet another setback to the project's schedule has occurred. Please note also that the last major uninterested party to the Alaska Gas Pipeline Project still projecting a 1985 completion date - Federal Inspector John Rhett - as much as conceded a delay to 1986 in the schedule he is publicly projecting during testimony (April 21) before the Interior Appropriations Subcommittee of the United States Senate.

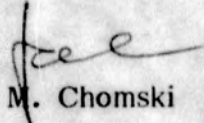
If this report raises any questions or if you have any other inquiries regarding the Gas Pipeline, please feel free to call. The material in the attached report should add to the information before the Legislature regarding the project and shed some light on the events of the upcoming six-nine months.

The Honorable Terry Gardiner
May 7, 1981
Page Two

I hope this session of the Legislature has not been too arduous for you and that all is well. I look forward to seeing you sometime in the future and am appreciative of the support you have given us in the past.

With best regards,

BIRCH, HORTON, BITTNER AND MONROE


Joseph M. Chomski

JMC:skp
Enclosures
cc: The Honorable James Kerttula

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May 7, 1981

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*ADMITTED IN D.C.

The Honorable Jalmar Kerttula
President
Alaska State Senate
Pouch V
Juneau, Alaska 99811
(Mail Stop 3100)

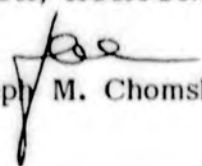
Dear Senator Kerttula:

Thank you for your kind letter of April 28, 1981 regarding some additional comments I forwarded to the Committee on the Gas Pipeline. After discussions with Joint Gas Pipeline Committee staff, we have prepared the attached report on the major regulatory development since my testimony before the Committee, and some related events. As a result of the added regulatory delay described in the report, plus continued silence from the financial negotiations, we must conclude that yet another setback to the project's schedule has occurred. Please note also that the last major uninterested party to the Alaska Gas Pipeline Project still projecting a 1985 completion date - Federal Inspector John Rhett - as much as conceded a delay to 1986 in the schedule he is publicly projecting during testimony (April 21) before the Interior Appropriations Subcommittee of the United States Senate.

Please feel free to call with any questions. I hope this report is useful to you and the Committee.

With best regards,

BIRCH, HORTON, BITTNER AND MONROE


Joseph M. Chomski

JMC:skp
Enclosure
cc: Terry Gardiner

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April 13, 1981

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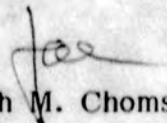
The Honorable Terry Gardiner
Chairman
Joint Natural Gas Pipe Line Committee
Alaska Legislature
Pouch V
Juneau, Alaska 99801

Dear Representative Gardiner:

I received the attached letter today from the Commissioner of Canada's Northern Pipe Line Agency, Mitchell Sharp. Commissioner Sharp seeks to add one additional Canadian interest to the ones cited in my testimony: that lessening U.S. dependence on imported petroleum is not only important to the U.S., but is in Canada's national interest.

A copy of Commissioner Sharp's letter is attached. I hope that the Committee can be informed of his views.

With best regards,


Joseph M. Chomski

JMC:kkf
Enclosure

cc: Honorable Jalmar Kerttula
Mark Wittow



Northern Pipeline Agency
Canada

Administration du pipe-line du Nord
Canada

Commissioner

Directeur général

8th Floor, Victoria Building
140 Wellington Street

April 3, 1981

Dear Mr. Chomski,

I wish to thank you for sending me a copy of your testimony on the pipeline. I have recommended it to those interested in the pipeline as an excellent summary of where matters now stand.

Your remarks on Canada's interest in the pipeline are quite accurate. There is a broader concern in Canada, however. We view the lessening of the United States dependence on imported petroleum as in Canada's national interest. Thus even if the pipeline did not provide a means of access to Canadian gas it would still be in our national interest to assist in the successful conclusion of this project.

If you ever visit Ottawa, please let the Agency know.

Yours sincerely,

Mitchell Sharp

Mr. Joseph M. Chomski,
Birch, Horton, Bittner and Monroe,
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U.S.A.

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November 12, 1980

Mr. Mark Wittow
Professional Staff Member
Joint Pipeline Committee
1024 W. 6th Avenue
Anchorage, Alaska 99501

Dear Mark:

Attached please find the report we promised you regarding the Alaska Gas Pipeline technical conferences, being held pursuant to the Commission's order. Our memorandum regarding the Certificate Application and the Cooperative Agreement will follow shortly.

If you have any questions, please feel free to call. I hope this short memorandum proves satisfactory. We will, of course, continue to attend the technical conferences here in D.C. and forward memoranda to you about them.

Cordially,

BIRCH, HORTON, BITTNER & MONROE


Joseph M. Chomski

JMC:brk

Encl.

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November 12, 1980

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*ADMITTED IN D.C.

To: Mark Wittow, Professional Staff Member,
Joint Pipeline Committee

Re: Technical Conferences in Alaska Northwest Natural Gas Transportation
Company (Alaska Northwest) FERC Docket No. CP80-435

In an order of August 1, 1980 the FERC published notice of Alaska Northwest's application for a certificate for the Alaska segment of the proposed gas pipeline. This order also established expedited procedures for the Commission's consideration of the application. The Commission decided to utilize the simple notice and comment procedures normally used in rulemaking proceedings instead of the time consuming adjudication procedures normally used in certificate proceedings. Instead of requiring the parties to file prepared written testimony, present witnesses at evidentiary hearings for cross examination, and file several rounds of briefs, the Commission decided to hold a series of technical conferences to be presided over by the Commission's Alaskan Delegate, John Adger, in conjunction with the Office of the Federal Inspector. The August 1, 1980 order specified that the technical conferences should analyze the applicant's proposed certificate cost estimate (\$7,900,000,000), center point (1.292) and related incentive rate of return issues. */ The order noted that the application lacked much data (e.g. financing plan, marketability of the gas, final design) which the applicant must file in the future before issuance of a final certificate. The Commission's Alaskan Delegate, John Adger, will issue interim reports

10.2 B

*/ The Commission's previous Order No. 31-B, issued September 6, 1979 in Docket No. RM78-12, directed that Alaska Northwest's application should include a proposed cost estimate and proposed center point. This order specified an overall rate of return of 17.5 percent with a proposed incentive rate of return mechanism. The center point is a factor greater than one applied to the cost estimate to cover unknown and unforeseeable events. The proposed incentive rate of return mechanism will increase the rate of return if actual construction costs are below the center point and decrease the rate of return if actual construction costs are above the center point.

to the Commission reporting on the progress of the technical conferences. After conclusion of the technical conferences the Alaskan Delegate will issue a final report to the Commission. The Commission will then issue a notice to the public, possibly before March, 1981, requesting written comments on the Commission's proposed certification of the pipeline. The Commission, after review of any comments filed in the future, will probably issue its order on certification, possibly in March, 1981.

Three technical conferences have been held in Washington, D.C., and another four technical conferences have been held at Fluor Corporation's offices in Irvine, California.

The initial technical conference was held September 3-4, 1980 in Washington, D.C. This conference considered only procedural matters, i.e., what procedure would govern future technical conferences. The parties agreed that presentations at the technical conferences would not be made under oath, and that no transcript would be kept of all statements made at the future technical conferences. Instead, at the conclusion of each technical conference, it was agreed that the Commission's Delegate, John Adger, would read to a reporter a summary of statements made at each conference. The reporter would then prepare a transcript of this summary which would be available to all parties. This initial technical conference also considered possible agendas for future technical conferences.

On September 26, 1980 the Alaska Delegate issued his first interim report to the Commission. This interim report noted that the Commission's order of August 1, 1980 had directed the Alaska delegate to commence a series of technical conferences on the project's cost estimate for the Alaska segment and related incentive rate of return (IROR) issues. The interim report (page 2) noted that certain design issues were not yet resolved, and that these would possibly have an impact upon the cost estimate:

1. the separation distance between the Gas Pipeline and TAPS pipeline;
2. the possibility of utilizing a tunnel to bypass the difficult Atigun Pass through the Brooks Range;
3. burial of the pipeline in an embankment rather than in a trench; and
4. access roads and work pads constructed of snow rather than gravel.

Memo to Mark Wittow
November 12, 1980
Page Three

The interim report stated (page 5) that the Alaska Delegate would attempt to determine whether additional alternative values of the certificate cost estimate (CCE) would be appropriate for alternative resolutions of the above unresolved design issues. The interim report stated (page 6) that all parties agreed that the Alaska Northwest July 1, 1980 certificate application was an appropriate basis from which to begin development of the certificate cost estimate (CCE) and center point values for the Alaska segment. The cost consequences of any alternative resolutions of outstanding design issues would be developed by Alaska Northwest as variations from the basic cost data (i.e., \$7,900,000,000) presented in the certificate application. The Alaskan Delegate decided that detailed evaluation of Alaska Northwest's basic cost estimate would thus be a first step in evaluating estimated costs of any alternative designs.

The interim report (page 6) states that the recent Cooperative Agreement between the project's sponsors, the North Slope producers and the State of Alaska (regarding a Design Board for formulation of a final design) will be not result in further changes to the design of the pipeline beyond those listed above currently being studied.

The interim report contemplates that at some time in the future Alaska Northwest will file a final design for the Alaska segment which will be developed by the Design Board. At that time any other party to the proceeding may submit its own comments on design issues including any proposed design changes. Exxon, Arco and Sohio have taken the position that the final design should include designs for the sales gas conditioning facility. Any future reports and comments on design issues should also address the IROR implications of those issues. The interim report (page 7) noted that several parties, including the Commission's staff, were reluctant to consider IROR issues until after all outstanding design issues and the cost estimate had been clarified.

The first interim report also summarized the procedure agreed upon at the September 3-4, 1980 conference which would govern future technical conferences.

Most of the technical conferences have been held at Fluor Corporation's offices in Irvine, California, since this is where most of the data regarding design and cost estimates are located.

Memo to Mark Wittow
November 12, 1980
Page Four

The next technical conference in Washington, D.C. was held October 7-9, 1980. The first day of this conference considered possible design changes and related implications for IROR issues. This conference noted that the Office of the Federal Inspector was preparing a report on how procedurally to handle information deemed by Alaska Northwest to be proprietary. All parties agreed that the sponsors must divulge all information regarding design alternatives which would have any effect on cost savings to Alaska Northwest. Mr. Adler noted that there were possible changes that would affect the location of the sales gas conditioning facility but the Design Board agenda does not include any discussion whatsoever of any change in location of the sales gas conditioning facility. Mr. Watkiss, counsel for Alaska Northwest, flatly stated that the only potential design changes would involve slight realignment of the distance between the oil and gas pipelines, the possible tunnel at Atigun Pass, and possible embankment mode. He flatly stated that there was no possibility whatsoever for changing the location of the sales gas conditioning facility. Mr. Watkiss stated that there was no information available at present regarding the cost impact of using the embankment mode instead of the trench mode. Mr. Loeffler stated that the State of Alaska has a tentative position that sufficient gravel is not available for certain areas of construction, and therefore snow pads might be required by the State of Alaska for an approximately 130-mile right of way over State land. There was a lengthy discussion of the Alaska Northwest CCE and center point data. The Commission Staff requested cost studies of many alternatives; Alaska Northwest objected and stated these alternatives were not realistic alternatives. Alaska Northwest maintained that there was insufficient time and personnel to perform the studies requested by the Staff, and that many of Staff's alternatives had been rejected in previous phases of this proceeding. Alaska Northwest explained the process for completing the final design of the pipeline. Alaska Northwest stated that there probably would not be any design changes which would affect the CCE or related IROR issues.

The technical conference continued on October 8, 1980. Alaska Northwest stated that its labor cost estimate was based on 1980 dollars and this figure would probably go up with inflation. Alaska Northwest stated that the Alyeska contract with labor would probably be the starting point for Alaska Northwest negotiations of labor contracts. Alaska Northwest agreed to provide the technical conference with data regarding Alyeska labor costs. Alaska Northwest stated it would oppose a certificate condition (similar to the recent Northern Border certificate condition) that would require a fixed labor cost index escalator; Alaska Northwest stated that such a condition would limit Alaska Northwest's negotiating flexibility with labor unions.