

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

1059 SCOMM 28: JOINT GAS PIPELINE COMMITTEE. 1981-82

In response to the Secretary's request, Atlantic Richfield, on February 25, 1980, informed Secretary of Energy Charles W. Duncan, Jr. that it was willing to discuss possible financing plans with the pipeline sponsors but that it would not assume responsibility for guaranteeing the debts of any other participant nor could it assure or guarantee the completion of the project. Atlantic Richfield also informed Secretary Duncan that it could not participate in the project unless all conditions necessary to finance and construct an economically viable system were satisfied and that it was unwilling to provide more than its proportionate share of the debt of the pipeline project.

In its communications with Secretary Duncan, our Company summarized its concerns relating to the financeability of the transportation system, pointing out that the Company could not provide the guarantees referred to in the President's Decision without placing the Company in severe financial jeopardy. The Company went on to enumerate the points that it ~~believed necessary to make the project~~ financeable and economically viable. Among the more important points highlighted by the Company at that time were the following: (1) approval of producer equity participation, (2) assurances that the entire project, including the Canadian leg, was economically viable and would be completed, (3) inclusion of the conditioning facilities in the transportation system and tariff, (4) tariff protection for the lenders against permanent or temporary interruption of service, and (5) a reliable cost estimate. As we noted at that time, there were other considerations; however, the foregoing list was of such importance that it was considered necessary to place special emphasis on the items contained herein.

In June, 1980, in response to further requests from the Department of Energy, Atlantic Richfield negotiated with the other producers and the pipeline

sponsors a Cooperative Agreement which enabled the producers and the sponsors to share the cost of developing a reliable pipeline design and cost estimate for the Alaska portion of the Transportation System, including the Gas Conditioning Plant.

As a result of this Agreement, by the end of 1981 Atlantic Richfield will have contributed approximately \$70 million toward the cost of the Design and Engineering study. The system cost estimate has now been delivered to the Federal Energy Regulatory Commission and is being reviewed by the Commission as a part of its certification process.

Concurrently, with the execution of the Cooperative Agreement, the pipeline sponsors and the producers signed a Joint Statement of Intention to Work together in an effort to develop a financing plan which could be presented to potential lenders and to the government to determine whether or not the project was viable. As a result of the efforts of the parties, on May 21, 1981, Atlantic Richfield, the pipeline sponsors and other producers agreed upon an outline of a financing plan and presented it to Secretary of Energy James Edwards. Included among the concepts set forth in the plan was an agreement by the Prudhoe gas producers and pipeline sponsors whereby the producers would be permitted to own 30% of the Alaska portion of the transportation system including the conditioning plant by providing equity in the amount of \$2.25 billion and arranging debt contribution up to \$6.75 billion. Atlantic Richfield's agreement upon these financing concepts was conditioned upon the following circumstances:

- (1) The conditioning plant to be located on the North Slope of Alaska would be included as an integral part of the Alaska portion of the ANGTS.
- (2) The debt/equity ratio for all capital investments in the system would be 75:25.

- (3) The investment limits for all participating companies would be defined at the outset of the financing effort. As a group, the producer companies would provide equity in an amount not to exceed \$2.25 billion.
- (4) Debt funds (pipeline and plant) would be sought on a project credit basis. The transmission group would be responsible for arranging \$15.75 billion in project debt and the producer group would accept responsibility for arranging \$6.75 billion in additional project debt. Producer debt would be accorded terms and conditions equivalent to the terms and conditions accorded other project debt. All financing layers would be guaranteed equal terms and conditions.
- (5) Each company's investment would be limited to a sum certain defined in the financing plan.
- (6) The Alaska Northwest partners would own 70% of the pipeline and the plant and the producing companies would own 30% of the pipeline and the plant. Equity commitments to the completion assurance pool would be on a 70:30 ratio.
- (7) All debt and equity participants would issue firm commitments, acceptable to all participants, prior to commencement of construction of the pipeline or plant.
- (8) All necessary governmental approvals and authorizations (including producer equity ownership) would be issued and accepted by the participants.
- (9) All parties would be assured that the project was economically viable. ✓
- (10) All parties would be assured that the Canadian segment would be financed and completed without U.S. company involvement.

Based upon the comments received from potential lenders, on June 17, 1981, the pipeline sponsors submitted to the President their recommendations for waivers considered to be necessary to permit the producers to consider participating in the project and to facilitate negotiations with potential lenders for the financing of the Alaska Natural Gas Transportation System.

Among the proposed waivers is a recommendation that the Alaska Natural Gas producers be permitted to own an equity interest in the transportation system. As we informed the Congress in 1977, we were not disturbed economically by being then excluded from equity participation in the project; however, we were deeply concerned that the President and the Congress would assume or suggest that our company had an obligation to put at risk a nonfinite sum of money in the form of open-ended guarantees of debts incurred by others while denying our Company any voice in management or voting power over expenditures. Even the fee for providing such guarantees was deemed by the President's Decision to be minimal and left to be determined at a later time. In 1977, we did not seek an opportunity to participate in the ownership or financing of the transportation system, on any basis. Until contacted by Dr. Schlesinger in 1979, our position remained the same. Since then, we have been informed by the Secretary of Energy, other administration officials and the pipeline sponsors that the gas pipeline project cannot be privately financed without producer participation. While we remain convinced that gas pipeline projects of this type should be owned and financed by gas pipeline companies, we are willing to consider participation in the ANGTS, but we have reservations about doing so.

To enable Atlantic Richfield to participate, even to a limited extent, it is necessary that the Congress approve a waiver of that part of the President's

Decision that excludes Atlantic Richfield and other producers from equity ownership in the pipeline. It is our belief that this barrier to producer participation was unwarranted in that it was based upon unrealistic judgmental theorizing by the Department of Justice which concluded that the producers should be excluded from transportation system ownership since such ownership in some manner might be construed to violate the antitrust laws. In our opinion, such determination was in error in 1977 and is equally in error at this time.

Our Company does not seek control of the transportation system, but it is neither able nor willing to commit the assets of Atlantic Richfield without ownership of an interest in the project which will enable it to ensure that our investment is properly managed. For example, our Company has no desire to influence or control access to the pipeline so long as the system is not jeopardized and so long as we are not required to contribute financially to permit such access. Similarly, we would want to participate in decisions relating to pipeline expansion only to the extent necessary to insure that our pre-existing investment in the pipeline system was not endangered by such expansion. Of course, all questions of access or expansion will come before the FERC for hearing and will be subject to Department of Justice review. We support the desirability of such Department of Justice review, and we are confident that this direct antitrust oversight will insure that the specific language in Section 13 of the Alaska Natural Gas Transportation Act and the policy behind such language will be strictly enforced.

While we firmly believe that producer equity ownership and debt responsibility in the pipeline system in no way violates the antitrust laws, to alleviate the apparent concern of some on this point, we suggested that the waiver language be accompanied with a provision stating that the waiver does not imply or effect an amendment to, or exemption from, any provision of the antitrust laws. Such a provision was included as Section 14 of the Alaska Natural Gas Transportation Act, and it would be appropriate to repeat the language in the waiver. We believe that it is inappropriate to create any antitrust standard applicable to producers only other than the standard set forth in Section 14, which seems to clearly reflect congressional intent to afford equal protection of law to all participants. Further, as noted in Alaska Northwest's June 17, 1981 waiver submittal to the President, producer ownership will, both initially and throughout the life of the project, be subject to FERC review. Thus, assurance will exist that producers cannot inhibit reasonable access or expansion.

Also included in the President's waiver proposals, is a recommendation that the conditioning plant required to prepare Alaska gas for shipment in the pipeline be included as an integral part of the Alaska segment of the ANGTS. The terms "gas processing" and "gas conditioning" have, during the history of this project, been used interchangeably as if synonymous. This is improper usage of these terms. Gas conditioning is properly defined as the act of rendering natural gas compatible with the design and quality specifications of a particular pipeline system. Gas processing refers to the act of removing liquid hydrocarbons for sale as natural gas liquids. It is important to keep this distinction in mind.

The gas conditioning plant to be constructed at Prudhoe Bay has been designed solely to meet the pipeline specifications selected by the sponsors. These specifications will require: (1) compressing the gas to unusually high pipeline inlet pressure; (2) establishing its hydrocarbon dew points at unusually stringent levels; (3) chilling the gas to below freezing temperatures; and (4) reducing the carbon dioxide content of the gas to a level significantly lower than the level ordinarily accepted for pipeline transmission. Such unique pressure and quality requirements will be imposed to provide initial pipeline compression, to facilitate the transportation of the gas, to prevent melting the permafrost and increase pipeline throughput capacity by chilling and to reduce transmission costs by eliminating carbon dioxide. These conditioning costs are therefore all properly a part of the cost of transporting the gas. The extraordinary specifications established by the pipeline sponsors for gas entering the ANGTS were designed to minimize the investment and operating costs of the transportation system. Further, the natural gas transmission companies which have already made public their arrangements for the purchase of Prudhoe Bay gas have contracted to take title to the gas including all entrained liquids at the inlet side of the gas conditioning plant. This reinforces the concept of the conditioning plant appropriately being considered a part of the overall transportation system.

The correctness of this concept has been demonstrated recently by Commission orders issued in March and June of 1981 in a proceeding involving Pacific-Offshore Pipeline Company (POPCO), FERC Docket CP74-35. The Commission there granted a certificate of public convenience and necessity to POPCO to construct an offshore pipeline and onshore gas conditioning facilities. Under the Commission approved plan, POPCO, a wholly owned subsidiary of Pacific Lighting Corporation, would purchase gas from the producer at the offshore production facilities, transport the gas onshore where it would be conditioned (or

treated) to pipeline specifications and then resold to Pacific Lighting. The main conditioning plant components included (1) removal of sulfur, (2) extraction of carbon dioxide and (3) removal of liquids necessary to achieve hydrocarbon dew point control. Thus, the conditioning plant certificated in POPCO is similar in essential purpose to the Prudhoe Bay conditioning plant. In certificating the conditioning facility, the Commission recognized the basic distinction between gas treating or conditioning and gas processing.

The POPCO proceeding demonstrates that inclusion of the Prudhoe Bay plant in the ANGTS is compatible with current Commission practice. Further, numerous certificated pipeline projects heretofore constructed in the lower 48 states have included conditioning facilities and the cost of service of such facilities have been included in approved tariffs.

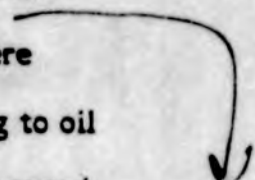
The producer/sponsor May 21, 1981 agreement on financing concepts recognized financing realities that had been increasingly apparent as design and cost estimate work proceeded, discussions between sponsors developed, and preliminary opinions from the financial community were received. As the investment banking advisors stated in their analysis of the project, "One financing absolute is that, in terms of financial risk assessment, the natural gas transportation related functions of the gas conditioning plant constitute an indispensable part of the ANGTS. It performs functions which should be part of the System. The gas conditioning plant function that is dedicated to readying gas for transmission is creditworthy only to

the extent that the credit support for the ANGTS affords it security. By the same token, the other components of the System cannot obtain private financing unless the gas conditioning plant can be financed and constructed, and the debt and equity investment therein protected through the tariff mechanism underlying ANGTS. For financing purposes, this link in the chain forged by the ANGTS requires the same quality support afforded other components." In summarizing their position, the advisors observed, "Private financing without some such sharing would not be possible, for no lender could assess the risks of the project absent an evaluation of the gas conditioning plant risk, and could not provide funds to the truncated project without the same assurances being provided to the plant that the pipeline segments of the project is accorded. The financial community will not accept a situation where one integral part of the project is subject to regulatory treatment creating credit support materially weaker than another integral part."

The President's waiver proposals contain other recommendations that are deemed necessary by potential lenders and the sponsors if the project is to go forward. As a participant in the other large pipeline project in Alaska, the TAPS oil pipeline, we can attest to the difficulties which are to be encountered and the additional costs to be incurred if the regulatory review process is permitted to continue without limits. To the extent that Alaskan Northwest is required to participate in unnecessary evidentiary hearings prior to the commencement of each segment of the pipeline system, it could significantly prolong the time for completion of the project and add billions of dollars in cost.

This project has been reviewed as extensively as any similar project ever undertaken in the United States. The sponsors have stated that further regulatory hearings should be kept to a minimum and that the proceedings that are required should be handled expeditiously. We concur with this recommendation and support the President's proposed waivers relating to further hearings.

Potential lenders have informed the ANGTS sponsors that private financing of the project depends upon many factors, not the least of which is regulatory certainty. As we have learned from our TAPS experience, the need to clarify all regulatory standards prior to commencement of a project cannot be overemphasized, and the failure to establish the binding guidelines for determining the tariff can have unforeseen and detrimental consequences. Though the TAPS owners were convinced in 1973 that Interstate Commerce Commission regulations relating to oil pipeline tariffs were well-established and predictable, our company is now engaged in a protracted proceeding before the FERC to determine retroactively to the commencement of operations in 1977 the proper tariff to be charged for the pipeline shipment of Alaska oil. This proceeding has required that we commit thousands of hours of management time to defend a regulatory approach that we believed to be "certain". The ANGTS project will require a capital commitment between five and six times the amount expended on TAPS, and we share the concern of the lenders that a future regulatory agency, when confronted with the actual tariff, may feel compelled to revisit the decision of a prior commission and reduce the amount to be paid or modify the shipper tracking mechanism in a manner that deprives owners and shippers of the recoupment that they require to justify their respective investments and obligations. The proposal to waive Sections 4, 5, 7 and 16 of the Natural Gas Act is designed to provide potential lenders and the sponsors the assurance that once commitments have been



made to this project there will be no arbitrary regulatory action which will jeopardize the recovery of cost of service or tariff. If Congress does not provide this degree of certainty, it could lead to the refusal of large segments of the financial community to participate in this financing because of their concern that the obligors on the documents of indebtedness might be unable to fulfill their obligations to the lenders. The TAPS owners were able to finance their project because of the willingness of their parent corporations to guarantee the debts of their respective affiliates involved in the project. No such assurance will exist in this undertaking, and the lenders will expect assurance of regulatory certainty before proceeding with the development of the financial plan.

Like other possible participants in this project, Atlantic Richfield requires assurance that Alaskan Northwest Natural Gas Transportation Company will be considered a "natural gas company" under the Natural Gas Act at the time that it or its affiliated company as a co-owner in Alaskan Northwest participates in the acceptance of the certificate of public convenience and necessity authorizing the owners of the project to proceed with construction and operation of the system. Thus, we concur with the recommendation of the President that Section 1(b) and 2(b) of the Natural Gas Act be waived to the extent necessary to classify Alaskan Northwest and any shipper of natural gas through the Alaska segment of the approved system as natural gas companies.

Perhaps the most controversial feature of the President's waiver proposals relates to the waiver of Section V Condition IV-3 of the President's Decision. This waiver would authorize the Federal Energy Regulatory Commission to permit billing to commence and collections to be made prior to actual delivery of Alaska gas if the Canadian, Alaskan pipeline or conditioning plant segment of the system

were completed and capable of operation and after a date established for payment by the FERC. We have been informed that some form of precommencement billing is necessary to fulfill a commitment of the United States to the government of Canada to permit investors in the Canadian segment to recover their investments if the entire project is not timely completed. Similar treatment is accorded the Alaska segment and the conditioning plant though the recovery is limited to debt service. Authorizing the Commission to permit collection of tariffs as to segments completed prior to the actual flow of Alaska gas should facilitate the financing of the project. Certainly, it will go a long way toward providing the assurances required by Canada prior to their issuing the necessary permits for the construction of the Canadian segment. The billing commencement waiver appropriately lessens some of the risks after physical completion. However, even if the full waiver package is approved, satisfactory financial commitments among lenders and equity participants must be negotiated. Until they are, we must remain uncertain as to whether or not the project can be privately financed.

Our company has specified the maximum commitment that it can make to the project. We are not trying to avoid risk per se, only risk beyond our financial capability; indeed, we find considerable risk in the thought of investing a finite sum of several billion dollars in this very costly system to send gas to a difficult-to-define future market in an economic outlook ill-defined as to inflation and cost of capital. Rather our concern is to reasonably limit our stockholders' risk capital to viable outer limits. Within those limits, we are concerned about the risk of overruns from unexpectedly high interest costs or inflation, about the risk of adverse political or economic events and about the risk of insufficient financial commitment from credit-worthy parties to assure that the expected project cost and possible overruns will be fully funded. We are equally concerned that wellhead

or tariff revenue might be reduced to facilitate financing. We are trying to lessen our concerns by (1) elaborate, early project engineering and costing, and (2) adequate contingent financing up front and/or some form of completion insurance. ?

If additional financial support for the project is required, the sponsors must look to other sources. Absent further participation, such as from other pipeline companies, State of Alaska, industrial users or other producers, the only other source may be the government.

We strongly believe that the project is in the national interest and that its construction will not only bring Prudhoe gas to the lower 48 states but it will also ensure that North Alaska is fully explored for oil and gas reserves. Absent an Alaska natural gas transportation system, many producers will be discouraged and exploration which would be in the national interest will not occur or will be deferred for decades.

In summary, while we cannot state that the Waiver package will be sufficient to satisfy the potential lenders' needs and ensure financeability of the project, it would appear that appropriate legislative action to clear away legal barriers is necessary to permit solicitation of project participation and to set in place some of the key economic and regulatory terms necessary for all to decide if the project is economically feasible. We consider construction of the ANGTS to be in the national interest and are hopeful of its success.

STATEMENT OF RADCLIFFE R. LATIMER
PRESIDENT, TRANSCANADA PIPELINE ALASKA, LTD.

Before
The Committee on Energy and Natural Resources
October 23, 1981

My name is Radcliffe R. Latimer. I am President and Chief Executive Officer of TransCanada PipeLines Limited and President of TransCanada Pipeline Alaska Limited, which is a partner in the Alaskan Northwest Natural Gas Transportation Company. I appreciate this opportunity to appear before you today in support of the Alaska Natural Gas Transportation System (ANGTS) and the Waiver of Law Package submitted to the Congress by President Reagan.

TransCanada is the major west-to-east pipeline and the largest pipeline company in Canada. Since it commenced operation in 1958, TransCanada has constructed 6,000 miles of large diameter pipeline. At present, the TransCanada system extends from the Alberta-Saskatchewan border in Western Canada to Montreal in Eastern Canada, a distance of 2,500 miles.

TransCanada has an annual throughput of approximately 1.4 trillion cubic feet of natural gas, of which in excess of 250 billion cubic feet or approximately 18% is exported to the United States, making it the largest exporter of natural gas to the United States from all sources.

TransCanada, along with its United States partner American Natural Resources, were the sponsors and are equal owners of the Great Lakes Gas Transmission Company, which traverses the upper midwestern United States for a distance of approximately 1,200 miles and transports over 400 billion cubic feet of natural gas annually.

TransCanada believes that a significant portion of the natural gas resources of North America lies in the Arctic regions of the United States and Canada and that the full development of those resources will make a substantial contribution to the long-term energy security of both countries. The discovery of hydrocarbons on the North Slope of Alaska and the MacKenzie Delta, Beaufort Sea and Arctic Islands regions of Canada confirms our beliefs.

These discoveries demonstrated the need for an economical transportation system to bring Arctic gas to market. As early as 1969 TransCanada became a charter member in a consortium formed for the purpose of developing a transportation system for the natural gas reserves at Prudhoe Bay in Alaska and in Canada's MacKenzie Delta. We firmly believe that transportation of natural gas from the Arctic is economically and technologically feasible but will require a substantial financial investment. TransCanada is committed and is prepared to participate as an investor in this financial investment.

In early 1980, TransCanada, through a U.S. subsidiary, became a partner in the Northern Border Pipeline "prebuild project" to bring Canadian gas to U.S. consumers prior to the later delivery of Alaskan gas. In doing so, TransCanada provided the assured gas throughput volumes that enabled the entire financing of the eastern leg prebuild. In August 1980, TransCanada, through another U.S. subsidiary and along with three other interstate pipeline companies, elected to become a partner in the Alaska segment of

the ANGTS. TransCanada's commitment to the project is based on a thorough review and analysis of TransCanada's interests and the economic and engineering feasibility of the overall ANGTS system.

Our analysis shows that the ANGTS is a sound investment for TransCanada and its partners. Although unprecedented in its magnitude, it is technologically feasible and can be constructed within the time and range of costs currently projected. The ANGTS will provide producers with the incentive to undertake new exploration in frontier regions. New discoveries will enhance the energy security of both the United States and Canada. Clearly, the ANGTS will be a valuable asset for investors and gas consumers, as well as a secure source of domestic energy for the United States.

These substantial benefits will not come easily. The ANGTS will be the largest energy project in history. The credit of the pipeline sponsors will not be sufficient to assure the successful financing of a project of this magnitude. Innovative financing techniques will be required if the project is to be constructed through private financing and without government guarantees. Approval of the waiver proposal submitted by President Reagan is the essential first step to permit the sponsors and producers to develop such a financing plan.

The ANGTS is necessary in the development of Arctic natural gas resources. If the ANGTS is not constructed in a timely manner development of frontier energy resources will be set back many

years with substantial detriment to the United States and Canada. It is imperative that we continue to make progress on the ANGTS. Passage by Congress of the Waiver of Law package is critical to that progress.

STATEMENT OF JEROME J. MC GRATH
PRESIDENT, INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA
BEFORE THE
FOSSIL AND SYNTHETIC FUEL SUBCOMMITTEE OF THE
HOUSE ENERGY AND COMMERCE COMMITTEE
AND THE
ENERGY AND ENVIRONMENT SUBCOMMITTEE OF THE
HOUSE INTERIOR COMMITTEE

October 27, 1981

I am Jerome J. McGrath, President, Interstate Natural Gas Association of America, often referred to by its acronym, INGAA. We appreciate this opportunity to appear before your Committees to express our endorsement of and support for the Alaskan Northwest Natural Gas Transportation project. Final approvals for this project are long overdue, and favorable Congressional action on the waiver package is essential to development of a financing plan which will, hopefully, enable the project to go forward.

INGAA is a national trade association representing virtually all of the major interstate natural gas transmission companies in the United States. Our members account for approximately ninety percent of all natural gas transported and sold in interstate commerce. All of the U. S. pipeline partners in Alaskan Northwest are members of INGAA either directly or through affiliates or subsidiaries. You have heard testimony from most, if not all, of the partners, and INGAA certainly joins in their unified support of the project and request for approval of the waiver package.

Since these companies are much more familiar with the proposed waivers and are in a much better position to comment on them than we are, my statement will not address the waivers as such. What I do wish to stress is the importance the natural gas pipeline industry attaches to securing natural gas supplies from Alaska at the earliest possible time. The delays encountered by

the effort to bring Alaska natural gas to the lower forty-eight states have been endless. The first proposal to build a pipeline from Alaska to the upper Midwest was submitted to the Federal Power Commission in March, 1974 -- over seven years ago. Since that time, the cost has spiraled upward and today financing is the critical issue that must be resolved. Without approval of the waiver package, the economic viability of the project is in grave doubt and even further costly delays are sure to follow.

The long and short of it is, we sorely need the Alaskan gas in the lower forty-eight states, and the Northwest Alaskan project is the best available means to get this gas to market. Alaskan gas will be needed to offset the gradual decline in lower forty-eight reserves of gas which most forecasters predict will occur. As has been pointed out to you previously in these hearings, the U. S. is currently producing more gas annually than we are finding, although the discovery rate of new reserves has increased dramatically since passage of the Natural Gas Policy Act (NGPA) in 1978. Nevertheless, the largest single untapped reserve of natural gas in the United States is the Prudhoe Bay area in Alaska, containing some twenty-six trillion cubic feet of proved reserves. With lower forty-eight production estimated to decline from about 20 Tcf. in 1980 to about 16 Tcf. in 1990, it is apparent that Alaskan gas must be brought into the lower forty-eight as early in the 1980's as is possible. Without Alaskan gas, there will be a considerable shortfall in supply available to meet projected demand.

Most current estimates project Alaskan gas coming on stream in 1986 and gradually increasing to about eight to ten percent of total U. S. supply b/

1990 and beyond. The line would have an initial capacity of 2.0 to 2.4 billion cubic feet per day (Bcf/d) with the capability for expansion to an average daily volume of 3.2 Bcf/d. These are significant amounts of gas to be introduced into the lower forty-eight states' market.

The U. S. pipeline partners in their own systems cover practically every area of the country -- from the East Coast to the West. These companies, after exhaustive study, have determined that not only will Alaska gas be needed to shore up declining supplies but that it will be marketable in their respective service areas. The cost of competitive sources of energy, principally fuel oil and electricity, are constantly rising in most regions of the country; and natural gas is still a bargain, even with higher supplemental sources such as high BTU coal gas and Alaskan gas. Moreover, as the cost of the Alaskan Northwest project is amortized over the project life, the cost per MMBTU becomes lower, enhancing its competitive posture. From the point of view of the interstate pipelines, the Alaska project presents a viable source of new supply; and the sooner it becomes available, the better off we all will be.

Finally, the Congress cannot overlook the fact that Alaskan gas can offset oil imports by a significant amount -- anywhere from 400,000 to 600,000 barrels per day, depending on the amount of gas delivered through the ANGTS. From the national security standpoint and certainly as a means of reducing our balance of payments, it makes eminent good sense to reduce our dependency on OPEC imports and increase our reliance on known sources of energy in Alaska and the North American Continent. The Alaskan Northwest project would be a major step in that direction.

The interstate pipeline industry, therefore, believes it imperative that the Alaska Northwest project go forward as expeditiously as possible. Congressional approval of the waiver package is essential.

I thank you for this opportunity to appear before your Committees to express INGAA's support for this important project.

STATEMENT OF
C. M. BUTLER III
CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION
BEFORE THE
SUBCOMMITTEE ON FOSSIL AND SYNTHETIC FUELS
COMMITTEE ON ENERGY AND COMMERCE
AND
SUBCOMMITTEE ON ENERGY AND THE ENVIRONMENT
COMMITTEE ON INTERIOR AND INSULAR AFFAIRS
HOUSE OF REPRESENTATIVES

October 30, 1981

Mr. Chairmen and Members of the Subcommittees:

I appreciate your invitation to appear before these Subcommittees to express my views of the waivers proposed to facilitate the financing of the Alaska Natural Gas Transportation System. At the outset of my testimony, two disclaimers are required. First, the views which I express should be attributed to me alone and not the Commission as a whole or otherwise in part. I have not discussed my policy predilections on these matters with my colleagues, nor have they discussed theirs with me. Secondly, I am subject to certain legal constraints in connection with my testimony, as follows.

As the Subcommittees are aware, a number of issues connected with this project have been decided by the Commission, 1/ and there are still other such matters pending before the Commission, including the adjudication of the project sponsors'

1/ The "Commission", when used in the context of an action taken prior to October 1977, refers to the Federal Power Commission (FPC); when used otherwise, the reference is to the Federal Energy Regulatory Commission (FERC).

application for a permanent certificate under Section 7 of the Natural Gas Act. In fact, the waiver package is of considerable relevance to that proceeding in this sense. The project sponsors claim that without the waivers, a viable financing plan cannot be developed. But the development of such plan is required for presentation to the Commission so that the Commission can decide, among other things, whether the project should be certificated. In these circumstances, I am free to express my views of policies applicable to the matters pending before you; however, any conclusions of fact which I might describe must be regarded by the Subcommittees as nothing more than tentative. As a matter of fundamental fairness to all parties to that proceeding, conclusions about such facts cannot be reached until factual presentations in the proceeding have been completed. 2/

The Alaska Natural Gas Transportation Act of 1976 (ANGTA) 3/ was enacted for two primary purposes: (i) to provide a means for sound selection of a transportation system for the delivery of natural gas from the North Slope of Alaska to the lower-48 states, and (ii) to expedite its construction and initial operation. The decision to enact such legislation was based on findings by Congress that

2/ In further connection with this matter, see Appendix 1 to this testimony.

3/ 15 U.S.C. § 719 (1976).

there was a shortage of gas supplies in the lower-48 states which the Alaskan supplies could help to alleviate. Now, five years later, the transportation system has been selected, but the project certification has still to be completed. However, we are advised by the project sponsors that once certain institutional and legal obstacles, several of which were created by the Presidential Decision 4/ contemplated by ANGTA, are eliminated, the last obstacle to a complete application for a permanent certificate will be removed through development of a project financing plan. In response to these most recent representations by the project sponsors, I have considered two questions. The first is whether the project is still necessary or desirable; the second is whether the waivers of law sought violate principles of sound public policy.

As to the first question, I believe that the Congressional policy findings which underpin ANGTA remain valid. As the

4/ Executive Office of the President, Energy Policy and Planning, Decision and Report to Congress on the Alaska Natural Gas Transportation System (September 22, 1977). Approved by joint resolution of the Congress, the Decision has the force and effect of law.

Commission found in its Order No. 31 5/ and reiterated in Order No. 45, 6/ virtually every estimate of proven reserves at Prudhoe Bay exceeds 26 trillion cubic feet (Tcf). Delivery of those reserves could supply more than two billion cubic feet of natural gas per day over the anticipated 25-year life of the proposed transportation system. That amounts to about five percent of current U. S. demand for natural gas. Moreover, estimates of potential natural gas reserves in Alaska range from 100-200 Tcf. Under those circumstances, it would clearly be advisable to bring gas from Alaska to the lower-48 states if that can be done economically. Conversely, it can be reasonably inferred that failure to build a transportation system for Alaska natural gas would operate as an impediment to further exploration for, as well as production of, such gas.

The project sponsors have indicated that the average price 7/ of the gas over the life of the project will approximate \$4.89/MMBtu in 1980 dollars. Assuming that the long-term

5/ Order No. 31, "Order Setting Values for Incentive Rate of Return, Establishing Inflation Adjustment and Change in Scope Procedures, and Determining Applicable Tariff Provisions," Docket No. RM78-12 (issued June 8, 1979).

6/ Order No. 45, "Regulations and Statement of Policy," Docket No. RM79-19 (issued August 24, 1979).

7/ I assume that the term "price" reasonably equates to the term "average annual annuity cost equivalent" used by the project sponsors' advisers.

market clearing price for natural gas nationwide is approximately equivalent to the average low sulfur No. 6 fuel oil price, and if the project sponsors' representations as to cost are accurate, the price of such gas to the lower-48 states could be expected to be reasonably economic. By comparison, we are now purchasing gas at the borders from Canada and Mexico at \$4.94/MMBtu. Additionally, the price of deregulated, deep-gas supplies is currently about twice the sponsors' projected cost of Alaska gas. In this connection, although the producers may charge the full price permitted under Section 109 of the NGPA, they are not required to do so; so there may be some "give" in the cost of the Prudhoe Bay gas if necessary to make it marketable, particularly in the early years of the operation of the system. Additionally, the project sponsors are not precluded from asking the Commission to "levelize" the tariff in a way that more closely matches the transportation rate with the average transportation cost over the life of the project. If the Commission were to find such a proposal to be in the public interest, the cost of the Alaska gas to consumers in the early years of the project would be lowered. However, these and other questions concerning the marketability of Prudhoe Bay gas must be addressed by the parties in detail in the certificate proceedings pending before the Commission.

Although questions about the marketability of Alaska gas are still open, there appears to be no question but that the gas -- at least in the early years of the project -- will be relatively high-cost. At the same time, our natural gas supply situation has eased to the point where it may be tempting to question whether the delivery of relatively costly Alaskan reserves is justifiable. I believe that there are two policy considerations which would provide justification. First, if the gas from Alaska can be marketed competitively with gas from traditional lower-48 sources as the project sponsors claim, there is no predicate for the argument that the line should not be built, assuming it can be done consistent with certificate determinations made by the Commission and referred to above. Secondly, the geological evaluations of the Commission's staff, and those of the U. S. Geological Survey, indicate substantial declines in the deliverability of reserves from the Gulf of Mexico producing region. 8/ The Commission's staff tells us that deliverability from that area could decline as much as 2 Tcf per year by 1985. Assuming only for the sake of argument that these assessments are correct, delivery of Alaska gas could offset those declines by 50 percent when the project is completed. Although these

8/ South Louisiana Onshore and Texas Railroad Commission Producing Districts 2, 3 and 4, and Offshore Louisiana and Texas.

declines are also being offset with additional gas supplies found in response to higher NGPA prices, delivery of Alaska gas should be viewed as an important hedge against, if not critical to avoid, significant gas shortages in the 1985-90 time frame, and beyond. I believe that recognition of these matters is implicit in President Reagan's message accompanying the proposed waivers. One can predict with assurance that history will criticize us severely for failing to provide Prudhoe Bay gas if that can be done at economic prices, and should gas shortages develop in the future.

I shall now address the question whether the requested waivers violate principles of sound public policy.

ANGTA created a unique process for selecting a transportation system for the delivery of the Prudhoe Bay reserves to lower-48 markets. The product of that process was a decision by President Carter, approved by Congress, which not only selected the system to be constructed, but also specified a general framework of conditions under which the selected system was to be constructed.

Section 5(a)(2) of ANGTA provides that, in the event a decision of the President takes effect pursuant to its provisions, the Commission shall issue a certificate of public convenience and necessity (the product of its normal authorization proceedings under Section 7 of the Natural

Gas Act) to the selected system. The Commission complied with that mandate by order of December 16, 1977, 9/ in which it issued conditional certificates to the sponsors of the selected project pending receipt of satisfactory evidence of compliance with the various terms and conditions which were made part of the President's Decision. Over the past four years, the Commission has issued a number of authorizations for various aspects of the project pursuant to those terms and conditions, including authorizations for the "pre-build projects." These projects involve early construction of certain southern Canadian and lower-48 ANGTS facilities for the purpose of importing gas which has been determined to be surplus to Canada's needs. Deliveries of pre-build gas commenced on October 1 of this year.

A brief legal history of the actions taken in connection with ANGTS involving the Commission (including a description of the authorizations which have been granted to date), and a list of matters which have yet to be decided by the Commission, is included as Appendix 2.

9/ "Order Vacating Prior Proceedings and Issuing Conditional Certificates of Public Convenience and Necessity," Docket Nos. CP78-123, CP78-124, and CP78-125 (issued December 16, 1977).

The waiver proposal submitted by the President would alter several of the terms and conditions in the Decision and eliminate certain other requirements and authorities.

In particular, the President's proposal would:

- lift the ban on producer ownership participation;
- make the conditioning plant required to prepare the gas for pipeline entry a part of the "approved transportation system," as that term is defined in the ANGTA;
- alter the Decision's limitation on pre-completion billing;
- allow the Commission to use procedures other than formal evidentiary hearings in the course of reaching certification decisions regarding the ANGTS;
- eliminate the Commission's authority to change its tariff orders to the detriment of debt service; and
- make other technical changes.

I shall comment only briefly on the matter of producer participation in the project. First, based on my experience in negotiating similar financing agreements, the contentions of the investment community that the project cannot be financed without the credit support of the producer-participants do not surprise me. Nor does the position of the producers

that they will participate only if they are permitted an equity interest in the project. Both of these arguments are advanced in favor of producer ownership. But beyond those reasons, I believe there is a largely unspoken advantage in allowing the producers to be equity investors in the project: They would appear to be excellent barometers of economic feasibility of this project. The relevant producers are major oil and gas companies, not unsophisticated in predicting the marketability of their products. Their consistent endorsement of the project despite speculation over the future of natural gas pricing policy provides a useful market indicator that gas from the project can be sold at competitive prices. Correlatively, given their critical importance to financing the project, should their enthusiasm for the marketability of the gas disappear, consumers would have had the benefit of an important market protection from the construction of a non-economic project. This protection stems from the exposure of the equity portion of the project investment -- no insubstantial sum of money -- to risk of loss in the events of construction delay, prolonged interruption of service, and pre-completion and post-completion abandonment. As I have indicated, the Commission will require the project sponsors to put on evidence in proceedings to be conducted concerning the marketability of Alaska gas under various circumstances, including changes in gas pricing policy.

I believe that the proviso to the waiver requiring the Commission to seek the advice of the Attorney General on antitrust questions and to make specified antitrust findings is an appropriate protection for the consuming public and is administrable by the Commission. The required findings are not unlike those the Nuclear Regulatory Commission is required to make in connection with the licensing of nuclear projects, and those the Federal Trade Commission is required to make in connection with pre-merger notifications under the Hart-Scott-Rodino Act.

The proposal would also waive the language of the President's Decision which has been interpreted by the Commission to exclude the gas conditioning plant from the definition of the approved transportation project. 10/ According to the synopsis of waiver accompanying President Reagan's proposal, President Carter's Decision in this regard was based on the absence of a described gas conditioning plant from the Alcan sponsors' certificate application. However, the Commission also construed the Decision in conjunction with Section 110 of the Natural Gas Policy Act

10/ Order No. 45 (mimeo at 4-5). In that order, the Commission pointed out that the President's Decision defined the approved transportation system as commencing on the discharge side of the gas conditioning plant, thereby excluding it from the approved transportation system. Id.

to grant broad discretion to the Commission to permit producers to collect an allowance for conditioning the Prudhoe Bay gas.

In my judgment, the previous Commission was correct in concluding that the President's Decision excluded the gas conditioning plant from the definition of the approved transportation system. However, I take strong exception to that Commission's rationale for disallowing producers -- as a matter of the Commission's discretion -- from receiving an allowance for the conditioning of Prudhoe Bay gas. The President's Decision clearly did leave discretion to the Commission to permit the recovery of those conditioning costs and, in places, even assumes that an allowance would be authorized. However, the order seems to disregard those facts after reciting them and concludes despite them that the President's Decision dictates a policy pursuant to which virtually all of the costs of conditioning will be borne by producers. It buttressed that conclusion with a factually unsupported assertion that traditional contracting practices between producers and pipelines in the lower-48 states were to levy such costs on producers.

In my view, the Commission should have started from a clean slate in deciding the issue and adhered to the crucial principle stated in the order. The transportation system and the gas which it would transport are sui generis, that is, not necessarily subject to traditional rules and practices. 11/ The Commission deviated from that principle in a fundamental way when it found that the usual practice in the lower 48 was for producers to bear conditioning costs required to make gas transportable and that, for that reason, the producers of Alaska gas should bear such costs. 12/ First, the previous Commission and I would agree that the cost of gas conditioning is a cost of making the Prudhoe Bay gas transportable; but I believe that, whatever historical practices have been, those costs should be identified for and borne by consumers. An attempt to "hide" such costs, or shield consumers from them, would tend to insulate the project from the risk that the gas would not be marketable, and thus tend to cloud the question whether the project should be built at all. Secondly, since transportation is such a major component of the cost of Alaska gas, the wellhead price realized by producers in current and foreseeable markets will doubtless be less than wellhead prices for natural gas produced in the lower-48 states.

11/ Correlatively, regulatory treatment of ANGTS should not be considered precedent-setting for unrelated projects.

12/ Order No. 45 (mimeo at 34-35).

it resolved in the context of ANGTS. As I have still to formulate my own views on the matter, I can express no opinion on its resolution at this time.

Waiver of Section 5, Condition IV-2, of the President's Decision means that the budget for the construction of the gas conditioning plant will have no bearing on the rate of return allowed the rest of the system. This does not preclude the Commission from requiring, through an incentive-penalty system, assurances that consumers will not bear an unreasonable risk of cost overruns in connection with completion of the gas conditioning plant.

President Reagan's proposal to waive Section 5, Condition IV-3, of President Carter's Decision is apparently the most controversial of the proposed waivers. The billing commencement condition of President Carter's Decision presently allocates both the risk of delay in project completion and the risk of noncompletion of the project to the project sponsors. The waiver would permit, but not require, the Commission to approve a tariff which would allocate such risks to the consumer.

As stated earlier, the waiver of Section 3, Paragraph 3, First Sentence, of the President's Decision would result in inclusion of the gas conditioning plant in the approved transportation system. To an extent, this aggravates the risk of delay in completion of the project because of the difficult logistics of constructing the gas conditioning plant at Prudhoe Bay. Because it would be constructed in large modules at Gulf Coast fabrication sites and then transported by barge to the North Slope, the plant could be delayed because its construction schedule is especially vulnerable to the vagaries of the Polar Ice Pack. While normally open for about six weeks each year, passage around Point Barrow to Prudhoe Bay is occasionally open for only a few days out of the year. (In fact, such a short season occurred during construction of the Trans-Alaska Oil Pipeline System (TAPS).) In the event of a bad year at a critical period in the construction of the conditioning facility, the inability to deliver needed equipment and material could force a delay in the expected commencement of gas deliveries.

The Decision did not answer the question to whom this risk of delay would be assigned, as the billing commencement condition therein referred only to completion of the approved

transportation system, which excluded the gas conditioning plant. In Order No. 31, the Commission split this risk between gas consumers and the project sponsors by allowing charges sufficient to cover debt service and certain other costs to begin as soon as all segments of the pipeline system were complete, but requiring return on and of equity to await gas flow.

The billing commencement waiver adopts an essentially similar approach to each segment of the pipeline system. It recognizes that gas flow could be delayed as a result of delays in the completion of any of the major segments, while the necessity to finance the segments which have not been delayed is continuous. In recognition that this project is primarily for the benefit of American gas consumers, sponsors of the Canadian segment are provided relief from this contingency by permission to begin charging the entire cost of service for the Canadian segment despite the absence of gas flow. 13/ However, U. S. project sponsors are provided only partial relief, to the extent of debt service and limited

13/ The sponsors of the project in Canada have been afforded such relief by the National Energy Board, FERC's Canadian counterpart. However, users of the pipeline (shippers) have declined to obligate themselves to the Canadian tariff until authorized by the FERC to recover payments pursuant to such tariffs in their rates. Thus the billing commencement waiver for the Canadian segment would provide the Commission with the authority to avoid frustrating the NEB's Decision.

other costs, in such eventuality. Prohibiting the return on or of equity during the period of noncompletion provides a powerful negative incentive to see that delays in the project are minimized.

Apparently, this aspect of the proposed financing has raised a question in the minds of some whether it is an appropriate exercise in public policy, even assuming that the project should be built and pre-completion billing is a necessary element of the financing plan. 14/ I would suggest to the Subcommittees that it is.

The cost-based methodology that we employ in setting rates does not allow regulated companies to reap the benefits of an improved product or reduced costs. 15/ The benefits of an improved product or lowered costs principally have to be passed on to the consumer. This creates obvious problems of incentives for efficiency and innovation. It also creates another and potentially more serious problem.

If regulated companies cannot reap the benefits of good fortune, they cannot be expected to risk the burdens of bad fortune. If the best they can hope for are rates that just

14/ The assertion is that the lenders will require assurances that debt service will not be impaired upon completion of discrete major segments of the project.

15/ In a scholarly article, that statement would have to be qualified in various ways. But, as a close approximation to the truth, it will serve well enough.

cover their costs, they cannot be expected to bear significant risk of falling short of recovering those costs. Either such projects will not be undertaken by the regulated companies, or the risk must be at least shared between investors and consumers. Thus, there is a choice between two options within the present regulatory framework, and each option carries its own price. Regulated firms can limit themselves to technologies and projects that carry little risk of failure, and the price can exclude any part of the loss from the failures that do occur. Or, regulated firms can turn to riskier technologies and projects in the hope of obtaining more or better production and lower costs, and the price that the public pays then will include the assurances of shared responsibility for losses. Either option is possible. What is not possible is to pay the lower price of the first option and obtain the benefits of the second. Or at least that is not possible if we can assume that investors are rational, and regulatory agencies are at least not prepared to be duplicitous.

If these expectations of economic behavior are accurate, the tariff provisions permitted by the waiver of the billing commencement condition of President Carter's Decision can be

viewed as the missing piece in an otherwise workable plan requiring the sharing of the risks of a concededly risky project among consumers and sponsors. I should point out that this kind of sharing is already contemplated and permitted in part -- that is, in the event of service interruptions -- in Order No. 31. In that event, minimum bill provisions would allow the recovery of the cost of debt service, operation and maintenance expenses, and taxes after the cessation of gas flow. The new tariff condition would provide the same assurances in connection with risks experienced before project completion, and thus before gas flow. In my view, this kind of risk sharing can be justified in cases such as the one before the Subcommittees which envision regulated companies undertaking high risk gas supply projects.

President Reagan's proposal would waive Section 7(c)(1)(B) to permit the Commission to employ informal procedures for the decision on the merits of the certificate application. The result of such a Commission decision would be to create a curious hybrid of administrative procedure. 16/ If workable, it should significantly expedite the Commission's decisionmaking. If the waiver is adopted, the Commission will be granted the flexibility to consider such procedure. That would probably

16/ Not, I might add, the first such curious hybrid the Commission will have dealt with.

assist the Commission to comply with the mandate of ANGTA to expedite the certificate process.

The waivers of Sections 4, 5, 7 and 16 of the Natural Gas Act are the subject of an extensive memorandum prepared at the request of the Honorable Philip R. Sharp, Chairman, and the Honorable Clarence J. Brown, Ranking Republican, Subcommittee on Fossil and Synthetic Fuels, Committee on Energy and Commerce, U. S. House of Representatives. I endorse the legal analysis of that memorandum, which is attached to this statement as Appendix 3.

Finally, the remaining waivers are technical in the main. I find no objection to them.

APPENDIX 1

Federal Trade Commission v. Cement Institute, et al. 333 U.S. 683 (1948), involved an adjudication by the Federal Trade Commission that the multiple basing-point delivered-price system of fixing prices and terms of cement sales employed by defendants in that proceeding violated the antitrust laws. One of the arguments levied in attempting to overturn the decision of the FTC was that members of that Commission should have disqualified themselves for bias. Bias was allegedly demonstrated in certain reports to Congress and the President, and in testimony before Congressional Committees, that the members, or at least some of them, held the opinion that the operation of subject pricing system was the equivalent of a price-fixing scheme in violation of the Sherman Act.

Two holdings of the Court in denying defendants' claim are critically important. First, the Court held:

. . . the fact that the Commission had entertained such views as the result of its prior ex parte investigations did not necessarily mean that the minds of its members were irrevocably closed on the subject of the respondents' basing point practices. (Emphasis added.) 333 U.S. at 701.

Secondly, the Court rejected the argument that "it was a denial of due process for the Commission to act in these proceedings after having expressed the view that industry-wide use of the basing point system was illegal." The Court said about that argument:

Neither the Tumey decision nor any other decision of this Court would require us to hold that it would be a violation of procedural due process for a judge to sit in a case after he had expressed an opinion as to whether certain types of conduct were prohibited by law. In fact, judges frequently try the same case more than once and decide identical issues each time, although these issues involve questions both of law and fact. Certainly, the Federal Trade Commission [when acting in its quasi-judicial capacity] cannot possibly be under stronger constitutional compulsions in this respect than a court.

The Commission properly refused to disqualify itself. . . . 333 U.S. at 702-03.

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Consistent with the Supreme Court's decision, the Court of Appeals for the District of Columbia has held that the standard for disqualifying an administrator in an adjudicatory proceeding because of prejudgment is whether a disinterested observer may conclude that the decisionmaker has in some measure adjudged the facts as well as the law. See, Association of National Advertisers, Inc., et al. v. Federal Trade Commission, et al., 627 F.2d 1151, 1158 (D.C. Cir. 1979).

From these principles, two propositions emerge. First, legitimate ex parte contacts do not require recusal. I was under no ex parte sanction in, for example, preparing the Transition Report on ANGTS. Factual judgments contained in that report have to be taken for what they are: judgments made on the basis of largely untested representations of interested parties, as supported by existing records and administrative, congressional and executive documents. Taken in the context of formal agency proceedings, those judgments can be characterized as nothing more than tentative. They are clearly subject to change on the basis of factual presentations to the Commission which if found persuasive and substantial would lead to other, inconsistent conclusions. The same is true of review of agency files and the like in preparation for testimony before this Committee. To the extent that I make any comments about the facts relevant to proceedings pending before the Commission, they must be recognized for what they are: nothing more than tentative conclusions, subject to change on the basis of facts adduced further in the proceeding.

Secondly, my opinion concerning policy and legal questions, as contrasted with factual questions, does not subject me to legitimate challenge that I should recuse myself from the proceedings. However, I feel compelled to point out that I am no more close-minded on points of policy than on questions of fact. I am perfectly willing to listen to competing viewpoints on matters of policy connected with this or any other project which will come before the Commission.

APPENDIX 2

Alaska Natural Gas Transportation System

The Alaska Natural Gas Transportation System (ANGTS) is an international project created to transport natural gas from the North Slope of Alaska, through Canada, to the lower 48 states. The United States portion of the system consists of three segments: (1) the Alaska segment, running from Prudhoe Bay on the North Slope to the Yukon border; (2) the Western Leg, running from the British Columbia border to California; and (3) and the Northern Border pipeline, running from a point on the Canadian border near Monchy, Saskatchewan, to Dwight, Illinois.

The ANGTS is unlike any other gas pipeline in the United States in that it is governed by a unique legal framework. The Alaska Natural Gas Transportation Act (ANGTA), 15 U.S.C. §719, et seq., enacted by Congress in 1976, supplements (but does not replace) the Natural Gas Act; certificates are issued under the Natural Gas Act pursuant to procedures mandated by ANGTA. Section 9 of ANGTA mandates expeditious consideration by all federal agencies of all federal authorizations "necessary or related to the construction and operation of" the ANGTS, while Section 10 specifically provides for limited and expedited judicial review of such agency action.

Pursuant to Section 7 of ANGTA, the President, in September of 1977, submitted his Decision and Report to Congress on the Alaska Natural Gas Transportation System (Executive Office of the President, Energy Policy and Planning) which designated both the project sponsors and the route for the ANGTS as well as many conditions for its construction. Congress approved the President's Decision by Joint Resolution, which became law on November 8, 1977. H.R.J. Res. 621, Pub. L. No. 95-158, 91 Stat. 1268, 95th Cong., 1st Sess. (1977). Important background documents that contributed to the President's Decision include Administrative Law Judge Nahum Litt's Initial Decision (430 pages) in Docket No. 75-96, et al. (February 1, 1977); the Federal Power Commission's Recommendation to the President (July 1, 1977); and the Federal Power Commission's Comments on the President's Decision (October 1977). The national commitment to construct the ANGTS was reaffirmed by the Congress in a Concurrent Resolution adopted on June 27, 1980. S. Con. Res. 104, 96th Cong., 2nd Sess. (1980).

The ANGTS is also governed by two international agreements with Canada, both of which have the force and effect of law. The "Agreement Between the Government of the United States of America and the Government of Canada Concerning Transit Pipelines," entered in force October 1, 1977 after ratification by the Senate, applies to all pipelines in both countries whenever one country's pipeline carries the other country's gas or oil. The treaty mandates nondiscriminatory treatment. (Note: The ANGTS transports Alaskan gas across Canada; the Great Lakes system transports Canadian gas through the U.S. from Western Canada to Eastern Canada.)

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The "Agreement Between the United States of America and Canada on Principles Applicable to a Northern Natural Gas Pipeline," signed by representatives of the two governments on September 20, 1977, is an executive agreement that was made part of the President's Decision (pages 47-83). Inasmuch as the Decision was approved by Congress, it (including the Agreement) has the legal status of a statute. The Agreement specifies the route of the ANGTS, and contains numerous conditions. Pursuant to the Agreement, our Commission has consulted with the National Energy Board of Canada in co-ordinating the respective certification of the various ANGTS segments in the U.S. and Canada, including related imports of Canadian gas to support the "prebuilding" of the lower half of the system. (In Canada, the ANGTS is known as the "Alaska Highway" project.)

One other relevant item of legislation is Reorganization Plan No. 1 of 1979, which was submitted by the President to the Congress and not disapproved by the Congress. The Plan establishes the Office of the Federal Inspector, which reports directly to the President. The Inspector is responsible for monitoring the construction of the pipeline, and for co-ordinating all federal permitting and certification of it. The Plan transfers to the Inspector the Commission's Natural Gas Act Section 3 and 7 jurisdiction to enforce the Commission's certificates and import authorizations issued to the ANGTS project sponsors.

Commission orders on the ANGTS have been attacked in court three times, and successfully defended by the Solicitor's Office in each instance. In Midwestern Gas Transmission Co. v. FERC, 589 F.2d 603 (D.C. Cir. 1978), the Court affirmed certain preliminary import determinations. The decision contains an excellent recitation of the procedural history of the project, including the basic judicial interpretation of both ANGTA and the President's Decision. In Earth Resources Co. v. FERC, 617 F.2d 775 (1980), the Court affirmed a Commission order establishing the size and pressure for the Alaska segment, confirming that ANGTA and the President's Decision conclusively terminated the NEPA process for the ANGTS. Finally, in General Services Customer Group v. FERC, D. C. Circuit, No. 80-1803 (1980), the Court issued an unpublished per curiam decision affirming the Commission's orders certificating the Northern Border prebuild project.

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In addition, in FERC v. Public Service Commission of North Dakota, 513 F. Supp. 653 (D.N.D. 1981), our Commission and the Federal Inspector filed a lawsuit to enjoin the North Dakota PSC from enforcing an order that would have required locating the Northern Border segment along a different route from the one authorized by the President, the Congress and our Commission. The Court granted the injunction.

During the past several years, the Commission has issued a long series of orders, pursuant to a variety of proceedings, the more prominent of which are listed below. Many of these proceedings utilized rulemaking or other expedited procedures. Unless otherwise indicated herein these orders were issued in Docket No. CP78-123, et al.

By an order issued December 16, 1977, the Commission granted conditional certificates to all of the ANGTS project sponsors, for all three segments, and pursuant to the mandate of the President's Decision. The order also appointed John Adger as the Commission's "Alaskan Delegate," to co-ordinate the project.

By an order issued August 6, 1979, the Commission established the pipe size and pressure for the Alaska segment. By an order issued on May 8, 1980 (with an erratum notice on May 21, 1980, and supplemented by an order of June 20, 1980), and pursuant to Section 17 of ANGTA, the Commission attached conditions to all ANGTS certificates requiring an equal employment opportunity and minority business opportunity affirmative action plan.

The Western Leg prebuild project was certificated in orders issued on January 11 and June 13, 1980. The Northern Border prebuild project was certificated in orders issued on April 28, and June 20, 1980. All of these orders also contained related import authorizations. (Initial Decisions were waived.) Additional import authorizations for imports through Northern Border were approved in orders issued on June 27, 1980 (Docket No. CP80-22) and April 24, 1981.

In Docket No. RM78-12, the Commission issued Order Nos. 31 and 31B, on June 8 and September 6, 1979, pursuant to the mandate of the President's Decision, establishing an incentive rate of return for the Alaska and Northern Border segments. These orders also approved the tariffs for Northern Border and the Alaska segment. To complete the process, in Docket No. CP80-435 the Commission's Alaskan Delegate, in conjunction with an employee of the Office of Federal Inspector, submitted to the Commission a lengthy report on the Alaska segment cost estimate, and the Commission has issued an order inviting comment on the report.

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In Docket No. RM79-19, the Commission issued Order No. 45 on August 24, 1979, setting out regulations and a policy statement on production related costs for Prudhoe Bay gas. The effective date of that order was stayed pending rehearing; at the request of the Secretary of Energy, the Commission extended the stay indefinitely pending negotiations by the ANGTS project sponsors with the Prudhoe Bay producers.

On February 26, 1980, the Commission issued an order attaching certain environmental conditions to the conditional certificates. On December 15, 1980, the Commission issued an order approving amendments to the Alaska segment partnership agreement. On February 23, 1981, the Commission issued an order attaching certificate conditions requiring compliance with an executive agreement of June 10, 1980, between the U. S. and Canada, regarding reciprocal procurement monitoring requirements.

On March 31, 1980, the Commission issued an order delegating to the Federal Inspector certain ANGTS archeological responsibilities. On December 19, 1980, the Commission issued an order delegating to the Federal Inspector certain ANGTS rate base approval responsibilities.

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PENDING AND FUTURE PROCEEDINGS

ANGTS proceedings currently pending before the Commission include:

1. The final certification proceeding for the Alaska segment.
2. Production related costs rulemaking for Prudhoe Bay gas.
3. The Alaska segment cost estimate proceeding.
4. Rate base proceedings for Alaska segment and Northern Border pre-1980 costs.
5. The Northwest Canadian Gas Sales Company certificate and import applications in lieu of Northwest Alaskan Pipeline Company.

To these could be added proceedings that have not yet been instituted:

6. Rulemaking on shipper tracking of ANGTS transportation charges.
7. In the more distant future, final certification of the non-prebuilt sections of Northern Border and Western Leg, and certification of shippers of Alaska gas.

The scope and current status of each of these proceedings is discussed below.

1. Alaska segment final certification.

Issues to be presented in the final certification proceeding might include, inter alia:

- (1) The financing plan, including tariff issues.
- (2) Cost of service and net national economic benefit.
- (3) Marketability of the gas.
- (4) Cost allocation for the conditioning plant.
- (5) Any remaining design questions.
- (6) Any issues deferred from the Alaska segment cost estimate proceeding.

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In this regard, finance condition No. 2 in the President's Decision provides that "If the direct capital cost estimates excluding interest during construction for the overall project in 1975 constant dollars filed with the FPC immediately prior to certification . . . materially and unreasonably exceed the comparable capital cost estimates filed by Alcan with the Federal Power Commission on March 8, 1977 . . . the FPC may not issue a certificate for the project." The proposed billing commencement date waiver would not affirmatively establish any particular billing commencement date as a matter of law; rather, it would cut back on the restrictions in the President's Decision so as to afford the Commission the legal flexibility to approve tariffs that permit a billing commencement date earlier than the one approved by the Commission in Order No. 31.

2. Production related costs.

On August 24, 1979, pursuant to a formal rulemaking proceeding, the Commission issued Order No. 45 in Docket No. RM79-19, adopting regulations and a policy statement on production related costs for Prudhoe Bay gas. The order was stayed to permit parties to file applications for rehearing, and a number of such applications were filed. At the request of the Secretary of Energy, the Commission issued an indefinite stay order. Thus, Docket No. RM79-19 is an open docket before the Commission, with applications for rehearing of Order No. 45 pending for decision.

3. Cost estimate proceeding.

The Commission issued an order in August of 1981, in Docket No. CP80-435, inviting comment and reply comment on a report submitted to the Commission by its Alaskan Delegate and by the Federal Inspector's Director of Audit and Cost Analysis, analyzing the Alaska segment cost estimate. Comments and reply comments have been filed, and are being analyzed by the Commission's staff pursuant to preparation of an order for Commission consideration. Thus, the cost of the Alaska segment is an issue presently before the Commission for decision.

4. Rate base proceedings.

In December of 1980, the Commission issued an order affording interested parties an opportunity to show cause why the Commission's Chief Accountant's audit report on pre-1980 Alaska segment expenditures should not be accepted by the Commission for rate base purposes. A comparable show cause order was issued in March of this year with respect to Northern Border's pre-1980

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costs. Comments and reply comments were received in response to both orders. Thus, the rate bases of both Northern Border and Alaskan Northwest, to the extent that they involve costs incurred prior to 1980, are both pending before the Commission for decision.

5. Northwest Canadian application:

The Commission issued an order on October 1, 1981, authorizing Northwest Alaskan Pipeline Company to import the Canadian prebuild gas at the present border price, and approving Northwest Alaskan's tariff for the resale of that gas to PIT for transportation through the Western Delivery System to its destination in Southern California. The order, however, deferred consideration of the application of Northwest Canadian Gas Sales Company for a certificate and import authorization to import and resell the gas in lieu of Northwest Alaskan, but afforded Northwest Canadian an opportunity to file additional information on the purpose of its application. To date, Northwest Canadian has not made any further filings. Thus, Northwest Canadian's application is currently pending before the Commission in an open docket.

6. Shipper tracking.

The Commission's staff is currently preparing, for consideration by the Commission, a notice of proposed rulemaking on the subject of tracking ANGTS transportation charges (including transportation charges incurred in Canada) in the ANGTS shipper tariffs.

7. Future certificate proceedings.

At some date within the next few years, Northern Border and PGT will file applications for certificates to construct and operate non-prebuilt portions of the Eastern and Western Legs, and shippers will file applications for certificates to ship the Alaska gas through the ANGTS. These applications may entail, inter alia, adjustments of depreciation schedules for the prebuilt segments.

APPENDIX 3

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D. C. 20426

August 18, 1981

MEMORANDUM TO: Honorable Philip R. Sharp
Chairman
Subcommittee on Fossil & Synthetic Fuels
Committee on Energy and Commerce
House of Representatives

Honorable Clarence J. Brown
Ranking Minority Member
Subcommittee on Fossil & Synthetic Fuels
Committee on Energy and Commerce
House of Representatives

FROM : Charles A. Moore
General Counsel
Federal Energy Regulatory Commission

RE : Proposal by Sponsors of the Alaskan
Natural Gas Transportation System (ANGTS)
for Congressional Waiver of Sections 4,
5, 7 and 16 of the Natural Gas Act in
Certain Respects Pursuant to Section 8g
of the Alaskan Natural Gas Transportation
Act of 1978

Questions Presented

By letter of July 24, 1981, to C. M. Butler III,
Chairman, Federal Energy Regulatory Commission, 1/ you
requested a legal memorandum addressing the following
questions:

1/ Hereinafter, the term "Commission" refers to the Federal
Power Commission at all times before October 1, 1977, and
the Federal Energy Regulatory Commission at all times
thereafter.

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(a) The full implications of the proposed waiver quoted hereinbelow, (b) whether there have been past Commission actions which justify the desires of the sponsors to have Congress provide the waiver, (c) hypothetical situations which would work to the injury of the pipeline sponsors of ANGTS or other participants in the project should no such waiver be provided by Congress, (d) hypothetical situations which might work to the injury of resale customers and consumers should such a waiver be provided by Congress, and (e) the reasonable likelihood of the hypothetical situations actually occurring.

The text of the waiver request, as set forth in your letter, is as follows:

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.

We are advised that this text is currently a topic of discussion at staff levels in the Administration and the Congress, and that the text may be revised in one or more respects. Accordingly, the memorandum is expressly limited to the preceding text, although I will be pleased to respond as expeditiously as possible to any questions you might have in connection with material changes in such text.

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Discussion

1. Background

As you know, the ANGTS is an international project created to transport natural gas from the North Slope of Alaska, through Canada, to the lower 48 states. The United States portion of the system consists of three segments: (1) the Alaska segment, running from Prudhoe Bay on the North Slope to the Yukon border; (2) the Western Leg, running from the British Columbia border to California; and (3) and the Northern Border pipeline, running from a point on the Canadian border near Monchy, Saskatchewan, to Dwight, Illinois.

The ANGTS is unlike any other gas pipeline in the United States in that it is governed by a unique legal framework. The Alaska Natural Gas Transportation Act (ANGTA), 15 U.S.C. section 719, et seq., enacted by Congress in 1976, supplements (but does not replace) the Natural Gas Act; certificates are issued under the Natural Gas Act pursuant to procedures mandated by ANGTA.

Pursuant to Section 7 of ANGTA, the President, in September of 1977, submitted his Decision and Report to Congress on the Alaska Natural Gas Transportation System (Executive Office of the President, Energy Policy and Planning) which designated both the project sponsors and the route for the ANGTS as well as many conditions for its construction. Congress approved the President's Decision by Joint Resolution, which became law on November 8, 1977. H.R.J. Res. 621, Pub. L. No. 95-158, 91 Stat. 1268, 95th Cong., 1st Sess. (1977).

The ANGTS is also governed by two international agreements with Canada, both of which have the force and effect of law. The "Agreement Between the Government of the United States of America and the Government of Canada Concerning Transit Pipelines," entered in force October 1, 1977 after ratification by the Senate, applies to all pipelines in both countries whenever one country's pipeline carries the other country's gas or oil. The treaty mandates nondiscriminatory treatment.

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The "Agreement Between the United States of America and Canada on Principles Applicable to a Northern Natural Gas Pipeline," signed by representatives of the two governments on September 20, 1977, is an executive agreement that was made part of the President's Decision (pages 47-83). Inasmuch as the Decision was approved by Congress, it (including the Agreement) has the legal status of a statute. The Agreement specifies the route of the ANGTS, and contains numerous conditions. Pursuant to the Agreement, our Commission has consulted with the National Energy Board of Canada in coordinating respective certification of the various ANGTS segments in the U. S. and Canada, including related imports of Canadian gas to support the "prebuilding" of the lower half of the system.

One other relevant item of legislation is Reorganization Plan No. 1 of 1979, which was submitted by the President to the Congress and not disapproved by the Congress. The Plan establishes the Office of the Federal Inspector, which reports directly to the President. The Inspector is responsible for monitoring the construction of the pipeline, and for coordinating all federal permitting and certification of it. The Plan transfers to the Inspector the Commission's Natural Gas Act Sections 3 and 7 jurisdiction to enforce the Commission's certificates and import authorizations issued to the ANGTS project sponsors.

Two categories of tariffs are involved. The project sponsors will own and operate the various segments of the ANGTS, but will not buy or sell the gas transported through it. The shippers will buy the gas at the Prudhoe Bay Field, ship it through the sponsors' facilities, and sell it somewhere at the other end of the pipeline. The sponsors will have tariffs authorizing charges to the shippers. The shippers will in turn have tariff provisions authorizing charges to their customers for the sale of the gas, which charges will include in some form reimbursement of the shippers for the transportation charges paid by the shippers to the sponsors, as well as reimbursement for the costs of purchasing the Prudhoe Bay Field gas.

Thus, for example, if a shipper buys gas at Prudhoe Bay for sale in Detroit, the shipper would incur separate transportation charges billed by the respective sponsors of the Alaska segment, the Canadian segment, and the Northern Border segment of the system. That shipper would request

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a tariff authorizing "flow through" to its customers of the full amount of transportation charges paid to the sponsors of each of the three pipeline segments through which the gas was transported, as well as the full cost of the gas itself.

The "flow through" issue is often referred to as "tracking" of charges. Tracking of gas purchase costs is authorized by the Commission's regulations, through purchased gas adjustment clauses. (See 18 C.F.R. 154.38.) Tracking of transportation charges has been authorized in certain instances on a case by case basis.

In Order Nos. 31 and 31-B, 2/ the Commission approved in principle the tracking by ANGTS shippers of transportation charges billed by U. S. certificated ANGTS project sponsors (i.e., the sponsors of the Alaska, Northern Border and Western Leg segments), but reserved for later resolution the issue of tracking the charges of Foothills Pipe Lines (Yukon) Ltd. (Foothills), the sponsor of the Canadian segment. The unresolved tracking issues (including tracking of Foothills' charges that have been approved by the National Energy Board of Canada) are currently under study by the Commission's Alaskan Delegate, who is preparing a report to the Commission.

The sponsors' and shippers' initial tariffs are approved by the Commission pursuant to Section 7 of the Natural Gas Act upon issuance of the certificates. Alaskan Northwest's pro forma tariff was approved in Order Nos. 31 and 31-B. Section 7 provides a "public convenience and necessity" standard. While the Commission may establish initial rates that meet the more rigorous "just and reasonable" standard in Sections 4 and 5 of the Act, it is not required by law to do so. The Commission must only find that the initial rates are in the "public convenience and necessity" and may reserve for later determination what the "just and reasonable" rate should be.

2/ Order No. 31, "Order Setting Values for Incentive Rate of Return, Establishing Inflation Adjustment and Change in Scope Procedures, and Determining Applicable Tariff Provisions," issued June 8, 1979 in Docket No. RM78-12; Order No. 31-B on rehearing, issued September 6, 1979, in the same docket.

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Section 7(e) of the Natural Gas Act gives the Commission authority to attach conditions to certificates. The courts have construed broadly the Commission's responsibility under the Natural Gas Act to condition certificates with respect to rate terms and other matters affecting the public convenience and necessity. See, e.g., Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378 (1959); FPC v. Hunt, 376 U.S. 515 (1964). But see Panhandle Eastern Pipe Line Co. v. F.E.R.C., 613 F.2d 1120 (D.C. Cir. 1979), cert. denied, 101 S. Ct. 247 (1980).

Section 4 of the Act requires that all rates and charges be "just and reasonable." After certification, all changes in the initially approved tariffs and rates must be filed with the Commission pursuant to Section 4. The Commission, pursuant to prescribed standards and procedures, may "suspend" such changes for up to five months pending a hearing. If the changes are suspended, the prior approved tariffs and rates remain in effect during the period of suspension. The changes may take effect after the suspension period but subject to refund (with interest) depending on the outcome of the hearing process on contested issues or other disposition by the Commission.

Section 5(a) of the Act authorizes the Commission to institute a proceeding on its own initiative, to consider the justness and reasonableness of a certificate holder's rates and tariffs, and to determine new rates or tariff provisions if the existing ones are determined to be "unjust, unreasonable, unduly discriminatory, or preferential." Such changes can only be prospective; in a Section 5 proceeding the Commission cannot suspend rates or order refunds.

Section 16 of the Natural Gas Act authorizes the Commission to modify or rescind its orders after they have been issued. This authority, under appropriate circumstances, may be utilized for a variety of purposes, ranging from correction of mistakes to modification of certificate terms and conditions in light of changed circumstances.

2. Nature of the Financing

The subject waiver is sought from Congress by the project sponsors of ANGTS in connection with the financing of the project. The financing mechanism selected by the sponsors

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has been referred to as "project financing." The propriety of project financing has been addressed by the Commission on a number of occasions, most recently in Ozark Gas Transmission System, FERC Opinion No. 125, Docket No. CP78-532 (July 28, 1981). In that opinion, the Commission described project financing generally as follows:

Project financing differs from conventional financing mainly in connection with loan security. Security generally takes one of two forms in a conventional financing. First, the project sponsor, or borrower, has sufficient unencumbered assets that the lender feels secure in making a loan on the basis of the borrower's general credit. The loan agreement, in such cases, may require any of a number of different undertakings on the part of the borrower to maintain his creditworthiness. Secondly, if the borrower does not have unencumbered assets sufficient to secure the borrowing, the lender may require the pledge of specific assets to be funded by the borrowing as collateral for the loan. As Judge Litt pointed out in his initial decision on the Alaskan Natural Gas Transportation System, this is itself a kind of project financing. In this case the lender is secure in the knowledge that the borrower has put enough money into the project that the economic value of the project, less equity and liquidation costs, will yield sufficient funds for the lender to recover the principal value of the loan and accrued interest. A convenient example of this kind of financing is the mortgage of a building.

A project financing, as it has come to be known in energy projects before the Commission, is a financing in which the general creditworthiness of the borrower is either insufficient or allegedly unavailable to secure the borrowing, and the underlying economic value of the assets to be financed are also insufficient to assure the lender that he will not lose his money. The latter inadequacy will presumptively obtain in the case of any pipeline financing, since the salvage value of the pipeline to be built should, in all cases,

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be less than the loan obligation. ^{21/} In this case, an optional financing vehicle is the stream of income to be generated by the project. However, that vehicle is only available in the event that the income stream can be assured whether or not the project should fail. Such assurance is sought in this case in the form of the so-called minimum bill. The minimum bill has been structured in a fashion which will yield sufficient revenues to cover debt service (both principal and interest payments), whether the project is successful or not. In the event the project were to fail, the minimum bill would be levied on the customers of the shippers in the form of a surcharge for gas they do not receive.

^{21/} In this regard Ozark's witness, Gary, states, 'Today we all recognize a mortgage on a pipeline is virtually worthless, except for one aspect, in making a legal investment.' Tr. 12/1064

Slip opinion, at 10-11 (footnotes omitted in part).

As the Commission pointed out in the Ozark case, substantial policy justification should be found in certificate applications before the Commission pursuant to which project financing is sought. In the case of the ANGTS, such justifications have already been considered by both the Executive and Legislative Branches of the Federal Government, as well as the Commission, and have been found sufficient to permit the project financing of the ANGTS. ^{3/}

Some of the justifications have included the substantial amount of natural gas to be delivered by the project, the potential for displacement of large quantities of foreign oil, reduction of pressure on the U. S. balance of payments, net national benefits to both the U. S. and Canada, and the anticipated average cost of gas over the project life.

^{3/} See, generally, Federal Power Commission, Recommendation to the President, Alaska Natural Gas Transportation Systems (May 1, 1977).

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3. Reason for the Proposed Waiver

The waiver has a rather singular purpose. It is intended to assure lenders for the project that the income stream which serves as security for their loans will not be reduced below the level necessary to retire the principal of the loan and to pay the interest thereon. It would accomplish this purpose by precluding the Commission from changing the rules of the game, so to speak, in a manner which would undercut the security for the loan. This objective would be achieved by withdrawing from the Commission its authority under the Natural Gas Act to change the project tariffs in such a manner as to reduce project revenues below the level necessary to service project debt. The request for the waiver evidences that certainty of the security is essential, i.e., in this instance that the lenders will rely heavily and to their detriment on the orders of the Commission granting the certificate and establishing the tariffs as preconditions to the sponsors' take down of the construction loans.

All of the foregoing has been explicitly recognized by the Commission in FERC Order No. 31. 4/ In that order the Commission stated:

The project sponsors have earnestly sought that this Order, especially as it relates to the tariff structure, provide assurance to prospective equity investors and lenders. The concern of the sponsors is wellfounded. The Commission fully recognizes that equity investors and lenders will make critical decisions respecting the financing of the construction of ANGTS in reliance on this Order.

The Commission has articulated in great detail its rationale for this Order. Where reasoned alternatives were available, we have provided a thorough analysis of the issues and the basis for our conclusions. This thoroughness provides the investor's best security in relying on this Order.

4/ Supra, note 2, at 4 (mimeo).

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The fact of the request for a waiver suggests that the project sponsors and the lenders feel that they need greater assurance than has been provided to date. The Chairman and I feel compelled to agree with that assessment. As the subsequent discussion and legal analysis shows, with the objective of "security" in mind, a waiver is clearly a far better assurance than an order of the Commission. For example, previous efforts by sponsors to secure additional certainty for lenders by attempting to obtain estoppel findings in Commission orders have been unsuccessful. 5/

5/ Applicants in the Great Plains case asked the Commission to make a very explicit estoppel case against itself by including certain statements in its order. Great Plains Gasification Associates, et al., PERC Opinion No. 69 (November 21, 1979) (reversed on other grounds, Office of Consumers' Counsel v. F.E.R.C., F.2d ____ (D.C. Cir. 1980), Case No. 80-1303, decided December 8, 1980). The estoppel option will be discussed in the text, infra. In its initial brief to the Presiding Administrative Law Judge, Great Plains claimed the following:

"... The lenders have indicated that they will require that the authorizations obtained [from the Commission] by the project companies contain [as a condition to take down of the loan for the project]:

(1) A statement of the Commission's intention not to revoke or modify the tariff provisions approved by it for this project during the term of the bank loan;

(2) A statement of the Commission's understanding that the lenders would not commit funds for this project without assurances that these provisions would continue in effect without modification during the term of the bank loan;

(3) A statement of the Commission's intent to suspend the application as to this project of any future rule, order, or decision of general applicability which might affect the approved tariff provisions until after the conclusion of a full evidentiary hearing to determine the propriety and

(Footnote 5 continued on next page)

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Important in the context of ANGTS financing is that a waiver would provide clear assurances and signals to foreign, as well as domestic, lenders. We are advised that a sizeable portion of the borrowing must be acquired from foreign investors because of legal lending limits and other institutional obstacles faced by domestic lenders.

4. Regulatory Risk

The regulatory risk perceived by lenders consists of two separate, but not unrelated, sets of events. They are: (1) that the Commission would change the tariffs initially approved on a claim of changed circumstances, and (2) that a subsequent Commission, composed of a majority with a different view of the public interest than the collective view of the Commission originally approving the tariffs, would change the tariffs to the detriment of the lenders in order to reflect their different views. The Commission's ability to change the tariffs in either of these events is not clear as a matter of law. It is not unlimited, but our analysis indicates that it is fairly broad. The effect of the proposed waiver would be to eliminate in material part the Commission's options -- to the extent they exist -- to change the tariffs in either of these cases.

5/ Footnote continued from prior page

lawfulness of such Commission action as it affects the tariff provisions on which the financing is based" Initial Brief of Great Plains Gasification Associates and the Customer Pipeline Companies, Docket Nos. CP78-391, et al., January 29, 1979, at 70-71.

Five other admissions were sought from the Commission, but those quoted are exemplary of what the lenders sought. Both the law judge and the Commission refused to provide them. See Opinion No. 69, at 63.

Similar estoppel findings were requested by the ANGTS sponsors in the proceeding that culminated in Order No. 31; however, they were refused in favor of the language quote at page 10, supra. As discussed hereafter, it is questionable whether such findings would achieve the desired or intended result.

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5. Constitutional Question

Implicit in the questions articulated in your letter is the issue of whether the waiver is a reasonably necessary mechanism to provide the lenders with the certainty they seek. The threshold issue, in this respect, is whether there is any constitutional bar to the Commission taking the kind of action described in the subsequent paragraphs. If such a bar exists, the waiver would not be necessary. Our research indicates that this question has not been authoritatively answered by the courts. That is, there are no clear constitutional limits regarding the Commission's power to change tariffs, where parties have substantially changed position in reliance on such tariffs, and the Commission had prior, actual knowledge of such reliance. The Chairman and I believe that a respectable case could be made that it would violate basic constitutional principles of due process for the Commission to change tariffs not explicitly conditioned to permit change, when the Commission is fully aware that the tariffs form the basis of project financing, and the changes will in one way or another undercut that basis. However, there is an absence of authority to support such a proposition. 6/

6/ The question whether legislative or quasi-legislative action with retroactive effect works to deprive an owner of property without due process is somewhat analogous. Unfortunately, there are no clear principles, and the cases go both ways. See generally, text and cases collected in Cong. Research Service of Library of Congress, The Constitution of the United States of America: Analysis and Interpretation (1972), at 1165, et seq.

A case strongly suggestive that the principles of estoppel do not apply to federal agencies is Federal Crop Insurance Corp. v. Merrill, 332 U.S. 380 (1947). In that case, certain farmers were assured by a local agent of the federal corporation that a certain type of crop could be insured. In fact, rules of the corporation provided that such crops could not be insured, although neither the agent nor the farmers had actual knowledge of the regulations. Relying on the agent's advice, the crops were planted and subsequently destroyed.

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In holding that the farmers could not collect insurance for the crops despite the payment of premiums therefor and the inducement of the local agent's assurances, the Court indicated that knowledge of the rules contrary to the agent's advice would be imputed to the farmers because the rules were published in the Federal Register. Despite the difference of the facts in the Merrill case (farmers had relied on apparent rather than actual authority), the Court used strong language to suggest in dicta that the government corporation would be treated as an agency of the United States and would be immune from doctrines like estoppel. Id. at 384-85.

These dicta have led one commentator to take the following position:

Merrill indicates that estoppel will not be used to protect an individual who has changed his position in reliance on administrative advice: 'It is settled law that no estoppel can arise against the government.' [Citing, Chapman v. Santa Fe Pac. R., 198 F.2d 498, 519 (D.C. Cir. 1951) (dissenting opinion), cert. denied, 343 U.S. 964 (1952).] B. Schwartz, Administrative Law (1976), at 133, et seq.

Professor Schwartz agrees with the Merrill-type result when the agency has acted in excess of its statutory authority. However, he goes on to say:

. . . Both reason and policy argue that prejudicial reliance warrants invoking the doctrine of estoppel against the government in other cases: 'when the sovereign becomes an actor in a court of justice, its rights must be determined upon those fixed principles of justice which govern between man and man in like situations.' Id., at 135 (footnote omitted), citing Ritter v. United States, 28 F.2d 265, 267 (3d Cir. 1928).

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The following cases support Professor Schwartz's policy proposal: Brandt v. Hickel, 427 F.2d 53, 56-57 (9th Cir. 1970); Chapman v. El Paso Natural Gas Co., 204 F.2d 46, 53-54 (D.C. Cir. 1953); United States v. Lazy FC Ranch, 481 F.2d 985, 988-989 (9th Cir. 1973); Oil Shale Corp. v. Morton, 370 F. Supp. 108, 124-127 (D. Colo. 1973).

The decision in the Lazy FC Ranch case, supra, indicates that a line of federal estoppel cases may be emerging, and that such is required by elementary notions of fairness. 481 F.2d at 989. The Chairman advises that his view is consistent with that of Professor Schwartz and the Court in Lazy FC Ranch. However, absent an authoritative pronouncement on the matter by the United States Supreme Court, or specific federal legislation, I cannot render an opinion as General Counsel of the Commission that the Commission would in all or substantially all cases be estopped by its orders from changing the ANGTS tariffs in such manner as to impair the underlying security for the financing of the ANGTS. In my judgment, the best opinion that could be rendered would simply agree that the Commission is constitutionally prohibited from setting a confiscatory rate of return. As stated by the Supreme Court in Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 690 (1923):

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.

See also, F.P.C. v. Hope Natural Gas Co.; 320 U.S. 591, 603 (1943). As the subsequent discussion reveals, short

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6. Statutory Question

The foregoing is not to suggest that there are no Supreme Court cases dealing with regulatory estoppel. To the contrary, there are two cases of considerable relevance; however, both are based on interpretations of the enabling legislation of other agencies. In the first of these, United States v. Seatrain Lines, 329 U.S. 424 (1946), the Court held that the Interstate Commerce Commission lacked the authority to alter the certificate of a water carrier on its own motion. The holding was based on the express statutory language which permitted such action with respect to motor carriers, and the absence of correlative statutory authority in the case of water carriers, in the Interstate Commerce Act.

6/ Footnote continued from prior page

of this constitutional limitation, the Commission has considerable latitude in the exercise of its jurisdiction under Sections 4, 5, 7 and 16 of the Natural Gas Act.

The fact that the lenders have induced the project sponsors to ask for the waiver may well indicate that an unqualified legal opinion cannot be obtained from lenders' counsel to the effect that a constitutional bar exists to provide an estoppel defense. A similar conclusion may be deduced from the request for estoppel admissions in the Great Plains case, supra, note 5.

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In Civil Aeronautics Board v. Delta Air Lines, Inc., 367 U.S. 316 (1961), the Supreme Court considered a similar question. The Court determined that Section 401(g) of the Federal Aviation Act prohibited the CAB from altering a certificate of public convenience and necessity, even where the certificating order purported to reserve jurisdiction prior to certification to make summary modifications pursuant to petitions for reconsideration. Reaching this result, the Court's analysis was founded on the plain meaning of the language in the enabling statute and its legislative history.

The Delta case is of particular importance to the subject of this memorandum for two reasons. First, the Court clearly explained the nature of the problem with the following statement:

Whenever a question concerning administrative, or judicial, reconsideration arises, two opposing policies immediately demand recognition: the desirability of finality, on the one hand, and the public interest in reaching what, ultimately, appears to be the right result on the other [footnote omitted]. Since these policies are in tension, it is necessary to reach a compromise in each case Id. at 321.

The second key element of the Delta case is the recognition by the Court that the limitations placed on the CAB under the Federal Aviation Act resulted from Congressional concern during the passage of its predecessor, the Civil Aeronautics Act of 1938, over the reliance on, and consequent expenditure by airlines of large sums of money on the basis of the CAB's certificate (route) decisions. In this connection, the Court stated:

In short, our conclusion is that Congress wanted certificated carriers to enjoy 'security of route' so that they might invest the considerable sums required to support their operations; and, to this end, Congress provided certain minimum protections before a certificated operation could be cancelled. We do not think it too much to ask that the Board furnish these minimum protections as a matter of course, whether or not the Board in a given case might think them meaningless. It

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might be added that some authorities have felt strongly enough about the practical significance of these protections to suggest that their presence may be required by the Fifth Amendment. See Seatrain Lines v. United States, 64 F. Supp. 156, 161; Handlon v. Town of Belleville, 4 N.J. 99, 71 A. 2d 624; see also 63 Harv. L. Rev. 1437, 1439. Id., at 331-332.

7. The Natural Gas Act

The Seatrain and Delta cases teach that the starting point in determining the practical necessity of the waiver as a security device is the language of the relevant enabling statute, the Natural Gas Act. Sections 4 and 7 are relevant, but the key provisions are Sections 5(a) and 16. Section 16 reads in pertinent part:

The Commission shall have power to ... prescribe, issue, make, amend, and rescind such orders, rules or regulations as it may find necessary or appropriate to carry out the provisions of this act.

Section 5(a) provides, in pertinent part, that if the Commission:

... [S]hall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, or classification rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. [emphasis supplied]

These statutory pronouncements are mandatory as opposed to precatory. The broad language of Section 16, when employed in conjunction with Section 5, has permitted the Commission to alter and amend conditions to certificated service with full approval by the

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courts. Section 5(a) has been interpreted as giving the Commission authority to alter the terms and conditions of certificated service even though the affected parties, acting alone, could not have changed them. F.P.C. v. Louisiana Power and Light Co., 406 U.S. 621, 646-647 (1972). In Opinion No. 754-A, Docket No. RP71-119, issued August 17, 1976, aff'd on other grounds, Hercules, Inc. v. F.P.C., 559 F.2d 1208 (3rd Cir. 1977), the F.P.C. concluded, with court approval, that it could exercise its Section 5 authority to promulgate new terms and conditions attached to certificates authorizing initial service.

The combined effect of Sections 5(a) and 16 is to require the Commission to amend terms and conditions of a certificate if those terms and conditions prescribe tariff provisions subsequently found to result in rates or charges which are not just and reasonable. As the United States Court of Appeals for the District of Columbia Circuit stated in American Smelting and Refining Company v. F.P.C., 494 F.2d 925, 940-941 (1974), cert. denied sub nom., Southern California Gas Co., et al., v. F.P.C., 419 U.S. 882 (1974), once the Commission finds that an existing rate or charge is unjust or discriminatory, 7/ it "must prescribe the remedy for that condition." 8/ If the existing illegal rate or charge is the result of the operation of a certificate condition, the remedy clearly will lie in the revocation or alteration of the order prescribing that condition, and thus the certificate itself.

7/ The Commission's authority to find that a tariff (previously determined to be just and reasonable) no longer functions in a reasonable manner has been upheld by the U.S. Court of Appeals for the District of Columbia Circuit in Pacific Gas Transmission Co. v. F.P.C., 536 F.2d 393 (1976).

8/ The D.C. Circuit has also taken this position in Pacific Gas Transmission Co. v. F.P.C., supra., where it stated at page 396 that "[a]fter such a finding, the Commission had not only the power but a solemn duty to take immediate action."

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Furthermore, the unique nature of the Alaskan Northwest tariff provisions may subject them to amendment on another basis. Because they were developed in a rule-making, the provisions of Order No. 31 arguably are not the result of the Commission acting in a judicial capacity, but in a legislative one, formulating and applying policy. The distinction is important because where the Commission acts in the former capacity, applying law or policy to past facts, a decision on the merits as to a disputed, and litigated issue of fact becomes final. United States v. Utah Construction and Mining Co., 384 U.S. 354, 421-422 (1966); Davis, Administrative Law Treatise, §18.09 (1970 Supp.). In the latter case, the Commission is free to take appropriate steps without being bound by its prior actions. Permian Basin Area Rates Cases, 390 U.S. 747, 789 (1968); Public Service Commission, State of New York v. F.P.C., 511 F.2d 338, 353 (D.C. Cir. 1975). The policy determination in this case has been that the public convenience and necessity required the assurances to investors in the ANGTS provided for by the tariff provisions of Order No. 31. Arguably, the Commission has determined that as a matter of policy, at least under present circumstances, a tariff designed to meet the conditions of Order No. 31 will be just and reasonable. The same reasoning might also apply to the shipper tracking provisions in the event that such provisions are adopted by the Commission through rule-making procedures. Although it is questionable whether the rulemaking-adjudication distinction would be given great weight in the context of the facts at hand, it might be enough to convince a future Commission that it could, within the law, conclude that a different policy determination better serves the public interest.

From the foregoing it is clear that there is a plausible case for Commission authority to subsequently alter the tariff conditions of Alaskan Northwest's certificate, relying on Sections 16 and 5(a) of the Natural Gas Act and judicial pronouncements authorizing agencies to make changes in policy. The foundation for that case is the general principle that a policy determination made by a present Commission cannot preclude a future Commission from making a policy determination to the contrary, provided that in doing so it adequately explains the reasons for its new position, Consolidated Gas Supply Corp. v. F.P.C., 520 F.2d 1176 (D.C. Cir. 1975), whether or not there has been a change of circum-

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stances. Greater Boston Television Corp. v. F.P.C., 444 F.2d 852 (D.C. Cir. 1970). A corollary to that principle is that a present Commission cannot bind a future Commission so as to preclude the prospective operation of Section 5. Optional Procedure for Certifying New Producer Sales of Natural Gas, 48 F.P.C. 218, 223 (1972); Pacific Gas Transmission Co. v. F.P.C., supra. These rules are analogous to those applicable to the legislature: namely, this Congress cannot preclude legislation, or amendments to legislation, by the next Congress.

8. Reasonableness of the Waiver Request

This line of analysis suggests several important conclusions, which bear ultimately on the recommendation of this memorandum. First, the presence or absence of a constitutional ban to the impairment by this or a future Commission of the tariffs upon which the lenders will rely is unclear. Second, there appears to be no statutory bar, such as was found to exist in the Seatrain and Delta cases, which would preclude the Commission from changing the tariffs. Even though it is clear that commentators, the Courts, at least by way of dictum, and the past and probably current Commissions accept the principle that elementary notions of justice should allow the project lenders to rely in good faith on the decisions of the Commission in making their loans, the request of the project sponsors indicating their "desires . . . to have these provisions waived" appears to be based on a concern as to the certainty of the federal estoppel doctrine under the Natural Gas Act. The questions that remain are those that are directly raised by your letter. They ask in essence whether there are either historical or predictable future facts which support or impugn the legislative request. That is, assuming that the waiver request is not patently unreasonable, is there a historical legal perspective from which the Congress could judge the future and find sound public reasons to grant or deny the waiver.

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9. Past Commission Actions

For the moment I will defer to subsequent paragraphs the question of "the full implications of the waiver" and turn to your second specific question: whether there have been past Commission actions which justify the desires of the sponsors to have the subject sections of the Natural Gas Act waived. In this connection, the following contains a summary of recent cases, representative of past Commission actions, which involved issues of claimed detrimental reliance. Having done so I will leave it to the Subcommittee to conclude from these decisions whether or not the project sponsors' request is justified.

A. Jurisdiction: Distrigas Corporation, et al. v. F.P.C., et al., 495 F.2d 1057 (D.C. Cir. 1974), cert. denied, 419 U.S. 834 (1974).

This proceeding involved, in pertinent part, a filing by Distrigas Corporation and its affiliates, Distrigas of New York Corporation and Distrigas of Massachusetts, (Distrigas) which requested the Federal Power Commission to grant Distrigas the authority under Section 3 of the Natural Gas Act to import liquefied natural gas (LNG) from Algeria. 9/ The filing also contained a request by Distrigas for the FPC to issue a disclaimer of the Commission's jurisdiction under Section 7 of the Natural Gas Act. 10/

9/ Following regasification, more than 80 percent of the gas was to be sold in the state of importation to distributors and direct customers and the remainder to distributors in neighboring states.

10/ The imported LNG was to be delivered and regasified at facilities at Staten Island, New York and Everett, Massachusetts.

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The Commission in a three to two vote granted the requested Section 3 authorization without condition but, noting that this was a novel situation, reserved the right to add conditions in the future if circumstances should change. The Commission noted that Section 3 of the Natural Gas Act specifically provided for such future amendments. However, the Commission did not find Section 7 jurisdiction over the regasification facilities and service nor over the facilities and services involved in the sale of the regasified LNG in the state of importation. 11/ The result of the decision was that there was no jurisdiction under Section 7 or Section 3 (by way of conditions to the import authorization) over the regasification facilities and service nor over the intrastate facilities and service. The Commission indicated its hope that this disclaimer of jurisdiction would make the project more attractive to private investors and "lead to more gas at a lower price to the consumer than if [the Commission] controlled every detail and decision related thereto." Two Commissioners dissented, arguing that the Commission should take jurisdiction under Sections 3 and 7 of the Natural Gas Act over the regasification facilities and the "intrastate" facilities.

Following the Commission's decision, Distrigas "assertedly in reliance on the Commission's limited jurisdictional disclaimer, . . . proceeded to construction of its Everett and Staten Island facilities, expending very substantial sums on each." In a new filing, Distrigas also applied for Section 3 authorization to import significant additional quantities of natural gas and for Section 7 authorization to sell these additional volumes, as well as certain of the originally authorized volumes, in interstate commerce.

11/ The Commission did take jurisdiction under Section 7 of the Natural Gas Act over the sales of gas which was ultimately destined for resale in interstate commerce. However, it found that jurisdiction over such sales attached only at the tailgate of the regasification plant.

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Meanwhile, at the Commission two of the original three person majority had left and had not been replaced. Therefore, the two dissenting Commissioners were now a majority. In response to Distrigas' applications, they found that circumstances had changed since Distrigas' original application had been acted upon by the Commission. Specifically, they stated that the original Distrigas application proposed new and increased sales for resale in interstate commerce. Therefore, the Commission held that Section 7 certification was mandated for all of Distrigas' facilities.

On appeal, Distrigas argued, among other things, that once the Commission's previous decision on the jurisdictional issue was final and Distrigas had subsequently acted in reliance on that decision by (1) contracting with its customers and (2) constructing its facilities, the Commission was foreclosed from changing its mind and asserting jurisdiction where it had previously declined to do so. Distrigas cited the Seatrain case, 12/ where the Supreme Court had overturned the Interstate Commerce Commission's attempt to revoke a certificate previously granted to a water carrier.

The Court found that the Commission had the authority to issue the order it had issued under Section 3 of the Natural Gas Act but remanded for additional proceedings before imposition of any requirements to certification under Section 7. The Court distinguished Seatrain on the basis of lack of statutory authority in that case, and noted that both Section 3 of the Natural Gas Act as well as the Commission's previous order specifically contemplated changes and amendments. The Court further found that if Distrigas had relied on an interpretation of the original Commission order to the contrary (i.e., that the original Commission order granted Distrigas a permanent immunity from regulation), Distrigas' reliance was misplaced.

12/ Supra, at 15.

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As part of its basis for rejecting the estoppel argument, the Court concluded that Distrigas' claim of injury was at that point hypothetical in nature since Distrigas had not demonstrated that the Commission would not ultimately authorize Distrigas' proposal.

On remand, the Commission granted Distrigas' application subject to certain conditions.

The Distrigas case is one where the Court approved a changed Commission's reversal of a previous Commission's ruling upon which the company and its lenders had arguably relied to their detriment. As a basis for that approval the Court stated, "any 'right' to non-regulation that the Commission's previous decision can be supposed to have vested in Distrigas was entirely contingent on the Commission's continuing to view such non-regulation as in the public interest." However, two facts tend to distinguish Distrigas from the ANGTS. One is the conditions cited by the Court in the original Section 3 authorization, which arguably placed Distrigas and its lenders on notice that the rule could change. The other distinguishing fact was that the Court found that the Commission's decision had not yet injured Distrigas and that it might not in the future. Presumptively, the matter was resolved at the Commission level in a way which did not adversely affect Distrigas or its lenders. Nonetheless, one could conclude that the uncertainty caused by the Commission's reversal is the type of action the ANGTS lenders seek to protect themselves against.

B. Cost of Service Tariff: Pacific Gas Transmission Co. v. F.P.C., et al., 536 F.2d 393 (D.C. Cir. 1976), cert. denied, 429 U.S. 999 (1976).

This case involved a Commission order which, pursuant to Section 5(a) of the Natural Gas Act, changed in

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part Pacific Gas Transmission Company's (PGT) cost-of-service tariff after a full hearing. Prior to the Commission decision, PGT had been permitted to adjust its rates automatically on a monthly basis to reflect all changes in its costs, including amounts for gas purchased from Canadian producers for resale in the United States. This tariff had been in effect since PGT was first authorized to import gas from Canada in 1960. 13/

In 1974 and 1975, after a hearing under Section 5(a) of the Natural Gas Act, the Commission modified PGT's cost-of-service tariff to provide that changes in the cost of gas purchased by PGT from Canadian suppliers could be passed on to PGT's customers only after PGT had applied for the rate increase pursuant to Section 4 of the Natural Gas Act, and after any suspension period imposed by the Commission thereunder. The Commission revised the tariff to provide that such filings would be subject to suspension by the Commission pursuant to Section 4 of the Natural Gas Act and, if suspended, subject to refund and possible reduction as provided in Section 4 of the Natural Gas Act. The Commission justified the revised tariff by stating that Canadian authorities had recently begun to require that significantly increased prices be charged for Canadian gas sold for resale in the United States. Furthermore, Canadian authorities had changed their pricing policy by referencing it to prices for alternate energy sources (primarily oil products) in markets served by Canadian gas. This formula change signaled further significant increases in the cost of gas purchased by PGT from Canadian producers (as much as four times higher than prior to the Section 5 proceeding). The Commission found that these changed circumstances rendered PGT's existing tariff "unjust and unreasonable" and required prior Commission review of rate increases for Canadian gas before they could be passed on to consumers in the United States.

13/ See Pacific Gas Transmission Company, 24 FPC 134 (1960).

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On appeal, PGT argued in part that the Commission-ordered modification of its tariff could result in delay or outright denial of its recovery of increased Canadian purchased gas costs which, in turn, would financially destroy PGT. PGT also argued that the Commission was without power to modify the cost-of-service tariff which a previous Commission had approved in 1960 when PGT was originally authorized to commence the importation of Canadian natural gas.

The Court denied all of PGT's claims and affirmed the Commission order and its action revising the tariff under Section 5(a). In support of its holding, the majority noted that the Commission had granted prompt authorization under Section 4 for Canadian gas rate increases which took effect after the disputed tariff change. The majority opinion indicated that failure of the Commission to include such increases might well be to "abdicate" its responsibilities under Section 4. However, Judge Bazelon in a dissenting opinion directed considerable criticism towards the Commission for injecting uncertainty into PGT's financial position. As the dissent stated: ". . . the FPC concedes that had PGT been required to absorb even the initial 32 cent price increase for a short period of time it would have been driven out of business, and 2,000,000 consumers would have been deprived of 40% of their gas supply." (536 F.2d at 397.)

- C. Advance Payments (30 day rule): Tennessee Gas Pipeline Co., et al. v. F.E.R.C., et al., 606 F.2d 1094 (D.C. Cir. 1979), cert. denied, 447 U.S. 922 (1980); Natural Gas Pipeline Co. v. F.E.R.C., 590 F.2d 664 (7th Cir. 1979); United Gas Pipe Line Co. v. F.E.R.C., 597 F.2d 581 (5th Cir. 1979); Trunkline Gas Co. v. F.E.R.C., 608 F.2d 582 (5th Cir. 1979).

These cases involve interstate natural gas pipelines which, pursuant to a series of Commission rulemakings, including most notably Order Nos. 465 and 499, made interest-free loans (advance payments) to natural gas

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producers as exploration and development investments which were to be repaid by future delivery of gas. Pursuant to these Commission Orders the pipelines were allowed to include such advances in their rate bases, for rate of return purposes, as exploration and development investments. This policy was advanced by the Commission as an incentive for the addition of gas supplies. The Commission's rulemaking orders spelled out in detail the requirements for inclusion of advance payments in Account 166. However, insofar as the "timing" of the expenditures by the producers versus the date of the pipelines investment, the Commission was silent, except to the extent the orders stated that amounts included in Account 166 could receive favorable rate base treatment where they were found to be "reasonable and appropriate." Subsequent to these Orders, pipelines invested at least \$5.5 billion in "advance payments" with producers. However, after these investments had been made, the Commission, acting under FPC Order No. 465, pursuant to the "reasonable and appropriate" language, disallowed rate base treatment for certain advances because they were made to the producers and included in the pipelines' rates more than "thirty days" before they were spent by the producers. As a result large amounts of advance payments were retroactively disallowed on a deferral basis for inclusion in pipeline companies' rate bases.

On appeal to three different Circuit Courts, the pipelines claimed serious injury and voiced loud complaints that the general language of Order Nos. 465 and 499 had offered no notice of the new specific timing rule imposed by the Commission. As acknowledged by the D.C. Circuit Court, ". . . substantial sums were involved and deferral has resulted in considerable losses for the pipelines' stockholders." (606 F.2d at 1108.)

The pipelines argued that, at the invitation of the Commission rulemaking orders, pipelines were encouraged to make advance payments to promote exploration and development of natural gas reserves for the interstate market. Pursuant to those orders, the pipelines argued, they had invested substantial sums of money in the advance payment program. Thus, they argued that it was unfair and illegal for the Com-

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mission, pursuant to the reasonable and appropriate standard, to establish in individual pipeline rate cases decided after the rulemaking orders had issued and after the advance payments contracts had been executed, that rate base treatment of advance payments would not be allowed more than thirty days in advance of when they were spent by the producers.

The three separate circuit courts reversed the Commission orders decided on this basis. However, the D.C. Circuit in Tennessee rejected the pipelines' claims of retroactive ratemaking and detrimental reliance and directed the Commission on remand to develop a timing relationship supported by substantial evidence. The Fifth Circuit in the United and Trunkline cases and the Seventh Circuit in the Natural case found that it was impermissible retroactive ratemaking to impose a timing requirement on Order No. 465 advances and that the pipelines had relied to their detriment on the absence of a timing requirement in the Order when they made advances to producers. Therefore, they reversed the Commission decision on the Order No. 465 advances and directed inclusion of the designated amounts in the respective pipelines' rate bases. Since Order No. 499 contained at least an ambiguously general reference to a timing relationship, those portions of the Commission decision were remanded because of a lack of substantial evidence supporting that portion of the Commission orders. Although the Commission was reversed in these cases, language from the Court's opinion in Tennessee is illustrative of the "regulatory risk" inherent to an industry subject to the Commission's jurisdiction.

We find that petitioners' arguments in support of their interpretation (of estoppel facts) are undercut by consideration of the character of the advance payment program as an experimental departure from well accepted and understood regulatory law. (606 F.2d at 1108.)

* * *

One of the risks incurred by the pipelines has been the 'regulatory risk' that an experimental program such as advance payments might miscarry, and that administrative readjustment would not prevent substantial adverse impact. (606 F.2d at 1120.)

D. Dedication of Gas Reserves: Air Products & Chemicals, Inc. v. F.E.R.C., F.2d (5th Cir. 1981), Case No. 78-2011, decided July 16, 1981.

This case involves a Commission order which ended a prior Commission policy under the "Chandeleur incentive doctrine" (of approximately seven years duration) which allowed offshore natural gas producers to reserve for their own use a portion of gas reserves which otherwise would have been dedicated to the interstate market. The prior policy had allowed these reservations as an incentive to producers to expedite the exploration and development of offshore reserves of natural gas. The Commission, in its final order, found that the reservation incentive was no longer needed because, among other things, the interstate market was suffering severe curtailments and thus the gas which would be reserved by the producers was needed to serve the interstate market.

On appeal the producers argued, among other things, that they relied to their detriment on the prior FPC policy allowing reservations and that it was unfair and illegal for the Commission to reverse its policy in an adjudicated case instead of a rulemaking proceeding to be applied prospectively.

The Court remanded the case to the Commission because of the improper way in which the Commission relied on extra-record evidence to support its decision, but it rejected the producers' arguments of detrimental reliance on the prior Commission policy. The Court noted that the old Commission policy was continually attacked by consumer groups in various cases and that it was, at its inception, described by the FPC as experimental. In sum, the Court found that the policy was

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never "well established" enough to have caused detrimental reliance thereon by producers or anyone else. The Court noted further that the producers were not precluded from selling the gas in interstate commerce for a fair price but rather were prohibited from reserving the gas for their own use.

E. Unsuccessful Project Costs: Tennessee, et al. v. F.E.R.C., 606 F.2d 1094 (D.C. Cir. 1979), cert. denied, 447 U.S. 922 (1980).

This proceeding involved, among other things, an attempt by Transcontinental Gas Pipe Line Corporation (Transco) to recover costs associated with four unsuccessful projects related to the production of synthetic natural gas (SNG). The Commission denied recovery of these costs because they were not "used and useful" in providing service and could not be charged to rate-payers. 14/

On appeal, Transco argued that it had spent \$22 million on these ultimately unsuccessful projects in purported reliance on a Commission policy allowing recovery of the costs of the projects if they proved to be unsuccessful. The Court found that the Commission had no policy allowing recovery of these costs and then affirmed the Commission's decision.

14/ A possible concern of the lenders is that a dogmatic application of the "used and useful" maxim would result in similar treatment of the ANGTS if the project were to suspend operation after completion or, through no fault of the sponsors they were unable to commence operation after completion. The need for assurances to the contrary (the minimum bill) provides a major impetus for project financing as opposed to conventional financing.

Other cases in which the Commission is currently under criticism for assertedly changing policies to the detriment of jurisdictional companies include (i) applications for rehearing of Commission Opinion No. 90 15/ and Order No. 94, 16/ and (ii) the oil pipeline cases where revision of the ratemaking methodology formerly employed by the Interstate Commerce Commission is under consideration. 17/

However, these cases should not be taken as a suggestion that the Commission never accords finality to its orders. In Texaco, et al., Docket No. CI77-329, et al., 13 FERC ¶ 61,222 (1980), for instance, a United States Senator filed a pleading on July 21, 1980, seeking to reopen a case settled on February 10, 1978. Part of the Senator's argument was that changed circumstances justified reopening the case, but the Commission refused to grant the intervention and declined to disturb its earlier order.

Arguably, cases such as those described above represent a possible "justification" or reason why the sponsors have now sought the waiver from Congress. At the same time, however, these decisions and others of a similar nature have generated some sympathy in the courts and have begun to establish the proposition that estoppel is available as a defense against the government if the government's wrongful conduct threatens to work a serious injustice and if the public's interest would not be unduly damaged by the imposition of estoppel. Lazy FC Ranch, supra, 481 F.2d at 989. Nevertheless, because the estoppel doctrine has not been fully developed under the Natural Gas Act, it is fair to state that only a waiver would provide the lenders with the same sense of legal certainty that a firmly established "regulatory estoppel doctrine" would afford these investors. Whether this legal uncertainty "justifies" the requested waiver is a value judgment best left to Congress. With this in mind, it is appropriate to consider your questions as to hypothetical situations creating injury to project participants.

15/ 12 FERC ¶ 61,080 (1980).

16/ 12 FERC ¶ 61,080 (1980); FERC Statutes and Regulations, ¶ 30,178 (1980).

17/ Trans Alaska Pipeline System (TAPS) (Phase I), Docket Nos. OR78-1, et al.; Williams Pipe Line Company (Phase I), Docket Nos. OR79-1, et al.

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10. Hypothetical Injuries to Project Participants

Our analysis has produced four general sets of hypothetical circumstances which might induce a Commission response changing the tariff provisions related to the project, absent the waiver. They are:

- (1) a changed economic environment resulting in materially different costs of capital (i.e., interest rates and return on equity) from those extant at the time of initial approval;
- (2) changed amounts of natural gas available to be transported resulting in a materially different economic life for the transportation system;
- (3) changed economics of the gas to be delivered by the system, relative to other sources of energy supplies, warranting an altered revenue pattern in order to avoid more serious economic dislocations; and
- (4) premature project failure.

As a consequence of these general events, the following hypothetical Commission actions might take place:

(a) Upon a finding of changed circumstances the Commission could determine, pursuant to Sections 7 and 16 of the Natural Gas Act, that the cost-of-service tariff (which provides that Alaskan Northwest's rates will be adjusted twice a year by a formula that requires Alaskan Northwest to change its rates to reflect actual costs in its charges to shippers) was no longer appropriate. The Commission could then require Alaskan Northwest to charge a stated rate, such as a flat rate per MMBtu of natural gas transported, and require a filing pursuant to Section 4 of the Natural Gas Act to be made prior to the effectuation of any increase in that stated rate. The rate increase filing could be suspended for up to five months, and the proposed rates thereafter collected could be subject to possible reduction and refund with interest.

The risks to Alaskan Northwest in the event of a Commission-ordered change to a stated rate form of tariff involve the adverse economic impacts resulting from the regulatory lag attendant to putting into effect a proposed

rate increase under Section 4 of the Natural Gas Act. The regulatory lag consists of the sum of: (1) the time necessary to prepare a Section 4 rate filing plus (2) the one-month notice requirements between the time the filing is made and the earliest possible effective date (absent a waiver of the notice requirements) plus (3) a suspension period of up to 5 months beyond the proposed effective date. During the lag period, Alaskan Northwest sponsors would not be able to recover all of the costs previously covered by operation of the cost-of-service tariff.

As noted previously, the FPC modified in part the cost-of-service tariff of Pacific Gas Transmission Company to require Section 4 filings to recover increased Canadian purchased gas costs. However, the Court concluded that the result was justified inasmuch as the Commission had, pursuant to Section 4, allowed a "non-niggardly" flow-through by the company of increased gas costs, notwithstanding the dissent's concern that delay would have resulted in adverse consequences.

(b) Alternatively, the Commission could decide at a future time to leave the cost-of-service tariff intact but remove the minimum bill (which guarantees recovery of actual operation and maintenance expenses, actual current taxes and debt costs). 18/ The consequence of this action could

18/ The minimum bill provides for the recovery of actual operation and maintenance expenses, actual current taxes, and all amounts necessary to service debt including interest and scheduled retirement of debt. Under no circumstances would debt service be impaired.

Recovery of equity investment and return on equity investment is, however, treated differently. The "90 percent billing adjustment ratchet" reduces charges to eliminate return on equity investment and associated taxes for any service diminution below 90 percent of tendered gas. This tariff provision would be applicable in instances when the reduction in service for any one month was greater than 10 percent. The reduction in charges to reduce the return on equity and

(Footnote 18 continued on next page)

be that during periods of interruption exceeding thirty days Alaskan Northwest would bear all of the financial consequences of the interruption because it would not be able to charge the shippers for any costs incurred during the period of interruption. 19/

(c) Another hypothetical involves a situation wherein the ANGTS project fails some time after the date construction had commenced. Assume further that upon review of

18/ Footnote continued from prior page

associated taxes would be proportional to the percentage of volumes tendered but not transported. The pipeline would be permitted to recoup any such billing adjustments by transporting volumes in excess of the contract level in subsequent months. The charge for such "Billing Adjustment Gas" transportation would be computed by using the same billing adjustment (i.e., the same dollar per Dekatherm). Any service reduction below 100% but more than 90% would be accounted for as "No Billing Adjustment Gas." As such, this gas would be transported in subsequent months at no added charge to the shipper.

The "90 percent billing adjustment ratchet" also operates during periods of interruption of service. It ceases to be operative, however, for any period of total cessation of service for more than 30 days. Beginning with the thirty-first day of any total cessation of service, the portion of the charges attributable to "equity costs" would be collected subject to refund pending a showing by Alaskan Northwest that it should be permitted to retain equity costs collected during the period of cessation of service. Equity costs, in this context, are defined to be "that portion of depreciation expense not necessary for debt service and associated taxes." (Order No. 31, at 181-182.)

The above discussed ANGTS tariff provisions differ substantially from lower-48 pipeline tariff provisions in a number of important respects. It is fair to state that the ANGTS tariff contains unique, "first-of-a-kind", provisions which have not been previously granted by the Commission.

19/ This assumes that in eliminating the minimum bill the Commission would also eliminate the opportunity to collect equity costs subject to refund and to make a showing pursuant to the provisions described in note 18, supra.