

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

1060 SCOMM 28: JOINT GAS PIPELINE COMMITTEE. 1981-82

the circumstances surrounding the project failure, a future Commission decided, pursuant to Sections 5, 7 and 16 of the Natural Gas Act, to reverse a previous decision in principle to require consumers to pay all debt costs regardless of the circumstances once final certification had been granted and debt servicing obligations had commenced. Thus, the partners of Alaskan Northwest (including sponsor-shippers) would be required to absorb all Alaskan Northwest debt costs as well as other (such as equity) Alaskan Northwest costs. Such a Commission decision would have an immediate severe financial impact on Alaskan Northwest, with the degree of severity being a function of the financial health of its partners.

(d) The Commission could decide several years in the future, pursuant to Section 5 of the Natural Gas Act, to direct the shippers of the gas to remove from their respective tariffs the rate adjustment (tracking) provisions which permit the shippers to flow through increases in transportation costs without the necessity of making a full filing under Section 4 of the Natural Gas Act (reflecting all current costs and revenues, not merely the increased costs of transportation). 20/ In these

20/ While the Commission has decided in principle to allow the shippers to track in a timely manner amounts reflecting transportation costs paid to the ANGTS sponsors under tariffs approved by the Commission, the Commission has not yet decided what kind of tracking of these costs by the shippers would be permitted. For example, the tracking provision could require a periodic rate filing under Section 4 reflecting only the change in transportation cost, similar to the shipper's current purchased gas cost adjustment clauses. Or the provision could permit the shippers to adjust their rates automatically on a simultaneous basis to reflect changes in ANGTS transportation costs. Such a provision would be similar to fuel cost adjustment clauses permitted in rate schedules and tariffs of electric utilities for transactions which are subject to this Commission's jurisdiction.

It should also be noted that no decision has yet been made by the Commission governing pass-through by the shippers of transportation costs incurred under tariffs subject to the jurisdiction of Canadian authorities.

Honorable Philip R. Sharp and
Honorable Clarence J. Brown

- 36 -

circumstances, the shippers could be subject to under recovery of the Alaskan Northwest transportation costs because of the same regulatory lag discussed above.

(e) If additional reserves of natural gas were found in Alaska sufficient to lengthen the economic life of the ANGTS beyond the 25-year life now inherent in the proposed depreciation rate, the Commission might at some future time reduce the depreciation rate so as to more accurately spread the recovery of the plant investment over the useful life of the project. 21/ Alaskan Northwest might oppose such a change on the ground that the resultant reduced amount of depreciation expense recovered on an annual basis would impair their ability to service debt having a shorter term.

(f) In the event of a premature end to the viability of the project after it had commenced operation (because of physical, market or other forces), the Commission might find that a faster write-off of debt was appropriate, rather than continued operation of the minimum bill provisions. This could cause financial harm to Alaskan Northwest if the debt-holder refused to allow Alaskan Northwest to accelerate repayment of its debt, particularly if the interest rate to be paid to the lenders on the debt is higher than the general level of interest rates being paid for comparable investments. Alternatively, absent a waiver, a future Commission could determine, based on either a change in policy perception or based on facts attributing fault to the sponsors for the project failure, that the sponsor-investors (as opposed to the consumers) should bear some part, or all, of the risk of loss of recovery of debt, and then appropriately adjust the tariff or minimum bill provisions.

(g) In the event that Alaskan Northwest transportation costs and the costs of Prudhoe Bay and other natural gas, increase significantly, a shipper's resale rate could be increased so as to adversely affect the marketability of a shipper's gas. Under this scenario, the shippers (particularly the non-sponsor shippers) might argue for a reduction in the Alaskan Northwest transportation charges so that the shippers could continue to market their gas. Absent a waiver the Commission would have the power to

21/ See, Memphis, Light, Gas and Water Division v. FPC,
504 F.2d 225 (D.C. Cir. 1974).

Honorable Philip R. Sharp and
Honorable Clarence J. Brown

- 37 -

order some sort of temporary or indefinite reduction to Alaskan Northwest's charges. In response, Alaskan Northwest, or some other party, might argue that the reduction in Alaskan Northwest's charges (regardless of the reason therefor) impaired the recovery of Alaskan Northwest's "minimum bill" costs and thus jeopardized the financial health of the project.

(h) Another hypothetical involves the pipeline-shippers' current purchased gas cost adjustment (PGA) clauses, which, as now written, would permit the shippers to pass through Alaskan purchased gas costs to their customers. If the Commission should decide to revoke or modify the PGA clauses, the shippers would be subject to regulatory lag in recovering Alaskan and possibly other purchased gas cost increases. To the extent that such a lag caused a financial strain on the shippers, it could affect the cash flow to the ANGTS.

(i) In Order No. 31, the Commission stated its intention to periodically review Alaskan Northwest's rate of return on common equity. Absent the waiver, the Commission's authority to conduct such periodic reviews would provide a basis to adjust the return on common equity downward to reflect any lowering of the cost of common equity to Alaskan Northwest. Such a lowering of common equity costs would most likely result from a general overall improvement in the economy resulting in an improvement in the financial markets, leading to a reduction in the return on equity needed by Alaskan Northwest to continue to render adequate service in the public interest. The argument that a reduction in equity return could impair collection of all debt costs in violation of the proposed waiver language would presumably be an argument by lenders and others that the interest coverage must be greater than one (i.e., 1.5, 2.0, etc.) in order to ensure that Alaskan Northwest's ability to pay debt is not impaired.

11. Hypothetical Injuries to Consumers

You have asked "what hypothetical situations there might be which would work to the injury of resale customers and consumers should the waiver be granted." At bottom the most injurious risk that could be borne by the consumer is that the project might be abandoned either before or after completion, and that the consumer, through the resale customer, would be surcharged for the investment in the project

but would not receive gas from it. Next most injurious is the risk that the consumer will have to pay for gas not received during sustained periods in which the pipeline is out of service. Arguably, for each risk which would exist to the sponsors and/or shippers in the absence of a waiver, there would exist a concomitant risk to the resale customers and/or consumers in the event a waiver is granted. However, in fairness these risks should be properly placed in the context of the facts of the proceeding and the legal status of the ANGTS project to date.

President Carter in his formal Decision, the Congress in its approval of the President's Decision and international agreements, and the Commission in its Recommendation to the President and in existing orders, have each concluded that this project is in the public interest. These approvals have led to the existing tariff, minimum bill and other provisions applicable to the ANGTS as described above. The project sponsors and lenders have nonetheless responded by seeking further assurance that the unique features of these determinations, as well as the Commission's final orders and rules, will not be altered or modified after adoption. Relevant here are the existing decisions of various authorities that the ANGTS may be project financed and that certain portions of the investment should be recoverable from consumers in events, including project interruption, where consumers do not receive the benefit of delivered gas. Thus, decisions have been made that impose risk on the consumers regardless of the waiver. Further, the Commission's ultimate orders and rules will allocate the remaining risks among the parties after consideration of all factors consistent with or affecting the public interest. Accordingly, an argument can be made that once the legal foundation for the ANGTS places the risks, the waiver would impose no substantial additional risk on the consumers, but only provide a method for assuring implementation of the federal decisions made. The extent to which a waiver would place additional onus on the consumers would include the implications of removing the "regulatory risk" from the sponsors. In other words, the consumers would then face the risk that a future Commission could not, based on changed circumstances or different policy perception, modify the ultimate ANGTS orders or rules within the parameters of their final issuance.

12. Reasonable Likelihood of These Events Occurring

From a legal standpoint, the likelihood that a future Commission would take or decline to take action of the type inquired about in your letter would appear to depend upon (a) whether a reconsideration of past policy determination occurs, and/or (b) the future existence of facts which would produce a policy response by the Commission. The likelihood of such facts occurring is a prediction or assessment that, presumably, has been made in connection with all federal determinations to date. In issuing the final orders and rules, the Commission is legally charged with the responsibility of weighing the risks, to both the sponsors and consumers, attendant to investing the sums necessary to complete the project. The risks are exceptionally difficult to quantify because of the infinite set of variables that exist, and in the end the question is one of judgment. Either the risks are too great for the consumers to be asked to bear (i.e., the project is not in the public interest), or they are not. The Commission may well be required to make that determination as part of its final certification of the project. 22/ Appropriately, the Congress must decide, through adoption or rejection of the waiver, whether to eliminate the "regulatory risk" inherent in continued Commission jurisdiction after final certification.

I am advised by the Chairman that he will support passage of a waiver designed to assure project financing of the ANGTS consistent with the positions expressed in this memorandum. 23/

22/ See President's Decision, Finance Condition No. 2, at pages 36-37.

23/ In this connection, the text of the ultimate waiver language, if any, is a matter of continuing interest to the Chairman, myself and the Office of the General Counsel. Without addressing any of the complexities involved with the final language, please be advised that we would welcome the opportunity to provide your Committee and other interested persons with any technical assistance or advice that may be requested.

Honorable Philip R. Sharp and
Honorable Clarence J. Brown

- 40 -

Hopefully the foregoing provides you with an adequate response to your inquiry given the length of time taken and the resources available to prepare this memorandum. Please understand that this response is not intended, nor should it be taken, as an official Commission position. Rather, this memorandum represents the combined efforts of the Office of the General Counsel and other Commission staff members, as well as opinions of the Chairman and myself.

PHILIP B. SHARP, IND., CHAIRMAN

ANTHONY TONY MCFEET, CONN. CLARENCE J. BROWN, OHIO
EDWARD J. MARKEY, MASS. JAMES M. COLLINS, TEX.
ALBERT GORE, JR., TENN. TOM CONCOBAN, R.I.
PHIL GRAMM, TEX. GARY A. LEE, N.Y.
AL SWIFT, WASH. WILLIAM E. DANNENMEYER,
MICKEY LELAND, TEX. CALIF.
RICHARD C. SHELLEY, ALA. THOMAS J. TAUBKE, IOWA
CARROLL COLLINS, R.I. HAROLD ROGERS, KY.
MIKE SYNAR, OKLA. CLEVE BEMEDICT, W. VA.
W. J. "BILLY" TALEN, LA. DANIEL R. COATS, IND.
RALPH M. HALL, TEX. JAMES T. BROYNELL, N.C.
TIMOTHY E. WIRTH, COLO. (EX OFFICIO)
JOHN B. DINGELL, MICH. (EX OFFICIO)

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON FOSSIL AND SYNTHETIC FUELS
OF THE
COMMITTEE ON ENERGY AND COMMERCE
WASHINGTON, D.C. 20515

July 24, 1981

The Honorable Charles M. Butler, III
Chairman
Federal Energy Regulatory Commission
825 N. Capitol Street
Washington, D.C. 20426

Dear Chairman Butler:

As you know, the sponsors of the Alaska Natural Gas Transportation System (ANGTS) have communicated to the President their request that he propose to the Congress waivers of several provisions of law which are considered by the sponsors and their financial advisors to be necessary to the financing of the project.

Among the proposed waivers are several that deal with the regulatory authority of the Commission with regard to the ANGTS. The President has asked us and other Members of Congress to work together with his Administration in exploring the meaning and acceptability of the suggested waivers, because after their proposal they would by law not be subject to amendment. In order to fully understand the effects of those waivers which relate to regulatory processes, we have decided to solicit your assistance.

We request that you assign the most expert attorneys and specialists on your staff to provide us by August 1 with a written legal memorandum which presents their best judgment as to the effects on normal practice and procedure before the FERC of the following waiver of law:

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

The Honorable Charles M. Butler, III
July 24, 1981

2

service debt, including interest and scheduled requirement 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.

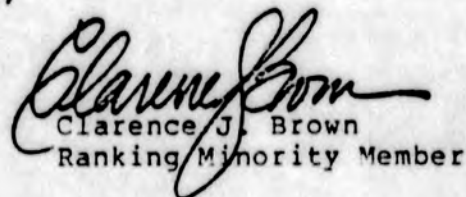
We want to understand (a) the full implications of such a waiver, (b) whether there have been past Commission actions which justify the desires of the sponsors to have these provisions waived, (c) what hypothetical situations there might be which would work to the injury of the pipeline sponsors of ANGTS or other participants in the project should there be no such waiver, (d) what hypothetical situations there might be which would work to the injury of resale customers and consumers should such a waiver be provided, and (e) the reasonable likelihood of such situations actually occurring.

We are not seeking an official Commission decision or statement on these questions, and certainly have no intent of affecting in any way future Commission decisions related to the ANGTS or any other matter, but seek instead to profit from the expertise available to you on your staff. We apologize for the extremely short time frame of our request, but we are attempting to gain this knowledge rapidly enough that a waiver package might be successfully dealt with during this session of Congress, under the procedures of the Alaska Natural Gas Transportation Act.

Thank you very much for your cooperation. If any questions arise please contact John Jimison or Michal Boland of our staff at 225-0320 or 225-3641.

Sincerely,


Philip R. Sharp
Chairman


Clarence J. Brown
Ranking Minority Member

PRS/jj

STATEMENT BY
MYER RASHISH
UNDER SECRETARY OF STATE
FOR
ECONOMIC AFFAIRS

BEFORE

A JOINT HEARING OF THE
SUB COMMITTEE ON ENERGY AND THE ENVIRONMENT
OF THE COMMITTEE ON INTERIOR AND INSULAR AFFAIRS
AND THE
SUBCOMMITTEE ON FOSSIL AND SYNTHETIC FUELS
OF THE ENERGY AND COMMERCE COMMITTEE

WASHINGTON, D.C.

OCTOBER 30, 1981

IT IS A PLEASURE TO BE HERE TODAY TO TESTIFY BEFORE YOUR TWO SUB COMMITTEES ON BEHALF OF SECRETARY HAIG. I REGRET THAT THE DEPARTMENT OF STATE WAS UNABLE TO ADDRESS THESE COMMITTEES LAST WEEK BECAUSE OF MY PARTICIPATION IN THE CANCUN SUMMIT. I APPRECIATE YOUR GIVING ME THE OPPORTUNITY AT THIS TIME TO PRESENT YOU WITH OUR VIEWS ON THE WAIVER TO EXISTING LAW WHICH THE PRESIDENT HAS SUBMITTED TO FACILITATE THE PRIVATE FINANCING OF THE ALASKAN NATURAL GAS TRANSPORTATION SYSTEM (ANGTS). IN PARTICULAR, I WOULD LIKE TO DESCRIBE WHAT WE BELIEVE ARE THE KEY BENEFITS THAT ANGTS WOULD PROVIDE THE UNITED STATES.

IN ORDER TO ASSESS THE ROLE THE ANGTS MIGHT PLAY IN THE U.S. ENERGY PICTURE, IT WOULD BE USEFUL TO BEGIN BY NOTING SOME OF THE FACTORS OVER THE PAST DECADE THAT HAVE LED POLICY MAKERS AND PRIVATE ENERGY PLANNERS ALIKE TO URGE THE EARLY COMPLETION OF A NATURAL GAS DELIVERY SYSTEM PROVIDING ALASKAN GAS TO THE LOWER 48 STATES.

THE IMPETUS OF ANGTS HAS ITS ROOTS IN THE TURBULENT GLOBAL ENERGY DEVELOPMENTS OF THE PAST DECADE. IN THE EARLY 1970'S, THE GROWTH IN AMERICAN ENERGY CONSUMPTION QUICKLY OUTSTRIPPED THE CAPACITY OF OUR DOMESTIC ENERGY PRODUCERS. IMPORTS NATURALLY FILLED THE GAP. IMPORTED ENERGY WAS STILL RELATIVELY CHEAP, EASY TO PROCURE, AND SEEMINGLY FREE OF POLITICAL RISKS.

BY SEPTEMBER 1973, OIL IMPORTS ALONE CONSTITUTED 38.3 PERCENT OF TOTAL OIL CONSUMPTION, UP FROM JUST 21.2 PERCENT IN 1968. WITH THIS RAPID GROWTH IN ENERGY IMPORTS

CAME INCREASED VULNERABILITY TO ENERGY IMPORT CUTOFFS. UNFORTUNATELY, MOST DID NOT RECOGNIZE THE SERIOUSNESS OF SUCH A DEVELOPMENT.

THE OIL EMBARGO OF 1973-1974, AND THE RESULTING ENERGY SHOCK HERE AT HOME, AWOKE THE AMERICAN PUBLIC AND POLICY MAKERS ALIKE TO THE DANGERS OF FURTHER INCREASING OUR DEPENDENCE ON FOREIGN OIL. SOARING ENERGY PRICES AND LONG LINES AT THE PUMP DROVE HOME IN A TANGIBLE WAY THAT INCREASING DEPENDENCE ON FOREIGN SOURCES FOR OUR ENERGY NEEDS WOULD ONLY MAKE THE UNITED STATES INCREASINGLY VULNERABLE IN TIMES OF UNCERTAIN SUPPLY. THE GLOBAL ENERGY CRISES IN 1979 AND 1980 AS A RESULT OF THE REVOLUTION IN IRAN AND THE IRAN-IRAQ WAR ONLY UNDERScore THE FACT THAT SUPPLY UNCERTAINTIES MAY BE INCREASINGLY COMMON IN THE FUTURE.

IT WAS AGAINST THIS BACKDROP THAT A VARIETY OF ALASKAN GAS PROPOSALS WERE CONSIDERED AND FROM WHICH ANGTS WAS ULTIMATELY SELECTED. FROM THE OUTSET, THE PRIVATE SECTOR WAS EXPECTED TO ASSUME THE CENTRAL ROLE REGARDLESS OF THE KIND OF TRANSPORTATION SYSTEM ULTIMATELY SELECTED. WHILE SUCCESSIVE ADMINISTRATIONS RECOGNIZED THAT THE GOVERNMENT HAD A LEGITIMATE OVERSEER ROLE, EACH STEADFASTLY MAINTAINED, AS THIS ADMINISTRATION DOES TODAY, THAT THE PRIVATE SECTOR SHOULD BE RESPONSIBLE FOR UNDERTAKING ALL PHASES OF THE PROJECT, INCLUDING ITS FINANCING.

WE BELIEVE EARLY COMPLETION OF ANGTS WILL ADD SIGNIFICANTLY TO THE ENERGY SECURITY OF THE UNITED STATES AND HELP

US REDUCE THIS VULNERABILITY TO WHICH WE HAVE BEEN EXPOSED IN THE PAST. WITH DIRECT ACCESS TO APPROXIMATELY 13 PERCENT OF U.S. GAS RESERVES, IT IS ESTIMATED THAT ANGTS WILL REPLACE APPROXIMATELY 400,000 BARRELS OF OIL A DAY, THUS FURTHER REDUCING U.S. VULNERABILITY TO INTERRUPTIONS OF OUR ENERGY IMPORTS. ON AN ENERGY EQUIVALENT BASIS, GAS SHIPPED VIA THE ALASKAN PIPELINE WOULD REPRESENT NEARLY 10 PERCENT OF TODAY'S CRUDE OIL IMPORTS. AS OUR NEED FOR ADDITIONAL GAS GROWS ANGTS IS EXPECTED TO PROVIDE AN ENERGY EQUIVALENT OF 600,000 BARRELS PER DAY OF IMPORT OIL.

COMPLETION OF ANGTS, AND THE READY ACCESS TO THE 48 THAT IT REPRESENTS, WILL ALSO SPUR EXPLORATION. THIS WILL UNDOUBTEDLY RESULT IN A SUBSTANTIAL INCREASE IN PROVEN RESERVES THAT GEOLOGISTS BELIEVE ALASKA HOLDS. WITHOUT THIS ACCESS, HOWEVER, EXPLORATION ACTIVITY WILL BE SIGNIFICANTLY LOWER, AND PROGRESS IN SUBSTANTIATING PROVEN RESERVES SIGNIFICANTLY REDUCED.

ANGTS WOULD ALSO PROVIDE AN INDIRECT BENEFIT TO OUR EUROPEAN ALLIES. BY GREATER USE OF DOMESTIC GAS RESOURCES, THE UNITED STATES WILL REDUCE ITS NEED FOR IMPORTED GAS IN THE YEARS AHEAD. WITH ASSURED ACCESS TO ALASKAN GAS, WE WOULD NOT NEED TO COMPETE WITH OUR EUROPEAN FRIENDS FOR ACCESS TO GAS SOURCES ELSEWHERE IN THE FREE WORLD NOTABLY IN AFRICA, THE MIDDLE EAST AND EVEN IN THIS HEMISPHERE. MAKING ADDITIONAL GAS AVAILABLE TO EUROPE WILL BE ESSENTIAL IF THE EUROPEANS ARE TO LIMIT THEIR VULNERABILITY TO ENERGY CUTOFFS FROM THE SOVIET UNION AND EASTERN EUROPE.

I WOULD ALSO LIKE TO EMPHASIZE THAT APPROVAL OF THIS WAIVER PACKAGE WOULD HAVE IMPORTANT FOREIGN POLICY BENEFITS IN OUR RELATIONS WITH CANADA. ENERGY PLANNERS HAVE LONG RECOGNIZED THAT CLOSE COOPERATION WITH OUR CANADIAN NEIGHBORS WOULD BE ESSENTIAL IN PROVIDING THE LOWER 48 STATES WITH SECURE, DEPENDABLE ACCESS TO ALASKAN GAS. CANADA, FOR ITS PART, KNOWS THAT A STRONG, ENERGY INDEPENDENT UNITED STATES IS IMPORTANT FOR THE SECURITY OF THE FREE WORLD. CANADIANS RECOGNIZE, MOREOVER THAT U.S. ACCESS TO ALASKAN GAS WOULD PROVIDE CANADA WITH GREATER FLEXIBILITY IN MANAGING ITS OWN ENERGY RESOURCES BY LIMITING FUTURE U.S. DEMAND FOR CANADIAN GAS. FINALLY, MANY CANADIANS BELIEVE THAT DEVELOPMENT OF ANGTS WILL PROVIDE IMPORTANT BENEFITS TO THE CANADIAN GAS INDUSTRY AND FURTHER CANADA'S RESOURCE DEVELOPMENT.

BILATERAL COOPERATIVE EFFORTS TO BRING ALASKAN NATURAL GAS THROUGH CANADA WERE FORMALIZED BY TREATY IN SEPTEMBER 1977. THIS TREATY AND THE COMMITMENTS IT REPRESENTS HAVE BECOME AN IMPORTANT SYMBOL OF ENERGY COOPERATION BETWEEN OUR TWO COUNTRIES. WE HAVE CONTINUED TO BUILD ON THIS TREATY THROUGH NUMEROUS DIPLOMATIC EXCHANGES THAT HAVE EXPANDED THIS INITIAL EFFORT.

FROM THE BEGINNING OF OUR DISCUSSIONS, CANADA HAS STRONGLY SUPPORTED THE PIPELINE PROJECT DESPITE ITS COMPLEXITIES AND UNCERTAINTIES. IN 1980, IN ORDER TO GIVE IMPETUS TO THE PIPELINE PROJECT, THE U.S. URGED THE CANADIAN GOVERNMENT TO AUTHORIZE THE CONSTRUCTION OF TWO SOUTHERN LEGS OF

THE PIPELINE (THE "PREBUILD" PORTION) THROUGH SOUTHERN ALBERTA, SASKATCHEWAN AND BRITISH COLUMBIA. WE ALSO URGED THE APPROVAL OF THE EXPORT OF CANADIAN GAS THROUGH THOSE SEGMENTS UNTIL THE ALASKAN GAS BEGAN TO FLOW. DOMESTIC OPPONENTS IN CANADA, HOWEVER, PRESSED THE CANADIAN GOVERNMENT NOT TO APPROVE THE CONSTRUCTION OR GAS EXPORT AUTHORIZATION IN VIEW OF THEIR OPINION THAT THE PROJECT WOULD NEVER RECEIVE THE PRIVATE FINANCING NECESSARY TO COMPLETE THE REMAINING SEGMENTS. CANADA, THE OPPONENTS CLAIMED, WOULD BE STUCK WITH THE SOUTHERN PORTION IN PLACE BUT GOOD ONLY FOR CARRYING ALBERTA'S GAS TO THE U.S. -- GAS WHICH MANY IN CANADA ARGUED CANADA WOULD NEED FOR ITS OWN MARKETS.

PRIME MINISTER TRUDEAU MADE THE DIFFICULT DECISION TO PROCEED WITH THE SOUTHERN LEGS ON THE BASIS OF ASSURANCES FROM BOTH THE ADMINISTRATION AND THE CONGRESS. PRESIDENT CARTER SAID IN A LETTER TO THE PRIME MINISTER THAT THE U.S. GOVERNMENT WAS COMMITTED TO THE PROJECT, WAS SATISFIED THAT IT WOULD BE COMPLETED, AND WOULD TAKE "APPROPRIATE ACTION" DIRECTED AT MEETING THE OBJECTIVE OF TIMELY COMPLETION. CONGRESS, FOR ITS PART, PASSED A CONCURRENT RESOLUTION SAYING "IT IS THE SENSE OF CONGRESS THAT THE SYSTEM...ENJOYS THE HIGHEST LEVEL OF CONGRESSIONAL SUPPORT FOR ITS EXPEDITIONS CONSTRUCTION AND COMPLETION..." THANKS TO THESE EXPRESSIONS OF SUPPORT, THE CANADIANS DID AUTHORIZE THE PRE-BUILD. THE WESTERN LEG WAS RECENTLY COMPLETED AND WORK IS ON SCHEDULE ON THE EASTERN LEG.

IT WOULD BE DIFFICULT TO OVEREMPHASIZE THE NEGATIVE IMPACT ON U.S.-CANADIAN RELATIONS IF THE U.S. GOVERNMENT DID NOT HONOR ITS ASSURANCES TO REMOVE STATUTORY IMPEDIMENTS TO PRIVATE FINANCING. THE CANADIANS WOULD UNDOUBTEDLY FEEL BETRAYED AND THE BILATERAL RELATIONSHIP WOULD SUFFER.

PRESIDENT REAGAN HAS REAFFIRMED HIS COMMITMENT TO THE PIPELINE'S CONSTRUCTION BASED ON PRIVATE FINANCING. THE WAIVER PACKAGE BEFORE THE CONGRESS TODAY IS THE CONCRETE EXPRESSION OF THIS GOVERNMENT'S WILLINGNESS TO LIVE UP TO THE ASSURANCES GIVEN TO PRIME MINISTER TRUDEAU AND THE CANADIAN GOVERNMENT. IN OUR VIEW, THIS WAIVER PACKAGE REMOVES UNREASONABLE RESTRICTIONS THAT WOULD UNNECESSARILY COMPLICATE THE PRIVATE SECTOR'S ROLE IN MAKING ANGTS A REALITY.

IN CONCLUSION, THE DEPARTMENT OF STATE BELIEVES THAT EARLY COMPLETION OF ANGTS THROUGH PRIVATE MEANS WILL PROVIDE IMPORTANT ENERGY SECURITY BENEFITS THAT THE UNITED STATES CAN ILL AFFORD TO REJECT. IT ADVANCES BILATERAL ENERGY COOPERATION WITH CANADA, YET PROTECTS THE FUNDAMENTALLY PRIVATE NATURE THAT HAS BEEN A PREREQUISITE FOR THIS ADMINISTRATION'S SUPPORT. WE BELIEVE THE PRESIDENT'S WAIVER PACKAGE ELIMINATES UNNECESSARY RESTRICTIONS THAT CAN ONLY COMPLICATE THE SPONSORING COMPANIES' ATTEMPTS TO ATTRACT FINANCIAL BACKING FOR THIS IMPORTANT PROJECT.

THIS CONCLUDES MY PREPARED TESTIMONY. I WILL BE HAPPY TO ANSWER ANY QUESTIONS THAT YOU MAY HAVE.

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M.
October 30, 1981

STATEMENT OF THE HONORABLE ROGER W. MEHLE
ASSISTANT SECRETARY OF THE TREASURY (DOMESTIC FINANCE)
BEFORE THE SUBCOMMITTEE ON ENERGY AND THE ENVIRONMENT
AND THE SUBCOMMITTEE ON FOSSIL AND SYNTHETIC FUELS
U.S. HOUSE OF REPRESENTATIVES

Messrs. Chairmen and Members of the Subcommittees:

I am pleased to have this opportunity to assist you in your consideration of the waiver of law submitted by the President to Congress on October 15 for the Alaska Natural Gas Transportation System (ANGTS). In proposing this package of waivers to Congress, the President aims to facilitate the private financing, and hence construction, of this multi-billion dollar energy transportation system. I urge Congress to adopt this waiver proposal in support of the expeditious completion of this important energy project on a privately-financed basis.

Background

By enacting the Alaska Natural Gas Transportation Act of 1976, Congress recognized the importance to our Nation of transporting the Prudhoe Bay gas to the lower forty-eight States. The Act provided a unique and comprehensive process to designate and approve a sound proposal for a natural gas transportation system, and to expedite its construction and operation. The Act required the President to submit to Congress a financial analysis of the system

designated for approval, along with a determination of whether the designated system could be privately financed, constructed and operated.

In response to this statutory provision, the Treasury Department prepared an extensive study in 1977 of the sources of funds available to finance the proposals for the ANGTS. The report concluded that an economically viable system to transport gas from Alaska to the lower forty-eight States could be privately financed -- that is, without Federal financial assistance. The report found, however, that a private financing would be difficult to arrange without prior resolution of a number of issues, such as determining a rate of return on the investment, forming a final consortium of equity investors in the project, and determining the extent to which benefited parties would provide financial support to the project. The feasibility of private financing could be determined only after these issues were resolved.

In 1977, President Carter reflected Treasury's findings in the Decision and Report to Congress on the Alaska Natural Gas Transportation System which designated the proposal of the Alcan Pipeline Company, predecessor to Northwest Alaskan Pipeline Company, to transport the natural gas from Prudhoe Bay to the contiguous forty-eight States. The Decision also specified terms and conditions under which the private financing would occur. These terms included:

1. a prohibition against gas producers' equity interest, voting power or management control in the Alaskan segment;
2. the exclusion of the gas conditioning plant from the pipeline system; and
3. a prohibition against the use of consumer charges prior to completion and commissioning the entire system.

As stated in the Decision, the terms and conditions were not meant to limit or foreclose their later modification, but were intended to begin the process by which a set of effective and workable guidelines evolved. Without a doubt, the Decision recognized the unprecedented physical size of ANGTS as an energy transportation system, and its enormous debt financing requirements. What few realized, however, was the magnitude of the project's need for funds as the proposal would approach reality.

Resolving a number of technical issues associated with the pipeline proposal required almost four years. In May 1981, the gas producers and pipeline sponsors reached agreement on a conceivable plan for financing the system on a private basis. Major provisions of the plan included:

- . Capital costs estimated at \$27 billion (\$21 billion for the pipeline, \$6 billion for the gas conditioning plant), with an additional \$3 billion for a completion assurance pool
- . a debt/equity ratio of 75%/25%

- an equity split of 70%/30% between sponsors and producers respectively, with each group responsible for an equivalent percent of the debt of the pipeline project.

The plan aims to accommodate the private financing of the pipeline the cost of which has escalated substantially during the past four years from an estimated \$10-\$13 billion to \$30-\$40 billion.

Waiver Proposal

Since the sponsors' financing plan for the system would require key modifications in existing statutes, President Reagan transmitted the proposed waiver of law to Congress in accordance with the Alaska Natural Gas Transportation Act.

The package of waivers submitted by the President proposes both substantive and technical changes to existing law to facilitate the private financing of the project. Three specific waivers which I would particularly like to discuss concern producer equity participation, the inclusion of the gas conditioning plant in the system, and billing prior to completion of the entire transportation network.

Producer Participation. As stated in the Decision in 1977, the strength of the sponsoring consortium of gas transmission companies was a significant element of the financing. In 1981, the strength of the consortium remains an important element in financing the project; but the substantial increase in credit support required to fund the system relative to the aggregate financial capability of the pipeline sponsors necessitates producer

equity participation. Creditors of the project will be concerned that the equity owners of the pipeline system possess the financial strength to complete the project and to help assure repayment of the debt. The participation of the gas producers on an equity basis will substantially add to the financial capability of the project participants to support the project, and thus facilitate its private financing.

Gas Conditioning Plant. ANGTS comprises four pipeline segments -- an Alaskan segment which will run from the Prudhoe Bay reserves southward to the Canadian border; a Canadian pipeline segment which will extend from the Alaska-Yukon border to Central Alberta; and from Central Alberta, Eastern and Western Legs which will transport gas to the Chicago and San Francisco areas, respectively. An integral part of the system also is the gas conditioning plant which prepares and readies the natural gas for shipment. The purposes and benefits of the pipeline and conditioning plant are intertwined -- both are required in the delivery of gas from Alaska to the ultimate consumers. In arranging the private financing, therefore, potential creditors of the system will evaluate the risks inherent in the entire project, including the conditioning plant. Before extending any funds, they will require assurance that all parties of the closely-integrated system have financial backing for its completion. An underlying regulatory and tariff structure comprising the whole system as one unit, as the waiver would allow, seeks to provide such assurance.

Billing Commencement. The waiver of law also includes a provision allowing the Federal Energy Regulatory Commission (FERC) to allow billing for transportation charges through the pipeline system prior to completing and commissioning the entire system. This provision would separate the ANGTS into three parts for billing purposes: an Alaskan pipeline segment, an Alaskan gas conditioning plant segment and a Canadian pipeline segment. For the Canadian segment, the full cost of service would be recovered upon completion of that segment, but no billing would begin on that segment prior to a date established by FERC. Upon completion and successful testing of the Alaskan pipeline segment, the waiver would permit recovery of a minimum bill consisting of actual operation and maintenance expenses, actual current taxes, and amounts to service principal and interest on debt. The billing, however, would not commence prior to a date established by FERC. Likewise, recovery of a minimum bill on the gas conditioning plant segment could begin upon its completion and successful testing, but not prior to the date established by FERC. This waiver would provide some assurance against the risk of not completing one of the Alaskan portions, or of the Canadian segment. This waiver, therefore, would protect potential lenders against the unlikely event of no completion of related portions of the system, but lenders would bear the risk of non-completion of the segment financed by them.

Conclusion

The Alaska Natural Gas Transportation System is the largest construction project ever contemplated by private enterprise. Although the requisite financing is uniquely large, complex and difficult, private financial markets appear capable of providing the estimated funds required for the project. In the United States, between \$400 billion and \$500 billion of new credit is generated on an annual basis, and these amounts do not take into consideration the financial capacities of foreign markets which may fund a substantial portion of the needed capital for the project. Furthermore, the funding needs of the project will not be met at one point in time, but will probably be phased in over a number of years. Thus, the financing requirements of the pipeline project will likely have a minimal effect on the financial markets, interest rates, and financing of other energy projects. Since the waiver package aims to facilitate the private financing of the project, and since private investors will not provide funds if the project does not appear to be economically feasible, there will be a free market determination of the allocation of economic resources to the project. Resources will thus be diverted from other, less efficient energy projects. Adequate equity and debt capital should be available, given the market's judgment that the project is economically feasible. Under such circumstances, the project would be financed and would benefit the economy.

In this regard, the Economic Recovery Tax Act of 1981 will play a role in determining the project's feasibility. While the Investment Tax Credit may be available to project sponsors during the construction phase, this availability was not appreciably altered by the Economic Recovery Tax Act of 1981. The Act does provide more generous cost recovery than was available under prior law in that the cost recovery period is reduced. However, as under prior law, cost recovery is not allowed prior to the year in which the property is placed in service.

We concur in the judgment of private financial advisers to the pipeline sponsors and gas producers participating in the project that Congressional adoption of the waiver package is essential to developing any possible plan to finance the project privately. While we cannot be completely assured of private financing if these waivers are adopted, we are certain that the project will not be financed without the waivers. I therefore urge Congress to approve the proposed waivers.

I would be happy to answer any questions.

STATEMENT OF
PETER M. SACERDOTE
PARTNER
GOLDMAN, SACHS & CO.
IN BEHALF OF
GOLDMAN, SACHS & CO.
LEHMAN BROTHERS KUHN LOEB INCORPORATED
AND
SHEARSON/AMERICAN EXPRESS INC.
Before the
ENERGY AND COMMERCE
SUBCOMMITTEE ON FOSSIL AND SYNTHETIC FUELS
and
INTERIOR AND INSULAR AFFAIRS
SUBCOMMITTEE ON ENERGY AND ENVIRONMENT
U.S. HOUSE OF REPRESENTATIVES

November 4, 1981

I am Peter M. Sacerdote, Partner of Goldman, Sachs & Co. This statement also reflects the views of Lehman Brothers Kuhn Loeb Incorporated and Shearson/American Express Inc. Our firms are investment banking financial advisors to Alaskan Northwest Natural Gas Transportation Company, the company designated by the President to design, construct, and operate the Alaskan pipeline segment of the Alaska Natural Gas Transportation System.

We have advised Alaskan Northwest on many issues relating to the development of a financing plan, including the identification of requirements for and sources of financing. We have assisted and advised our client on a wide range of subjects such as the incentive rate of return mechanism, the cost of service tariff, and the cost estimate structure. While our role to date on behalf of Alaskan Northwest has been limited to that of financial advisor, investment bankers also can assist in arranging financing, typically as agent in the direct placement of securities with institutional lenders and as organizers of syndicates for the underwriting of publicly offered securities. Unlike commercial banks, investment banking firms do not lend or otherwise provide capital directly to projects.

As financial advisors to Alaskan Northwest, Shearson/American Express Inc. (since 1976), Lehman Brothers Kuhn Loeb Incorporated (since 1978), and Goldman, Sachs & Co. (since 1979) have been directly involved with many of the participants and prospective supporters of the project. These include the transmission company sponsors, the North Slope producers, the State of Alaska, potential major foreign and domestic lenders and suppliers, and governmental export agencies supporting the supplier companies.

The three investment banking firms advising Alaskan Northwest have acquired substantial familiarity with many of the aspects of the project. This relates to our work with Alaskan Northwest and Fluor Corporation, the prime management contractor, on the cost estimate, the incentive rate of return mechanism, and certain project design issues. We have also worked with expert consultants with whom Alaskan Northwest has contracted for studies relating to the marketability and net national economic benefits of Alaskan gas. Finally, we have advised Alaskan Northwest that certain waivers of law have become necessary for private financing arrangements to go further.

We are here today to present our views on the waiver proposals which President Reagan has recommended to the Congress in support of the Alaskan Natural Gas Transportation System. Four have particular significance for financing. These are waivers which would permit North Slope gas producers an equity position in the Alaskan segment of the project, provide for the inclusion of the gas conditioning plant in the ANGTS, modify the conditions under which billing commencement of Alaskan gas consumers can begin and reduce the potential of certain regulatory initiatives which could undercut the security position of potential project lenders.

In our judgment, these four waivers are absolutely necessary to achieving the private sector financing required by the President's Decision. Without their approval, the project's future as a private venture is in grave doubt and the ultimate recovery of approximately 13 percent of our country's proven gas reserves and the substantial national and consumer benefits to be realized therefrom will be seriously jeopardized for the foreseeable future.

In arriving at these conclusions we considered the basis and rationale for the waivers in the context of the project's current cost estimate, which has more than doubled since the original 1977 estimate, and the current financial environment, which is markedly less favorable from that which existed when the project was originally approved. We also took into account the relationship that has necessarily evolved between the transmission company sponsors, producers, and potential lenders as a result of the greater financing requirements, and the less favorable financial environment.

HISTORY OF FINANCING INITIATIVES

The President's Decision presented an analysis of the project's anticipated capital requirements, which in 1977, were estimated at \$13 billion in when spent dollars and set forth certain ground rules under which a private financing was to occur. These parameters included: (a) a prohibition against producer equity ownership in the Alaskan pipeline segment; (b) the exclusion of the conditioning plant from the ANGTS; (c) a prohibition against governmental financial support of the project; and (d) a prohibition against the use of consumer charges prior to the completion and commissioning for operation of the four pipeline segments of the ANGTS. Once commissioned for operation, the President required that consumers of Alaskan gas commence paying the irrevocable financial obligation provided for under the FERC gas tariff which at all times provides for the full payment of debt service costs. The President's Decision also envisioned that 75 percent of the financing would be debt which would be project financed, that is, the assets and cash flow of the project would provide the principal source of credit support to lenders.

A financing plan incorporating these parameters was developed shortly thereafter, incorporating the following features: During the construction phase, debt capital for the Alaskan pipeline

segment would be raised on a project financing basis with no corporate or government completion guarantees. The 25 percent equity component would be provided by the transmission company sponsors. Additionally, as mandated in the President's Decision, the conditioning plant would not be the responsibility of Alaskan Northwest.

In the absence of conventional corporate or government completion guarantees, the plan provided that lender concerns with completion risk were to be met through a detailed risk analysis coupled with a prearranged completion assurance pool to function as follows: The project's final cost estimate would be subject to an independent risk analysis and overrun probability assessment which would determine the amount required for an initial pool of capital. Commitments would also be obtained for a second capital pool, a completion assurance pool, which would be available in the improbable event that project costs exceeded the initial pool. Both capital pools would be irrevocably committed prior to the commencement of construction.

Once the four pipeline segments were certified as completed and commissioned for service, credit support for the project's debt would be provided through the FERC-approved gas tariff which would assure the payment of the project's debt service under all circumstances. Based on the tariff and regulatory provisions providing for the full and timely flow through of project costs to gas consumers, financing commitments would be secured from institutional lenders to refinance a portion of the commercial bank financing. In addition, the financing plan envisioned the possibility that public debt markets could also be used to refinance construction loans.

Changes in Circumstances Since the President's Decision

A number of significant developments have occurred since the President's Decision which have had the cumulative effect of increasing the financing which project sponsors must arrange. These factors have increased the financing requirements in when spent dollars from the 1977 estimate for the entire system (comprised only of the four pipeline segments and not the conditioning plant) of approximately \$13 billion to the 1981 estimate of \$27 billion for all Alaskan facilities. These developments include:

- (a) escalation in project costs due to four years of higher than expected inflation;
- (b) escalation in project costs due to the need to increase interest rate assumptions during the construction periods;
- (c) inclusion of the \$6 billion conditioning plant in the project;

- (d) refinements in the pipeline design; and
- (e) sizable increases in required reserves and contingencies.

In addition, the financial markets in the U.S. and abroad have been characterized since 1977 by increasing volatility, high interest rates, and major structural changes. The availability of long-term debt has been adversely affected by a decline in the appetite of long-term lenders for such debt because of the impact of inflation on their investment portfolios. On the other hand, the demand for fixed rate long-term funds has been strong and competition for the available capital has been intense.

A final category of developments requiring the rethinking and revision of the financing plan envisioned in the President's Decision were the changes mandated by the conditions for producer and lender participation, to which we now turn.

Before meaningful discussions could begin to arrange for the producer financial support envisioned by the President's Decision, much had to be accomplished, including resolution of (1) the wellhead pricing of Alaskan natural gas, as part of the Natural Gas Policy Act of 1978, (2) the incentive rate of return mechanism, and (3) key design specifications upon which the estimates and financing requirements could be determined. In May, 1981, soon after resolution of these milestones, but much later than had been anticipated in 1977, Alaskan Northwest and the producers entered into an agreement on financing plan concepts. This agreement incorporated the producers' requirements that, as condition for their financial support, the conditioning plant be included in the ANGTS, and the producers be permitted to own equity in the project with the rights and privileges normally attendant to such ownership. Current law prohibits satisfaction of these conditions.

Agreement on producer/sponsor financing plan concepts permitted presentation of a Project Overview incorporating the financing plan to major U.S. lenders for their review and reaction. We participated in all of these presentations, which were made in May, 1981. In a letter dated August 28, 1981, the four-bank group advised Alaskan Northwest of the results of their preliminary assessment of the financing concepts and the general availability of debt support for the project. They also suggested certain modifications to the financing approach to financing for Alaskan Northwest and the producing companies to consider.

In their letter, the banks advised Alaskan Northwest that a modification of the financing proposal should be considered which would permit some degree of debt repayment assurance during the precompletion phase, involving a combination of (a) acceptable debt assumption arrangements by the sponsors and producers, and (b) acceptable commencement of billing provisions prior to completion of the ANGTS. They also emphasized the importance

of (c) post-completion tracking mechanisms and (d) regulatory certainty throughout the life of the project.

Essential Steps Which Must be Taken in Response to New Circumstances

It is our judgment that the changes in circumstances just described now mandate suitable responses to realize the desired private financing of the ANGTS. Guidelines and terms of financing conceived of more than four years ago as embodied in the President's Decision must be modified to reflect and respond to new and unforeseeable developments. All project participants and beneficiaries will have to provide more support for the project. Most significantly, we have recognized the need for expanded sources of credit backing in order to raise the enormous sums of capital which must be raised. This must be provided in several forms, including conventional direct corporate assurances for large portions of project debt. The sponsors and producers have already agreed in principle to provide such assurances of project debt, notwithstanding that the President's Decision generally did not envision such support, particularly not from the transmission company sponsors. A positive aspect of the reliance on sponsor and producer corporate credit support is the reduction in external financing requirements which results. Since there would be an assured source of repayment of the bulk of project debt by the equity owners, the need to provide precommitted contingency financing is substantially reduced.

Obtaining the benefits of other financing plan modifications which are needed to achieve private financing of the ANGTS will depend upon the enactment of waivers of law, the subject of today's hearings. One of these waivers will provide the added support now called for from Alaska gas consumers to coincide with the additional support which sponsors and producers will provide in the form of project debt assurance.

We would now like to review in some detail the justification and our reasons for supporting and recommending enactment of the waivers relating to the financing of the project.

COMMENTS ON THE PROPOSED WAIVERS

It is our considered judgment, based largely on the changes described earlier, that the approval of waivers permitting producer equity participation, incorporating the conditioning plant into the project, permitting billing commencement to begin upon completion of the Alaskan/Canadian segments and the conditioning plant, and providing regulatory certainty are critical to facilitating private financing.

Producer Equity Participation

Despite recognition in the President's Decision that the producers should participate in financing the project, the equity restrictions imposed on them by the Decision are incompatible

with a meaningful producer contribution to financing. The producers expect a meaningful say in how their money will be spent. Without equity participation and its resulting voice in project management, the producers will not provide direct funding or credit backing for the project. There must be no misunderstanding that somehow private financing will be possible without significant producer support. The combined financial capability of the ten transmission company sponsors is no longer adequate to support a project of this magnitude.

Prudhoe Bay Gas Conditioning Plant

The agreement on financing concepts arrived at between producers and transmission company sponsors recognized financing realities that had been increasingly apparent as design and cost estimate work proceeded, as discussions between sponsors developed, and as preliminary opinions from the financial community were received. As the four-bank letter of August 28, 1981, confirmed, 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 certain functions which should be compensated for as 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.

Potential lenders have indicated their insistence on viewing conditioning plant timing and completion risks as an integral part of project evaluation. Once this reality is accepted, the concept expressed in the financing concept agreement must follow, that is, that all components of the project group have an investment in the conditioning plant similar to their investment in the Alaska pipeline segment. These considerations dictate that the conceptual agreement on financing provide that the producers and the gas transmission companies share the equity and the responsibility for arranging or supporting the debt funds for the gas conditioning plant in the same proportion they agree to contribute to the Alaska pipeline segment.

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 afforded. 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. Decoupling the project for billing-on-completion purposes is financially desirable because it reduces a real or imaginary completion timing risk, but the advantage is lost when the underlying credit support, the regulatory and tariff structure, is not available to each segment.

Impediments to fully incorporating the gas conditioning plant in the project are removed by the waiver. We believe that to achieve private financing, the plant must be in every sense a part of the project.

Billing Commencement Date

While the proposed billing commencement waiver will not necessarily ensure private sector financing, we believe that without such a waiver private sector financing is impossible.

A workable financing plan will require reducing the potential risks borne by the lenders by the maximum extent possible, given the magnitude of the capital required. This, in turn, requires the highest attainable level of lender participation both in terms of the number of lenders participating and the amount of debt provided by each lender.

To attract such extensive participation mandates that the total system be segmented for purposes of billing commencement. Such treatment would permit certain lending institutions to increase their participation in the project and remain within their lending limits. Segmentation of the project reduces the risk faced by lenders that their entire investment could be jeopardized in the very unlikely event that one segment is not completed. It permits a lender to lend to the Alaskan segment without having to worry about completion of the Canadian segment, a segment over which the Alaskan borrower would have no control.

Lastly, the U.S. government assured the Canadian government that the U.S. would permit the Canadian segment sponsors to recover tariffs attributable to their segment when it had been completed. If this treatment were given to the Canadian segment and not the Alaskan segment, the former would be a more attractive credit in the eyes of lenders. This perception, in our view, would seriously impair the availability of funds for the Alaskan segment. The requirement that FERC establish a "completion date" for the project and that no billing occur before that time would provide the most powerful incentive for all involved to complete all segments as close to that date as possible.

Regulatory Certainty

The cost recovery mechanisms for Alaskan Northwest and the shippers of Alaskan gas are the tariffs approved by the FERC and the Canadian National Energy Board pursuant to which Alaskan

Northwest charges the shippers for transportation service and the shippers, in turn, charge their customers. As the Commission found in its Orders 31 and 31B, these tariffs are the "economic lifeline of the project." Because of the extraordinary risks attendant to the project and the enormous amount of financing needed, lenders will require assurance that, once approved by the FERC, the tariffs will not be subject to future regulatory action which would impair the recovery of debt interest and principal.

CONCLUSION

In conclusion, we believe that further progress on the financing of the project is tied to favorable Congressional action on the proposed waivers of law. Assuming the four essential producer and financing waivers are approved, the obvious question is: Does this now make the project privately financeable? Based on the banks' August 28 response and our knowledge of the position of other potential supporters of the project, we believe the project can be privately financed, but support by the sponsors and producers above the levels they have preliminarily indicated will be required. If this additional support is forthcoming, we believe there will be funds available on a worldwide basis sufficient to provide the debt financing for the project. After completion, when ANGTS is operational pursuant to satisfactory tariff and tracking arrangements, the credit of the project itself should, in our view, provide adequate assurance of debt service and the continuing pledge of corporate credit by the sponsoring companies and the producers should not be required.

We understand that the companies which have supported this project for the past years and have collectively invested about \$550 million to date are prepared to continue their strong support of the project. We remain optimistic that the aggregate credit so committed, together with the tariff and tracking mechanisms necessary to provide a basis for project credit after the line is operational, will permit us to continue in our determined efforts to meet the challenge of financing this project.

Before responding to such questions as the Members might pose, we would choose to close our prepared remarks with an affirmation of our strong belief in the merits of this project, and of our unshakable conviction that the project is necessary for the energy future of this country. Only if we can develop domestic resources, and provide the transportation systems to bring those resources to market, can we lessen our dependence on foreign oil. The benefits of this project, in terms of the balance of payments, lessening our dependence on insecure and uncertain supplies of energy, providing the necessary incentive for exploration and development of frontier resources, and in providing jobs and a major stimulus to the U.S. economy, all

of these argue most compellingly that the Congress should remove all barriers to private financing.

We cannot, of course, assure the Congress that approval of the waivers guarantees the financing of the project. The difficulties which still lie before us are great, and many issues remain to be resolved. We know that without the waivers we cannot proceed; with them, we will do our best to achieve a successful private financing for this vital energy project.

I thank you for the opportunity of appearing, and will be pleased to respond to such questions as you might have.

STATEMENT OF

JEROME F. HASS

Professor of Managerial Economics and Finance
Graduate School of Business and Public Administration
Cornell University

BEFORE THE

HOUSE SUBCOMMITTEE ON FOSSIL AND
SYNTHETIC FUELS OF THE
ENERGY AND COMMERCE COMMITTEE

AND

HOUSE SUBCOMMITTEE ON ENERGY AND
THE ENVIRONMENT OF THE
INTERIOR AND INSULAR AFFAIRS
COMMITTEE

November 4, 1981

Introduction

Mr. Chairman and members of the Committees: My name is Jerome E. Hass. I appreciate your invitation to appear before these distinguished committees to express my views on the waivers proposed by the President to facilitate the financing of the Alaska Natural Gas Transportation System (ANGTS).

I am Professor of Managerial Economics and Finance at Cornell University's Graduate School of Business and Public Administration. In 1976 I took leave from Cornell to become Chief of the Division of Economic Studies at the Federal Power Commission. During my 16 months in that position I became intimately familiar with natural gas issues in general and the ANGTS in particular as one of the two principal staffers who drafted the Commission's second nationwide natural gas wellhead pricing rule (Opinion No. 770) and the Recommendations to the President on the ANGTS. In the summer of 1977 I joined the Energy Policy and Planning group (Executive Office of the President) headed by Dr. Schlesinger and was one of the three principal staffers supporting the negotiations with Canada on the Agreement of Principles between the two countries and drafting the President's Decision and accompanying Report.

In late fall of 1977 I returned to my teaching position at Cornell. I have, however, remained an active participant in the development of the ANGTS. First I helped the FERC devise the incentive rate of return; second, I assisted the Secretary of Energy to bring the producers and sponsors together in the early stages of the development of the financing plan currently under discussion; thirdly, I have assisted the staff of the Office of the Federal Inspector in developing a deeper and more complete appreciation of the subtleties of federal regulation and ANGTS issues.

Thus I feel well qualified to speak on the issues before you today.

Participation by Producers

While I cannot speak for the President, Dr. Schlesinger, or the staff that assisted in the drafting of President Carter's Decision, as one-third of that staff I can state categorically that we erred. It was nonsensical to believe that the producers would be willing to take down or guarantee debt without commensurate control over the project during the planning and construction stages. We were extremely busy during the summer of 1977 and, when the Department of Justice (DOJ) proposed the condition which excluded any equity participation or control by producers, we simply did not fight it. It didn't take us long to recognize our error; when Dr. Schlesinger first met with the producers in early August, 1979 to elicit their financial support for the project, his office had already entered into discussions with the DOJ concerning the relaxation of their earlier position.

While there is no doubt that an important reason for having the producers take responsibility for a major piece of the total financial package is because they have the money to do so, it is also important to permit them to take a significant financial position in order to demonstrate their judgement and faith regarding the economic viability of the project. To my knowledge, no other parties have the expertise that these companies do with respect to managing large scale projects and arctic construction. I believe they will be the bellwether to the conventional investment community, who will be hard-pressed to find any other comparable expertise without a vested interest to consult with them on this viability of the project, and they will lead no one unless they make a substantial commitment.

Most important, it would be sheer folly (except, perhaps, in the case of extreme emergency) for the government to consider providing financial

support. With all due respect to the Army Corp of Engineers and the Office of the Federal Inspector, I do not believe they have nearly as much expertise as the producers and the capital market to objectively evaluate such a project. In other words, if producer equity participation is permitted and a private financing fails to materialize for lack of producer support, the project should be mothballed.

It is essential to recognize the particularly important role that Exxon plays in judging the economic viability of the project. Not only are they much bigger than their partners, but are also much more diversified and less dependent upon the Prudhoe Bay field and the ANGTS for their own economic viability:

	<u>Company</u>		
	<u>Exxon</u>	<u>Arco</u>	<u>Sohio</u>
1980 Sales	\$64 Billion	\$24 Billion	\$11 Billion
Total Asset, end of 1980	\$49 "	\$17 "	\$12 "
Market Value of Equity*	\$26 "	\$11 "	\$10 "
Prudhoe Bay Net			
Reserves as Percent			
of Company Reserves,			
end of 1980			
Oil	24%	71%	99%
Gas	28%	64%	96%
Percent of 1980 Oil			
Production from Prudhoe			
Bay	20%	47%	97%

* October 23, 1981

Exxon does not have the intense interest which the other two companies must have in providing a delivery system for their gas. Exxon can afford to be objective and, if necessary, defer the project indefinitely. For this reason I am concerned that their role to date appears to be largely passive -- saying they will take their 11 percent "fair share" (36% of 30%) and nothing more, and that their commitment is finite -- \$3.4 billion. This may not be a sufficient signal for the market -- even if the sponsors can handle their share. In 1979 Exxon proposed the producers take 40 percent of the action, and I would not be surprised to see that number reappear.

The producer's witnesses have made a point that the anticipated overall rate of return on their ANGTS investment is in the 10-13 percent range. This is true only if they purchase the debt themselves.

<u>Capital</u>	<u>After Tax Rate of Return</u>	<u>Relative Importance</u>	<u>Weighted Return</u>
Debt	.06 - .08	.75	.045 - .060
Equity	.22 - .30	.25	.055 - .075
			.100 - .135

If they resell the debt to some third party once construction is complete or never purchase debt (simply guarantee it during the construction period), their rate of return will be higher. They may also ask for commitment or guarantee fees which would increase their rate of return. Finally the calculation above ignores that the debt is likely to be repaid much more rapidly than equity, skewing the weighted average toward the higher return on equity through time.

State of Alaska Participation

A second error in the President's Decision was assigning an important role for the State of Alaska. There is no doubt that they will benefit significantly from the project. Aside from the original lease bonus bid of \$900 million they received in 1969, they will receive one-eighth royalty, 10 percent severance tax, a 9.4 percent state income tax, and local property taxes. These last three items, on the gas alone, will amount to more than \$1.2 billion in 1990 based on a projected NGPA price of \$4.90/Mcf and production of 2 Bcf per day:

Royalty	(2 x 365 x \$4.90 x .125)	\$ 447 million
Severance	(2 x 365 x .875 x \$4.90 x .10)	313 "
Income Tax	(Plant and Pipeline)	67 "
Property Taxes	(1.7% of net plant)	370 "
		\$1,197 million

This is more than \$2000 per capita at today's Alaska population and the calculation excludes the state income tax on producer profits from gas sales. This substantial benefit is consistent with an earlier Net National Economic Benefit study which estimated that the state would capture the lion's share of the NNEB (32 percent).^{1/}

Whether the State participates in the financing is problematical. Given the substantial cash flow they are currently receiving from oil production, they seem to have the capacity to stall indefinitely, and there is little leverage which can be placed on them. No financing plan can be premised on their participation.

^{1/}"A review of Alaska Natural Gas Transportation System Issues," ICF Incorporated, May 1979; FERC Contract No. EJ-78-C-01-6395; p. 12.

The Billing Commencement Issue

President Reagan has requested a modification of the billing commencement condition in the Decision to permit a full cost of service to begin for the Canadian section once it is complete (after a date certain) and a minimum bill to cover operating expenses and debt services for each of the other two sections -- the conditioning plant and the Alaskan section pipeline.

With respect to the Canadian section waiver, such a modification appears essential for two reasons. First, as a matter of perceived equity, the anticipated after tax return for the Canadian equity sponsors is well below that anticipated on either Alaskan components or the lower-48 sections. While the NEB has set slightly higher allowed rates of return on equity than the FERC set on the Alaskan pipeline section, the U.S. equity sponsors are able to receive substantial tax benefits from the immediate partnership flow-through of investment tax credits and the tax savings arising from the interest on the debt of the project during construction. These tax benefits also reduce substantially the net cash flow the U.S. sponsors must provide. Canada has no investment tax credit; furthermore, it does not permit consolidated taxation, so that interest expenses during construction cannot be used to reduce the sponsors' tax obligations. Relatively speaking, the Canadian sponsors must put up 25¢ for each dollar of construction (75¢ debt) and earn roughly 18 percent while the Alaska pipeline equity sponsors put up much less than 15¢ (net of tax savings) and earn a 20 to 35 percent rate of return. Thus, in comparative terms, the Canadian sponsors are getting far less while putting up much more. Also, while NOVA and Westcoast, Foothills' equity sponsors, are large firms, the Canadian section of this project is comparatively large and constraining on their aggressive business orientation:

Canadian ANGTS Capital Outlays (\$1980, CN)	\$6.8 billion
Canadian Sponsors' Capital (12/31/80)	3.0 billion
ANGTS Capital as Percentage of Total Capital	<u>227%</u>
U.S. ANGTS Capital Outlays (\$1980, plant and all pipe)	\$17.2 billion
U.S. Sponsors' Capital (12/31/80, excluding TransCanada)	23.9 billion
U.S. Producers' Capital (12/31/80)	49.1 billion
Combined U.S. Capital	73.0 billion
ANGTS Capital as Percent of Capital of	
Sponsors	72%
Producers	35%
Combined	<u>24%</u>

It is, therefore, understandable why they desire billing to commence as soon as they have completed their section.

The second reason is that no U.S. creditworthy party appears ready, willing, and able to pay the Canadian sponsors other than ANGTS customers. The shippers could conceivably finance the tariff for a while, but all but one at this time are Alaska section sponsors, and it is likely their creditworthiness will be strained to the limit with having to provide debt guarantees on the conditioning plant and Alaska pipeline debt. The producers could also provide some interim financing, but they have excluded that possibility from the outset, when Exxon made its first proposal in October of 1979. So it appears that unless the government wishes to provide for this contingency, there is no other option.

While we are on the subject of Canadian tariffs, don't be surprised if the Canadian sponsors approach the National Energy Board (NEB) for larger rates of return than the NEB has specified. The original rates were set in a period when inflationary expectations were somewhat lower than they are today.

Since much of the case above is made on the basis of comparisons, the Alaska pipeline and plant sections would not seem to require such a broad waiver, so I was pleased to see the President chose to exclude the return of and on equity in the preoperational billing for these sections. In fact, it is not clear that any preoperational billing is necessary if creditworthy parties (the producers and sponsors) guarantee the debt until billing commences. But since their degree of creditworthiness is limited, and preoperational billing after the pipeline or plant is complete reduces the amount of producer and/or sponsor creditworthiness needed, this aspect of the waiver makes some sense.

So long as gas prices remain regulated at below the market clearing price, the situation can be described as "You can pay me now or you can pay me more later!" With the return of and on equity held hostage, there is virtually no doubt that the entire system will eventually be completed. Thus consumers of the pipeline companies that purchase the gas are having no significant additional risks imposed upon them with the passage of the waiver. They will have to pay some charges somewhat sooner than if the waiver were not permitted, but these payments would otherwise be added to rate base and be charged to customers later, with interest. The maximum charge to a customer appears to be in the neighborhood of \$1.50/month for probably no longer than one year -- but this is clearly a function of the

debt repayment schedule. You and the FERC could keep this to a minimum by encouraging the sponsor to negotiate their debt repayment schedules to provide minimum repayment the first year of anticipated service.

To reiterate with respect to the additional "risk" borne by consumers if the waiver is granted, it is very low as long as the return of and on equity is withheld for the completed section. This is especially true if the Incentive Rate of Return (IROR) is deemed to continue to be operative, as it should; it provides a strong penalty for delay and should continue to be geared to completion of the entire system as the principal device to assure the planning and control necessary to achieve a timely and minimum cost completion.

Some earlier comments in this set of hearings have characterized these waivers as not consistent with our competitive system. That is true, but it must be remembered that the ANGTS system is itself to be a regulated entity, making that otherwise reasonable criterion largely irrelevant. Regulation of the return to equity takes the upside potential away from the equity investor and, correspondingly, they are reluctant to take more downside risks than necessary. It appears in this case that it will be necessary for the equity sponsors to guarantee the debt until the tariff triggers as a condition for private financing; if that is true, it appears reasonable to reduce that particular burden by granting them relief of that burden at the earliest reasonable date, as the waiver appears to have captured.

Inclusion of Conditioning Plant

The waiver package seeks to redefine the ANGTS system to include the conditioning plant and to clarify that Alaskan Northwest Natural Gas Transportation Company is a "natural gas company" under the Natural Gas Act at the time of final certification to construct and operate the pipeline and plant. These waivers accomplish two things.

First, they make parts of Section 110 of NGPA inoperative with respect to Prudhoe Bay gas and reverse FERC's Order No. 45 by effectively granting full conditioning cost recovery over and above the NGPA Section 109 wellhead price set by Congress. Only you can judge whether that is reasonable, but the Commission was clearly conditioning that recovery on significant participation by the producers in the financing of the project. You may wish to consider the same.

Second, it clearly makes the gas conditioning plant eligible for the special regulatory treatment provided by the Revenue Act of 1971 with respect to the investment tax credit (ITC). If the conditioning plant were kept separate, conceivably the Commission could capture the half billion or so dollars of investment tax credits it will generate for consumers while still allowing reasonable after tax profit to equity capital suppliers. Including the plant as part of a natural gas company's system blocks the Commission from considering the ITC in setting its rates. This is clearly a sweetener to system equity suppliers and imposes additional costs on gas consumers so long as gas price regulation continues.

Net National Economic Benefit

Mr. McMillian's testified that the Net National Economic Benefit (NNEB) of the project is estimated to be in the neighborhood of \$40 to \$90 billion with a median of \$60 billion. In reviewing the study which supports this range, I have found two questionable assumptions. First, the study includes the present value of the NGPA wellhead price as a cost. But the only resource cost for the gas is the incremental expenses the producers will have to pay to sell gas and, assuming the proposed waterflooding program would have to be undertaken even if the gas is not sold, these costs are minimal. Deleting this cost element would add another \$25 billion to the NNEB, making the median value \$85 billion. However, the second assumption is that a 3 percent real interest rate is sufficient to discount the national costs and benefits. Most economists would disagree. In the Decision we used 10 percent as the rate to discount constant dollar costs and benefits. This would reduce the present value of the benefits from \$110 billion to roughly \$60 billion; the present value of the costs (excluding wellhead price) would fall from \$25 billion to something like \$20 billion. Thus the NNEB under this higher discount rate would be in the neighborhood of \$40 billion. My personal belief is that 10 percent is too high and 3 percent is too low, making the NNEB fall between \$40 and \$60 billion for the "base" case.

A critical question, of course, is who receives the NNEB, whatever its value. There are five parties: producers, system capital (debt and equity) suppliers, State of Alaska, U.S. taxpayers, and consumers. Each gets a share of the pie, and their relative share depends critically on the value of the gas and the regulatory mode (i.e., will natural gas be

deregulated). I have earlier noted that substantial benefits accrue to the State. The U.S. taxpayer gets his/her share via the income taxes paid by the producers and the pipeline sponsors. The system capital suppliers get a very small and more or less fixed amount. If there is continued gas price regulation (ala NGPA), a large share is split between the producers and customers. If deregulation of natural gas is operative, the producers (and, to a lesser extent, the State and U.S. taxpayers) capture the share that would otherwise accrue to customers receiving the gas. This is because under deregulation, the price the customer pays is exactly equal to the national economic value of the gas and, insofar as it costs less than that to produce and deliver, the other parties share the difference.

Impact of Deregulation

Deregulation of all natural gas, including Prudhoe Bay gas, would not substantially affect the NNEB, per se, but would materially alter the allocation of risks and rewards in the sharing of whatever NNEB there was among the various participants. It would shift much greater risk on to the producers (and via the royalty provision, the State), but also provide the chance for them to gain substantial benefits. Consumers would bear no risk since, regardless of whether the project was completed or not and regardless of its cost, the price they will pay will be set solely by competitive forces in the end user market.

From a national perspective, in terms of assuring that design and construction of the system is done most efficiently, deregulation virtually eliminates the need for the incentive rate of return plan developed by the FERC in response to the terms set down in the President's Decision. Deregulation would result in producers receiving a netback price, so it would be in their own best interest to ensure that transportation costs were minimized. This might also create an incentive for the State to take an equity role in the pipeline to protect its interest in the netback and avoid a confrontation similar to that currently between the producers and the State over the TAPS tariffs. If so, this is a clear plus for advocating deregulation.

Deregulation would also make the issue of whether the conditioning plant should be part of the system moot from the customers' perspective.

Most importantly, it places the critical decision as to whether the NNEB is positive clearly in the hands of those best able to make that judgment -- the producers. If they proceed, they must have to bet that the gas will sell in a competitive market at a price sufficiently high to cover all costs of production and delivery, including an adequate return on invested capital. Virtually all the risk is borne by them and other equity sponsors of the ANGTS.

While this is undoubtedly a great benefit of deregulation, deregulation also presents some real problems. The first of these is the possibility of a windfall profits tax, and that possibility might be enough to dampen the enthusiasm of the producers for the project. Don't be surprised if they seek congressional assurances on this at some future date (such as during deregulation hearings).

The second problem has to do with short-term marketability. In a sense this is not a problem since the gas is sold on a long term basis, but netback pricing could result in a low or negative wellhead price in the early years of the project. To some extent this problem can be reduced by altering the tariff structure over time from that premised on the conventional straight line depreciation and declining rate base to, by one means or another, an inverted depreciation schedule which results in a more levelized cost of service tariff. In fact, there is nothing theoretically wrong with having even negative depreciation (the asset appreciates in value) that would allow the delivered cost to rise through time, but there is a critical limit here: whenever tariffs on the system are deferred to be collected later (with interest), cash flow to service debt (and equity) is reduced. Thus the theoretic capability is practically limited by the real needs for cash flow from consumers to cover operating costs and service capital. Insofar as the debt capital suppliers will undoubtedly be pressing for early debt repayment, this will pose very practical limits on the degree of levelizing achievable.

Thus the producers (and State) may have no choice but to sell the gas for very low or even negative prices in the early years. But this is not an unusual case for any product that takes time to develop a market. As long as the potential to earn high profits is not endangered by the fear of a windfall profits tax, the producers and State should be able to work it out.

I am in favor of natural gas deregulation because it places decisions such as those you are facing today directly before those who are most affected and best able to ascertain the impacts. It is true that it would result in an immediate and large increase in residential gas bills, but then these consumers would be facing the true marginal cost of energy we pay as a nation. The result would be a higher degree of conservation of our scarce energy resources and better economic decision making on energy supply projects. I would like to see the natural gas deregulation issue settled quickly, for I fear that deferring it until the NGPA breaks down on 1/1/85 will only result in a new set of regulations. But that is a topic for another day.

New Tax Law Impact

In an earlier hearing, the question was raised regarding the impact of the new depreciation schedules on the project. With deregulation, of course, there would be no impact on consumers and the time value of the accelerated depreciation would be captured by the producers. Under continued regulation, as administered by the FERC, consumers would capture all of the time value benefits of the more rapid acceleration of depreciation of the system; none would be obtained by the pipeline equity suppliers or the producers. By deferring income tax payments, the new accelerated depreciation does assist somewhat in generating cash flow to service debt.

Conclusion

I am not an expert on the geopolitics of world oil or the geological prospects for domestic oil and natural gas production. In earlier testimony, Chairman Butler testified that there is a good likelihood that as much as 2 TCF (10%) of our nation's natural gas production may be depleted by the mid-80's as the Gulf of Mexico fields play out. If so, and other gas alternatives remain expensive, Alaska gas could be valued at least as high as crude oil and may even command a premium. On the other hand, if there is a natural gas "glut," its value will roughly equal #6 high sulfur resid, which traditionally has sold at roughly 80 percent of the price of crude oil. Thus as the world oil and domestic gas supply situation changes, so does the value of the ANGTS.

While the net value of the project clearly depends on the cost of the project and what we will pay for alternate fuels, we have a natural tendency to focus on the downside risk and seldom focus on the upside potential. The NNEB will increase substantially if we were to recognize that Prudhoe Bay gas sales will run at 2 Bcf per day for at least 35 years, and that's probably just the beginning of gas from Alaska and the Beaufort Sea that could be transported through the system. Already the Kuparuk formation is about to come on line and a number of "tight" holes have been drilled elsewhere. The pipeline can be expanded at relatively low cost to carry additional volumes and the anticipation of its presence will undoubtedly stimulate exploration activities.

As responsible policy-makers, it is imperative that Congress provide a framework in which a portfolio of energy alternatives be allowed to develop. In the absence of deregulation, approving the waiver package, perhaps with some modifications, will provide an opportunity for the marketplace to judge whether this project should proceed. Sound portfolio management requires that the various components of the portfolio be less than perfectly positively correlated with one another and the ANGTS proposal meets that critical test. If it turns out that world oil is abundant and cheap, and that large amounts of other gas are available at low cost, then the ANGTS project could end up a marginally costly (in an opportunity sense) venture. But if the world oil and domestic gas supplies prove to be unstable and costly, the ANGTS project will be a real winner for us. To me the ANGTS project is like insurance for the nation, but even better: the downside risk appears small and the upside potential enormous.

Statement of

Edmond R. du Pont, President
Edmond R. du Pont and Associates

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

November 4, 1981

Mr. Chairman and Members of the Committee, I am Edmond R. duPont, President of Edmond R. duPont & Associates. I am pleased to have the opportunity to appear today to comment on the President's submission of a proposed waiver law relative to the Alaska Natural Gas Transportation System.

I wish to focus today on one aspect of the total analysis of this project; the comparison of the cost of gas during the life of the system to the cost of oil. The testimony presented by John McMillian (Oct. 20, 1981: pps. 46-47) made the following statement, "These costs, when deflated to 1980 dollars, average from \$4.65 to \$5.00 per million Btu's during the first twenty years of the project...This declining real cost is the basis for the bargain that the Alaskan gas represents for the nation..."

The problem with this statement is that a comparison is being made of a stream of prices that declines over time expressed in constant 1980 dollars with one that increases over time. The principles of finance require that such comparisons incorporate a discount factor to account for the fact that the person paying the lower price can invest the difference at a positive rate, thus a dollar saved now is worth more than a dollar saved later. For instance, at a 10 percent discount rate, a dollar saved now could earn another full dollar in seven years

with annual compounding; hence a dollar saved seven years from now is worth only half as much as one saved now. A dollar saved 14 years from now would be worth only a quarter as much.

Most analyses of this project show that the initial price for the gas would be in 1980 dollars about \$8.50 to \$9.00 per million btu, well above a projected oil price of about \$5 to \$6. The gas price is expected to decline in constant dollar terms and the oil price to rise. In most cases they cross over between two and five years after project completion and the oil price rises well above the gas price.

The application of discounting to such price streams will tend to reduce the impact of the lower gas prices in later years and of the high oil prices also, since the dollars in the later years have a lower present value. The higher the discount rate, the more this is true. It follows then that there is a single discount rate that gives the same present value to a rising and a declining price stream. At this rate the customer is indifferent whether he contracts for oil or gas. At a higher discount rate he prefers oil because it is currently cheaper. At a lower discount rate he prefers gas because it becomes cheaper later.

In fact, a purchaser of the gas in 1987 looking at a world with no real increase in oil prices would be indifferent as to which fuel he chose at a discount rate of 8 percent in real

(constant 1980 dollar) terms. As the expected price increase path for oil rises, this discount rate increases by about the same amount as the real rate of increase for the oil. If the project cost assumptions in this case are correct, the project is an economically attractive one so long as the real discount rate is less than 8 percent more than the expected real increase in the cost of oil.

A rate of 8 percent is less than the long run average return on common stocks, but greater than the normal real return for long term debt. The project, as presented, is not unambiguously attractive. It is necessary, then, to look at two questions. First, who pays the difference if the project is overpriced. Second, regardless of the long term economics, how can the gas be sold during the period in which it is priced higher than oil, assuming that a decontrolled gas market is in equilibrium at the oil price when the gas is delivered.

The answer to the first question is: either the customers, the producers, or the sponsors pay the difference if the project is overpriced depending on the exact mix of waivers and tariff provisions. When so much debt funding is at stake in a single project, lenders will demand guarantees from one or the other, or all three. I think these assurances are necessary because the loss of so much money in a single transaction would do significant harm to our major financial institutions and should be avoided.

Of the waivers at issue here, the inclusion of the conditioning plant and the billing data waiver shift the risk towards the customers. The waiver concerning authority to modify or rescind orders makes permanent whatever mix of risk burden is decided. The inclusion of producers as equity participants increases the capacity of the sponsors to bear the risk but does not necessarily shift any burden.

In the existing tariff order, the incentive return system shifts some risk to the sponsors, while the minimum bill shifts much of the risk of the debt holders to consumers. Appendix A contains a discussion of the risks of this type of project and the kinds of approaches commonly taken to transfer them.

The second question concerns the saleability of the gas. By 1987, a high enough percentage of lower 48 gas will be decontrolled under current law that we can expect the market to have reached a clearing price. Most analysts expect this price to be near that for crude oil, or slightly below it, to allow for fixed distribution costs to large industry and for the discount from crude cost that has been traditional for residual fuel oil in the past.

During the early years of the project, if normalized accounting is used, and the full cost of both gas and transportation are charged as a single unit price at the ANGTS delivery points, the Alaskan gas can be expected to cost more than the average market clearing price at the delivery points.

There are three ways to distribute the burden of this price. Two are relatively simple ways that could be found to level out the early costs to match the available market. The first is to set the wellhead price low in the early years with an escalator that reflects the appropriate discount rate, to provide a present value equivalent to a constant real rate. Alternatively, the transportation cost could be fixed and the wellhead cost freed of control with no take-or-pay limits on the delivery side of the line. In this way the full market burden would be shifted to producers who would have to adapt to the market continuously.

A second approach would be to use at least a partial flow-through accounting system. Perhaps the investment tax credit could be amortized over the first five years and flowed through to consumers. This would reduce cash flow to the sponsors at the beginning, but would also reduce rates substantially.

The third way is to execute a long term take-or-pay contract that guarantees passthrough of the price, whatever it is, and that it is passed through in the rates by both FERC and the states.

The first approach shifts the risk to the producers, the second to the sponsors and the third to consumers. The choice of who assumes the ultimate risk is up to you.

Mr. Chairman, that concludes my presentation. I would be pleased to answer any questions you may have.

Prepared Statement
Of
DANIEL E. MUSE
Commissioner
Colorado Public Utilities Commission

Before The
Subcommittee on Fossil and Synthetic Fuels
Of The House Committee on Energy and Commerce
And The
Subcommittee on Energy and the Environment
Of The House Committee on Interior and Insular Affairs

Washington, D.C.

November 9, 1981

Mr. Chairman, fellow Committee members, my name is Daniel Muse.

I am a member of the Colorado Public Utilities Commission. It is both a great honor and a privilege to appear before you today on a matter of such profound public interest. I appear here because as a public utility commissioner, I feel uniquely qualified to address some of the issues raised by the waiver package proposed for the Alaska Gas Pipeline project which are the subject of these proceedings. As a Public Utility Commissioner, it is my responsibility to balance the interests of investor and ratepayer alike, and to set just and reasonable rates, charges and tariffs to adequately compensate the utility while insuring that the quality and quantity of service received by the ratepayer is consistent with the price he must pay for that service. In short, I am neither a friend nor foe of either interest but instead an arbiter for the public interest.

This role has made me sensitive to inequities wherever I find them. To my regret, I find them in the waiver package now before you. In a letter of August 11, 1981 to Chairman Sharp, the Colorado Public Utilities Commission raised several questions about the propriety of several aspects of the proposed waiver provisions. I will now amplify on the issues raised therein.

The first concern that we expressed was with respect to requests to waive provisions of Section 7(c) of the Natural Gas Act, which empowers FERC to conduct formal adjudicatory or evidentiary hearings on Certificates of Public Convenience and Necessity regarding the construction and operation of interstate pipelines such as the Alaska Natural Gas Transportation System. Sponsors of the waiver package

desire to substitute the written comment procedure in lieu thereof. The Colorado Commission firmly believes that FERC should be left the discretion to determine in formal evidentiary proceedings whether or not certain Certificates of Public Convenience and Necessity should be issued on this project. We do not believe that questions as to the necessity of construction of ANGTS have been adequately answered. We do not believe that it should be constructed at any cost nor that it should be constructed without an opportunity to assess whether conditions should be attached to the construction, performance or the rate of return to be allowed.

The Commission's concern about the need to build the ANGTS results from the fact that there are no current shortages of natural gas in the lower 48 states. Also the Commission envisions no shortages in the foreseeable future. In a recent FERC publication, the 28 pipeline companies that transport 99% of the natural gas used in interstate commerce projected no significant disruption of natural gas supplies for 1981-82 even if this is a colder than normal winter. The publication further indicates that this temporary surplus represents continued reductions in demand for natural gas because of conservation, a sluggish economy and price competition from alternate fuels such as fuel oil and coal. Evidence that there are reductions in demand for natural gas includes the decrease in Canadian and Mexican imports of natural gas by 21.4% for calendar year 1980.

Within the Rocky Mountain Region, gas reserves are very substantial. A geological survey conducted by Barlow and Haun, Inc. in January 1979

but updated in January 1980, placed regional known reserves at 14 TCF and undiscovered resources most probably between 73 and 89 TCF. That same survey indicates that ~~Regional~~ ^{REGIONAL} reserves may actually exceed 143 TCF. Estimates of from 16.5 to 33 TCF of natural gas reserves in the overthrust belt area of Wyoming have prompted a consortium of interstate pipeline companies to plan the construction of the trailblazer pipeline system. The pipeline system will market this Rocky Mountain natural gas in the Eastern and Midwestern regions of the United States because of inadequate demand for these huge resources within the Rocky Mountain region. In Colorado, 98% of all gas consumed by jurisdictional utilities is purchased from Colorado Interstate Gas, Western Slope Gas Company or Colorado wellhead gas producers. Recent supply calculations from Colorado Interstate Gas and Western Slope indicate reserve-life indices that are increasing not decreasing. These increasing indices do not take into account possible future purchases by Colorado Interstate Gas of the 73 to 89 TCF yet to be discovered in the region. Western Slope Gas Company's 1980 sales were down approximately 15% from 1979. Sales levels in 1981 are expected to be 15% below the 1980 levels. Much of the reason for the reduced sales is conservation. Conservation has resulted from substantial natural gas price increases since enactment of N.G.P.A. in 1978. In November of 1978, the national ceiling rate for natural gas was \$1.54 per MCF. The current rate for N.G.P.A. Section 102 gas is \$2.94 per MCF. Since the N.G.P.A. went into effect the natural gas prices to customers in Colorado have risen dramatically. Commission staff estimates calculate that by 1985 ratepayers of Colorado's largest distribution utility will pay rates 428% higher than in 1978. In Colorado, less than 15% of the electrical energy is generated

by gas and oil and that percentage is declining. The reasons for the decline include the availability of high grade low cost coal as a primary generation fuel, the retirement and infrequent use of older oil- and gas-fired generators and the ability to purchase electricity from other utilities at cost below self-generated oil- or gas-fired generation.

In Colorado, the per capita gas consumption has decreased annually every year since 1976. These statistics by no means prove that the ANGTS is not necessary, but they do illustrate the need to quantify more precisely what existing reserve levels are in the lower 48 states and whether those levels will meet domestic needs in light of decreasing usage. Before we launch headlong into a venture as costly as the one now before us, such an examination should be a prerequisite. Evidentiary hearings would provide an appropriate forum for this kind of review. Estimates of reserve quantities could be put to the test, judgments about costs of construction and production could be validated or refuted. With the stakes being as high as they are, I see no good reason why such careful evaluation and analysis should not be undertaken. Formal hearings for Certificates of Public Convenience and Necessity would be the perfect vehicle for review.

Evidentiary hearings also would allow consideration of the appropriateness of attaching conditions to the construction and performance of the pipeline project. Cost overruns in public utility plant projects have become common place; some have run as high as 500%. Already the costs for this project have climbed to approximately 161% of earlier projections. Cost overruns, represented by higher construction costs, must be borne by the ratepayers unless abuse of management discretion is clearly demonstrated. Evidentiary hearings would have the advantage of helping to ascertain whether costs and other calculations

are realistic and, when appropriate, provide an opportunity to make necessary adjustments as a means of making the project more cost efficient.

Performance guidelines and criteria can be considered in certificate of necessity proceedings also. Part of the rationale for the project is the assumption that there are 26 TCF of recoverable natural gas. If the amount actually recoverable is substantially less, then the entire financial viability may be greatly impaired. In 1975, the Colorado Public Utilities Commission intervened in a Colorado Interstate Gas pipeline application for a Certificate of Public Necessity and Convenience. Colorado Interstate Gas wanted to construct a pipeline from Bear Paw region of North Central Montana into Wyoming to interconnect with Colorado Interstate Gas' existing pipeline system. The purpose was to bring what was estimated as substantial reserves from the Bear Paw region to Colorado Interstate Gas markets. During the course of the evidentiary hearings, the estimated reserve projections were discredited and as a consequence plans for the pipeline were scrapped. If these estimated North slope quantities can not be recovered then ratepayers who may be assessed fixed-charge expenses in advance may have paid for a project which is not fully used and useful in delivering economical natural gas.

Evidentiary hearings would allow FERC to set conditions on the allowance of full rate base treatment and also set an incentive rate of return if appropriate. In Colorado in the 1979 Trans-Colorado Pipeline case, our Commission established an incentive rate of return formula. The purpose was to guarantee a minimum volume flow of natural gas as a precondition to earning a rate of return. To provide an incentive, the Commission set a demand charge to be applied to the first

4000 MCF of gas sold, a commodity charge at the companies' actual cost, and a 15% rate of return on all demand above 4000 MCF. The more gas the pipeline company transports and sells, the greater the return on investment.

Evidentiary hearings are important. Ratepayers have a real and substantial stake in paying no more than is actually necessary for the provision of utility service. A comment procedure would be grossly inadequate to satisfy this valid interest. Please continue FERC authority to conduct evidentiary hearings.

The second major issue of concern expressed in the Colorado Commission's letter of August 11 was the proposed waiver of provisions of Sections 4 and 5 limiting FERC's ability to alter or amend filed rates or to reduce charges by ANGTS owners. The waiver conditions, if adopted, will prohibit FERC from changing the initial rates of return even though economic conditions may change drastically. Such a result is totally inconsistent with fundamental principles of public utility rate making. This perpetual guarantee of a fixed rate of return may result in excessive profits for investors and unjust and unreasonable rates for ratepayers. Rates of return are directly tied to the cost of equity capital which fluctuates either up or down based on general economic conditions such as inflation.

In Colorado during the period 1973-1975, when the cost of borrowing money was high, this Commission increased allowable rates of return to address adverse market conditions in an effort to facilitate the acquisition of investor equity. As a consequence, the allowable rate of return climbed from 12.53% in September, 1972 for the state's largest gas and electric utility to 15% in March, 1975. When the economy improved substantially in 1976 and 1977, the allowed rate of return was

reduced to 13.9% because the cost of equity capital declined to this level. If the high cost of equity capital that we are now experiencing declines in similar fashion, the 17.5% rate of return will provide a windfall to investors of the ANGTS. The allowance of a rate of return only 1% higher than the actual cost of equity capital for ANGTS will result in an over-collection of revenues of 6.1%. Excess earnings would be in the range of \$125,000,000 on an annualized basis or more than \$3 billion over the life of the project (assuming a 25% equity contribution). Under these circumstances, a rate of return subject to adjustment would seem essential.

The establishment of a 17.5% rate of return on equity for the project causes me concern for another reason as well. The pre-billing provisions, if implemented, would in effect reduce substantially any risk of loss to the investors of this project. Any rate of return should be based upon risks comparable to the investor's risk in this venture, not general market investor risks. I think it can be legitimately argued that the allowance of pre-billing would result in an investor risk approaching zero. In such an instance, the riskless capital rates of treasury bonds may be the appropriate measure of a fair return. For calendar year 1981, the treasury bond rate has averaged 12.94% on 20-year capital market bonds, and 12.74% on 30-year market bonds. Since the ANGTS project is estimated to have a 25-year life, the rate of return on equity paralleling these rates would seem to be appropriate.

The waiver provisions to limit the allowable suspension period to one day rather than the current five-month period have been advanced by the package sponsors because of concerns that operation of

the suspension mechanism may lead to needless delays in recovering increased operating expenses of the project. This justification for waiving the suspension period is not persuasive for several reasons.

First, the FERC is not required to suspend filed rates. By statute, it is empowered to allow filed rates to become effective on 30-days notice or shorter notice if application therefor is made in appropriate circumstances. The FERC does allow rates to become effective without suspension. The same option would be available with respect to the ANGTS project. There is no reason to suspect that the FERC would act arbitrarily or capriciously in suspending rates and tariffs. For that reason FERC should be allowed to continue to exercise its administrative discretion unimpaired.

A second reason to reject such a waiver provision is that without a suspension period, ratepayers will be deprived of the use of their money for the entire period of any adjudication of rates and tariffs. If a refund is awarded, with the waiver of suspension provision in effect, ratepayers will be deprived of their capital five months longer than at present. The prospects of long delays before refunds are provided is real. Although refunds provide reimbursement on a dollar for dollar basis, plus interest, full compensation for the use of ratepayer money may still not be realized. Full compensation would be realized only when the interest rate on refunds is equal to the lost opportunity to invest in alternative investments. In addition, the reduced purchasing power of the refunded dollar could result in a net loss in the real value of money, when those funds are withheld for long periods of time. By allowing FERC discretion to suspend, these time value of money problems will be mitigated.

The third major area of concern expressed by the Colorado PUC, in the August 11th letter, is the possible application of pre-billing costs to ratepayers for all expenses prudently incurred during the construction phase of the project. Such a provision expressly shifts the risk of project failure to the ratepayers which is antithetical to basic principles of public utility ratemaking. Traditionally, a public utility asset only becomes a chargeable expense to ratepayers when it becomes used and useful in the provision of utility service.

In the regulatory arena, this view has been long held for several reasons. First, the investors in public utility projects will have an opportunity to earn an assigned rate of return on a product which has a guaranteed market once the plant is completed. In light of this circumstance, it has been deemed appropriate for any pre-completion risk to be borne by those who stand to profit once the facility becomes operational. Because investors have a real and substantial stake in seeing the plant completed and at the earliest possible date, deferral of any contribution by ratepayers provides an incentive to complete the project efficiently and quickly.

In addition, if ratepayers are required to pay for public utility service before they actually receive the benefit, an economic inequity clearly results. Although payment is made now, they may get an inferior product later or conceivably receive nothing at all if the project is a failure. A third problem with ratepayer contributions before project completions is an inevitable mismatch between who pays for the project in advance and who actually receives the benefits. Some of the ratepayers who are now on the Colorado public utility system will not be on the system in 1987 when ANGTS is scheduled for completion.

For these reasons, the implementation of pre-billing would create substantial problems for Colorado ratepayers and is not favored by the Colorado PUC. If it is determined that pre-billing is necessary, certain precautions should be taken to minimize the potential harm.

Any pre-billing requirements should include an express provision for refunds or a credit to be offset against billings after the pipeline becomes operational. An interest component should be built into the refund or credit mechanism. If refunds or credits cannot be implemented because of administrative difficulty or other valid reasons, then the funds provided by ratepayers should be treated as contributions in aid of construction and thereby either considered as a reduction of rate base or as zero cost capital. The effect of allowing such a mechanism would limit the pipeline owners to a return only on capital they actually invest in the project rather than on the entire value of the plant.

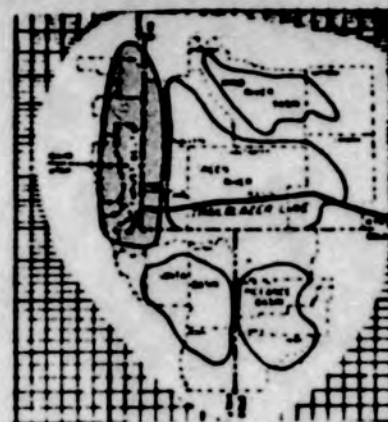
In summary, the ANGTS program with the proposed waiver package causes me grave concern. If the requested waivers are implemented, the ratepayers will be making a massive investment in a project where there exist serious questions as to necessity and feasibility.

Thank you for this opportunity to testify.



BARLOW & HAUN, INC. GEOLOGISTS

Casper, Wyoming
January 31, 1980



Mr. Leon Kreisler
Natural Gas Pipeline Company of America
122 South Michigan Avenue
Chicago, Illinois 60603

Re: Trailblazer Pipeline Project

DOCKET NO. CP79-80

2ND AMEND. & REVISED EXHIBITS

Dear Mr. Kreisler:

Mr. Kieser asked us to provide you with an overview of gas supply as it is being developed in the area of the proposed Trailblazer system. As you know our firm has from time to time provided gas supply information to the Trailblazer group and the following comments are a summation and review of some of the data.

In January, 1979 Barlow & Haun, Inc. analyzed the gas reserve and potential resource in the basins adjacent to and in the area of the proposed Trailblazer Pipeline. Our estimates were as follows:

BASIN OR AREA	RESERVES		UNDISCOVERED RESOURCE		
	Cumulative Production	Remaining	Min.	Most Likely	Max.
Thrust Belt	0.01	1.25 to 2.5	10.0	16.5 to 33	49.1
Green River	3.90	6.6	9.4	22.75	46.4
Wind River	1.15	3.0	12.3	19.9	24.0
Uinta-Piceance	1.10	1.3	9.0	12.0	22.0
Hanna-Laramie	0.09	0.001	0.001	0.001	0.002
Denver	1.00	1.6	0.5	1.0	2.0
Great Plains	Minor	Minor	0.2	0.4	0.8
Total	7 TCF	14 TCF		73 to 89 TCF	

Developments in 1979 have not caused our perspective of this potential gas supply to change. A range of values had been given for the Thrust Belt because the play was in an early stage. Although the play is still in an early stage encouraging results during 1979 favor the upper range of estimates for remaining reserves and most likely resource.

In July, 1979 we studied drilling rates and gas discovery rates in greater detail for response to FERC's question 50d-to Trailblazer regarding the timing of

TESTIMONY
OF
ROBERT A. GEORGINE, PRESIDENT
BUILDING AND CONSTRUCTION TRADES DEPARTMENT, AFL-CIO

BEFORE THE
HOUSE SUBCOMMITTEE ON
FOSSIL AND SYNTHETIC FUELS

NOVEMBER 9, 1981

MR. CHAIRMAN, I AM ROBERT A. GEORGINE, PRESIDENT
OF THE BUILDING AND CONSTRUCTION TRADES DEPARTMENT,
AFL-CIO.

OUR DEPARTMENT REPRESENTS 4.5 MILLION WORKERS IN
THE BUILDING AND CONSTRUCTION TRADES.

I THANK YOU FOR THE OPPORTUNITY TO PRESENT THE
VIEWS OF OUR ORGANIZATION ON THE IMPORTANCE OF THE
ALASKA NATURAL GAS TRANSPORTATION SYSTEM BOTH TO THE
ENERGY SECURITY OF THIS COUNTRY AND TO THE POSITIVE
IMPACT CONSTRUCTION OF THE PROJECT WILL HAVE ON OUR
ECONOMY.

LET ME STATE AT THE OUTSET THAT THE VARIOUS
MEMBERS OF THE AFL-CIO, INCLUDING THE BUILDING AND
CONSTRUCTION TRADES DEPARTMENT, STRONGLY SUPPORT THE
WAIVER OF LAW PROPOSED BY THE PRESIDENT.

THE ANGTS, WHICH WILL CONSIST OF A GAS
CONDITIONING PLANT AND 4,800 MILES OF PIPELINE AND
RELATED FACILITIES, WILL PROVIDE A VITAL TRANSPORTATION
LINK CONNECTING VAST NATURAL GAS RESERVES IN ALASKA TO
MARKETS IN THE LOWER 48 STATES.

ITS EXPEDITIOUS CONSTRUCTION TO ASSURE DELIVERY
OF OVER 13 PERCENT OF THIS COUNTRY'S PROVEN NATURAL GAS
RESERVES UNQUESTIONABLY IS IN THE NATIONAL INTEREST.

WITHOUT THIS TRANSPORTATION LINK TO MOVE ALASKAN
GAS RESERVES TO LOWER 48 STATE MARKETS, THIS COUNTRY
WILL INCREASE ITS DEPENDENCE ON OPEC OIL -- OIL WHICH
REMAINS SUBJECT TO EMBARGO OR DRASTIC PRICE INCREASES.

WITHOUT THIS TRANSPORTATION LINK, THIS COUNTRY
COULD AGAIN EXPERIENCE THE DISASTROUS EFFECTS OF GAS
CURTAILMENTS, INCLUDING THE TEMPORARY CLOSING OF FACTORIES
AND WORKER LAYOFFS EXPERIENCED IN THE MID 1970'S.

THE ANGTS WILL PROVIDE THE FOLLOWING BENEFITS TO
THE UNITED STATES:

- O PROVIDE NATURAL GAS THAT WILL BE NEEDED BY
HOMES, BUSINESSES AND INDUSTRY IN THE 1980's
AND THEREAFTER;
- O PROVIDE A LOWER-COST ENERGY ALTERNATIVE TO
FOREIGN OIL OVER THE LIFE OF THE PROJECT;
- O ENHANCE U.S. NATIONAL SECURITY BY REDUCING
OUR DEPENDENCE ON FOREIGN OIL;
- O STIMULATE THE DEVELOPMENT OF ADDITIONAL
NATURAL GAS SUPPLIES IN THE NORTHERN
REGIONS OF ALASKA;
- O IMPROVE THE U.S. BALANCE OF PAYMENTS.

THE INTEREST OF THE INDIVIDUAL MEMBERS OF THE
BUILDING TRADES IN OBTAINING THESE BENEFITS IS
IDENTICAL TO THAT OF ALL AMERICANS.

OUR MEMBERS REPRESENT A SUBSTANTIAL PERCENTAGE
OF THE U.S. POPULATION, AND AN ENDORSEMENT OF THIS
PROJECT BY THIS SEGMENT OF SOCIETY SHOULD BE
APPROPRIATELY CONSIDERED BY CONGRESS IN ACTING UPON
THE WAIVER PACKAGE.

EVEN MORE IMPORTANT TO THE BUILDING TRADES IS THE
FOLLOWING BENEFIT:

- O CREATION OF A SIGNIFICANT NUMBER OF NEW
JOBS FOR U.S. WORKERS IN CONNECTION WITH
THE CONSTRUCTION AND OPERATION OF THE ANGTS.

AT THE PRESENT TIME, ABOUT 1,000 PEOPLE ARE
WORKING ON THE ALASKA PIPELINE SEGMENT OF THE PROJECT.

NEXT YEAR, EMPLOYMENT WILL PEAK AT ABOUT 3,100 --
APPROXIMATELY 60 PERCENT ASSOCIATED WITH THE GAS
CONDITIONING PLANT AND 40 PERCENT WITH THE PIPELINE
SEGMENT AND THE COMPRESSOR STATIONS.

ABOUT 600 OF THE 3,100, OR 20 PERCENT OF THE
WORKFORCE WILL BE IN ALASKA.

IN 1983, PEAK EMPLOYMENT WILL REACH APPROXIMATELY
9,500, OF WHICH 65 PERCENT WILL BE IN THE LOWER 48
STATES.

FROM 1984 THROUGH THE END OF CONSTRUCTION IN 1987,
THE MAJORITY OF EMPLOYMENT WILL OCCUR IN ALASKA.

THE PROJECT'S PEAK EMPLOYMENT WILL OCCUR DURING 1985 AT OVER 16,000 WORKERS, 90 PERCENT OF WHOM WILL BE LOCATED IN ALASKA.

THE MANPOWER PROJECTIONS FOR 1982 THROUGH 1987 ARE SHOWN IN THE ATTACHED TABLE.

THE EXPERTISE NECESSARY TO CONSTRUCT THE NORTH SLOPE GAS CONDITIONING PLANT AND THE ALASKAN PIPELINE SEGMENT OF THE ANGTS WILL INCLUDE ASBESTOS WORKERS, CARPENTERS, CATERERS, ELECTRICIANS, IRON WORKERS, LABORERS, OPERATING ENGINEERS, WELDERS, TEAMSTERS, MASONS, BOILERMAKERS, MILLWRIGHTS, SHEET METAL WORKERS, PAINTERS, PIPEFITTERS AND PLUMBERS.

EXPENDITURES FOR CRAFT LABOR ALONE WILL TOTAL MORE THAN \$2 BILLION IN 1980 DOLLARS FOR WAGES AND RELATED BENEFITS.

THESE STATISTICS DEMONSTRATE THAT THE ANGST
WILL HAVE A SIGNIFICANT POSITIVE EFFECT ON OUR
NATION'S ECONOMY AND EMPLOYMENT.

THIS IS PARTICULARLY IMPORTANT IN VIEW OF THE
CURRENT DEPRESSED STATE OF THE CONSTRUCTION INDUSTRY.

IN ADDITION, THE OPPORTUNITY TO WORK ON THE ANGST
WILL BE OPEN TO ALL.

THE DEPARTMENT OF THE INTERIOR HAS ISSUED FINAL
RULES TO ENSURE THAT NO PERSON OR FIRM WILL BE EXCLUDED
FROM PARTICIPATING IN ANY ACTIVITY CONNECTED WITH THE
CONSTRUCTION OR OPERATION OF THE ANGST ON THE BASIS OF
RACE, CREED, COLOR, NATIONAL ORIGIN, AGE OR SEX.

THE OFFICE OF THE FEDERAL INSPECTOR ALSO HAS APPROVED
THE PROJECT'S AFFIRMATIVE ACTION PLAN WHICH MANDATES EQUAL
OPPORTUNITY ON THE PROJECT FOR EMPLOYMENT AND CONTRACTING
AND ASSURES THAT ALL AMERICANS WILL RECEIVE A FAIR SHARE
OF THE OPPORTUNITIES CREATED BY THIS PROJECT.

THE BUILDING AND CONSTRUCTION TRADES WELCOME THE
OPPORTUNITY TO PARTICIPATE WITH INDUSTRY IN CONSTRUCTION
OF THE LARGEST PRIVATELY FINANCED PROJECT EVER UNDERTAKEN
AND ARE PREPARED TO MEET THE CHALLENGES OF THE ANGTS.

TIMELY CONSTRUCTION OF THE ANGTS AT THE LOWEST
POSSIBLE COST TO ALASKAN GAS CONSUMERS WILL REQUIRE
DEDICATION, COMMITMENT AND COOPERATION BY EVERYONE
INVOLVED.

WE ARE EAGER TO DO OUR PART TO HELP OUR COUNTRY
BECOME MORE INDEPENDENT FROM ALL SOURCES OF FOREIGN
ENERGY.

THIS CONCLUDES MY PREPARED REMARKS.

Alaska Natural Gas Transportation System
Alaska Segment

PROJECT MANPOWER

1982 - 1987, By Quarter

<u>Year/Quarter</u>		<u>--Pipeline & Comp. Stations--</u>			<u>----Conditioning Plant-----</u>			<u>-----Total Project-----</u>		
		<u>Alaska</u>	<u>Lower 48</u>	<u>Sub-Total</u>	<u>Alaska</u>	<u>Lower 48</u>	<u>Sub-Total</u>	<u>Alaska</u>	<u>Lower 48</u>	<u>TOTAL</u>
1982	1st	190	720	910	20	820	840	210	1,540	1,750
	2nd	280	890	1,170	170	900	1,070	450	1,790	2,240
	3rd	280	920	1,200	240	1,000	1,240	520	1,920	2,440
	4th	260	950	1,210	340	1,560	1,900	600	2,510	3,110
1983	1st	900	890	1,790	390	4,650	5,040	1,290	5,540	6,830
	2nd	2,300	810	3,110	460	3,690	4,150	2,760	4,500	7,260
	3rd	2,550	680	3,230	510	4,260	4,770	3,060	4,940	8,000
	4th	2,500	510	3,010	780	5,660	6,440	3,280	6,170	9,450
1984	1st	4,400	360	4,760	810	5,540	6,350	5,210	5,900	11,110
	2nd	6,900	340	7,240	940	3,630	4,570	7,840	3,970	11,810
	3rd	8,200	350	8,550	1,060	4,260	5,320	9,260	4,610	13,870
	4th	6,000	330	6,330	1,210	4,200	5,410	7,210	4,530	11,740
1985	1st	8,900	280	9,180	1,090	3,190	4,280	9,990	3,470	13,460
	2nd	13,200	270	13,470	1,100	1,450	2,550	14,300	1,720	16,020
	3rd	12,300	250	12,550	1,230	530	1,760	13,530	780	14,310
	4th	7,000	230	7,230	1,200	430	1,630	8,200	660	8,860
1986	1st	8,500	210	8,710	1,190	430	1,620	9,690	640	10,330
	2nd	9,100	210	9,310	1,200	430	1,630	10,300	640	10,940
	3rd	4,900	170	5,070	900	420	1,320	5,800	590	6,390
	4th	1,800	150	1,950	80	410	490	1,880	560	2,440
1987	1st	400	80	480	40	280	320	440	360	800
	2nd	770	80	850	20	240	260	790	320	1,110
	3rd	550	70	620	20	210	230	570	280	850
	4th	150	60	210	10	180	190	160	240	400

WRITTEN SUBMISSION IN SUPPORT OF
ORAL TESTIMONY TO BE DELIVERED
BEFORE THE HOUSE COMMITTEE ON
INTERIOR AND INSULAR AFFAIRS AND
THE HOUSE COMMITTEE ON ENERGY AND
COMMERCE REGARDING THE ALASKA
NATURAL GAS PIPELINE WAIVER PACKAGE

SUBMITTED BY
THE COUNCIL FOR YUKON INDIANS
WHITEHORSE, YUKON TERRITORY, CANADA

INTRODUCTION

The Council for Yukon Indians, representing all of the 6,000 native Indian people in the Yukon Territory, Canada, would like to thank the Joint Committee for being given the opportunity to testify before you on November 9th, 1981.

We believe that our message to your Committee may very well be met with both surprise and even some anxiety. However, we are of the opinion that our government, the Government of Canada, has been misleading the United States authorities with respect to the status of our outstanding native land claims. We wish to take this opportunity to set the record straight. We believe that you, the American legislators who are considering the present Bill, should be fully aware of the disturbing fact that even after eight years of negotiation, the Canadian Government has failed to reach a settlement with our people regarding our long outstanding claim to ownership of our land. This claim includes the entire pipeline corridor through the Yukon Territory.

We suggest that after you have heard our oral testimony, you might invite Canadian government officials to testify before your Joint Committee. We suggest that you invite them to refute our representations. We suggest that they will be forced to confirm the embarrassing circumstances which they have brought upon themselves.

The Council for Yukon Indians is committed to the position that there will be no construction of the pipeline

within the Yukon Territory until our people have achieved a just and equitable settlement of our outstanding land claims.

BACKGROUND

The proposed pipeline corridor is routed through hundreds of miles within the Yukon Territory.

Native people make up more than a quarter of the total population of the Territory.

No treaty has ever been signed between our people and any level of government to extinguish our aboriginal title to the Yukon Territory. Indeed, Americans faced a similar situation in Alaska where construction of the Alyeska pipeline was delayed until a settlement with the Alaska native people was achieved in the early 1970s.

The Canadian Government recognizes our claim. Negotiations have been proceeding for some time between our organization and the Government of Canada. However, there is still no settlement. Consequently, the proposed pipeline corridor is on land upon which there is a pre-existing claim of ownership by the native people of the Yukon.

It is impossible to predict when our people and the Government will agree to a settlement. Unless and until the Canadian Government's attitude changes, the negotiations will be arduous, rocky and burdened with uncertainty.

CANADIAN GOVERNMENT POSITION

We said at the outset that our Government has misled the U.S. Government. We believe that Canadian officials have continuously left the American Government with the impression that the outstanding native claims in the Yukon were either not worthy of American concern or that these claims would be expeditiously dealt with and settled.

For example, President Carter made a statement in a report to Congress in which he indicated:

The problem of resolving native claims in the Yukon Territory in Canada has once threatened to delay construction. However, the Government of Canada has recently assured the U.S. that resolution of these claims will not delay construction and will not result in any monetary costs or claim against the pipeline. Under the agreement it is expected that construction in the Yukon will commence by January 1, 1981.

We are also led to believe by the U.S. oil producers that they, too, have been given the impression by the Canadian Government that our claims were either settled or at least were not an obstacle to the pipeline project.

POSITION OF FOOTHILLS PIPELINES (YUKON) LTD.
(the Canadian developer)

We are not certain what the Canadian developer has told you about our situation, but we believe that Foothills Pipelines is clearly on record as saying that there should be no pipeline construction until settlement of native claims.

For example, Foothills, in an undertaking before the National Energy Board (Undertaking #1, Appendix 5-2, National Energy Board Report), indicated:

Foothills has taken the position that construction of a pipeline in the Yukon should not proceed until there is a broad acceptance of the project by the residents of that area.

(Ref.: Mr. S.R. Blair's testimony to the National Energy Board, December 10/76 - transcript pp. 18780-18793)

Mr. Blair, who is president and chief executive officer of the company, clearly stated his commitment to the National Energy Board:

... as a responsible pipeline operator, we would not proceed to run over the local people where even a significant majority, even 5% or 2% of responsible local citizens say, "we don't care what permits you have got, we don't care what licence or what legal document you are holding in your hand; we don't want you in here and get off". For such a particular case I have asserted that we don't go in there; we talk and keep talking and persuading until we can get in and that is a truth of responsible pipeline management.

... we would regard such outright hostility and defiance by a significant representation among the responsible citizens resident in the region as constituting a force majeure which should be referred back to the Board and among the contracted parties for further review.

(N.E.B., Exhibit N-GH-5-112, April, 1977)

In a press statement by Foothills Pipelines on October 17, 1979, Mr. Robert Blair stated:

In recent meetings with the CYI as well as with the Government of Canada, Foothills (Yukon) has urged that such negotiations be resumed and carried to completion or common agreement before construction activity could raise questions of land occupancy legal rights.

THE CYI POSITION

Our position is clearly on record. We take the position that there must be no pipeline construction within our territory until we agree to a just and equitable settlement of our claim.

Any attempt at construction of the pipeline within our territory will be met with firm legal action to prevent the project from proceeding.

This is not a hollow threat. We took legal action to upset the decision of the National Energy Board in respect to this very pipeline, only to be frustrated by the Canadian Parliament which passed special legislation superseding the National Energy Board decision. Our law suit was made academic.

CYI also challenged the Foothills oil pipeline application before the National Energy Board. We succeeded on a preliminary motion in having the Foothills application thrown out by Canada's regulatory energy tribunal.

We are committed to continuing with our course of action with the objective of blocking the construction of this pipeline until we have reached a just and equitable settlement of our claim. Such a position should not come as any surprise to you, a nation which has so jealously upheld the doctrine that native people maintain aboriginal

title to land for which no treaties have been signed. Your Government, recognizing this serious impediment to the construction of the Alyeska pipeline, and facing the threat of litigation by way of injunction, expeditiously settled the Alaska claim.

We plead with you to recognize and respect our interest. We recognize that the U.S. Government cannot settle our claim - but you can demand that one of the terms of passing this proposed Congressional Bill be that the native claims in the Yukon Territory must be settled before pipeline construction commences.

To do otherwise is to walk recklessly into a labyrinth of unknowns, fraught with lawsuits, time delays and huge financial cost overruns which will be borne ultimately by the American consumer.

Sound planning dictates that before construction commences, the pipeline route be free from all encumbrances, including aboriginal ownership.

The United States must tell the Canadian authorities in no uncertain terms that a precondition to this mammoth pipeline project proceeding is the settlement of our claim. We thank you for your assistance to that end.

Thank you.

THE COUNCIL FOR YUKON INDIANS

SEE APPENDIX ATTACHED

APPENDIX

Selected passages and quotes relevant to the Council for Yukon Indians' submission

1. President Carter's statement in a report to Congress:

The problem of resolving native claims in the Yukon Territory in Canada has once threatened to delay construction. However, the Government of Canada has recently assured the U.S. that resolution of these claims will not delay construction and will not result in any monetary costs or claim against the pipeline. Under the agreement it is expected that construction in the Yukon will commence by January 1, 1981.

2. The Hon. Allan MacEachen, the Canadian Minister responsible for the pipeline:

It is a matter with all its implications for the Government of Canada. I believe that there was some interest in the United States in knowing whether we intended to charge the pipeline, for example, for any settlement that might be negotiated, so that assurance was clearly given. I believe that as I recollect was one very important concern.

The second point is we believe that through the process of negotiations with the Indian representatives we can and ought to be able to reach a settlement of native land claims. We believe that and we are proceeding on that basis, that it should be possible to arrive at a fair and just settlement.

Minutes of Proceedings of the
Special Committee on the
Northern Pipeline Act;
27-2-78; 1:41

3. The Hon. Allan MacEachen:

Mr. Chairman, I would prefer that Mr. Faulkner would deal more fully with the question of land claims. I have given what I know to be the importance that the government attaches to the settlement of the claims, and I am aware of varying time frames that have been advanced.

Your question, however, is quite specific, and says "What will we do if we do not succeed?" Well we are operating on the assumption that we must succeed. Presumably there is in the back of your mind the thought that maybe if these claims are not settled they will become a deterrent in the construction phase. That may be in the back of your mind; I am not sure that it is. We have not made contingency plans against the possibility that we would fail in reaching a settlement; at least, I have not.

Maybe the Minister of Indian Affairs can throw more light on that.

....

There are, as I understand it, various legal devices that can be used in situations of this kind. We have been quite conscious of the opportunity that a bill of this kind might be sent to remove, for example, some of these legal devices. We have not done that. We are operating on the assumption that we can reach a settlement, that we must reach one, and it is certainly not my intention to expose to the Committee contingency plans as to what we would do or not do two or three years down the road. We are putting our emphasis on the negotiations and we have not, in this bill, removed any of the legal remedies that may be currently available to any group in the country that might wish to take action in the courts.

Minutes of Proceedings of the
Special Committee on the
Northern Pipeline Act;
27-2-78; 1:71

4. The Hon. Hugh Faulkner, Minister of Indian Affairs, speaking in Parliament:

I would now like to look specifically at the Yukon Indian land claim. I have purposely left the most pressing issue to last, and that is this issue of the Yukon land claim relative to the pipeline. The pipeline is a reality which cannot be avoided. It is therefore in the interests of both the government and the Yukon Indian people to ensure that the land claim is settled quickly and fairly, and that both sides do everything possible to avoid prejudicing the negotiations toward the settlement of the claim. We have three full years before construction starts in earnest in the Yukon, and I believe this should be sufficient to achieve a just settlement of the claim and to make a good start on its implementation.

Hansard, February 14, 1978,
p. 2845

5. The Hon. Hugh Faulkner, Minister of Indian Affairs:

Well, I have not been directly involved in this business of land claims very long, but I have been interested in the issue for a long time. I have always felt that the fair and just settlement of land claims was one of the most important things we are doing, not only as a government, but as a country. And I am convinced that the fair and just settlement of the land claims north of 60 is a precondition to the sort of normal political economic evolution that everyone in the north would like to see take place.

Minutes of Proceedings before
the Special Committee on the
Northern Gas Pipeline;
Vol. 3:10; 1-3-1978

6. Telex of The Hon. Hugh Faulkner, Minister of Indian Affairs, to Daniel Johnson, President of the Council for Yukon Indians on September 20, 1977 (excerpts):

I want to make it clear that the announced agreement in principle for a gas pipeline through the Yukon has not altered in any way the

Government's view that the successful resolution of your claim is of paramount importance. The process that is now leading to a settlement will continue to receive my complete support.

...

... The pipeline agreement we have reached with the U.S.A. underlines the importance of resuming discussions at the earliest possible date.

Found in Appendix "NGP-5" to Minutes of Proceedings of the Special Committee on the Northern Gas Pipeline, Vol. 7, March 8, 1978.

7. Press statement of Foothills Pipe Lines (Yukon) Ltd., issued October 17, 1978 (excerpt):

It has been known publicly that the Indian people in the Yukon Territory are represented for land settlement negotiations by the Council of Yukon Indians. In recent meetings with the C.Y.I. as well as with the Government of Canada, Foothills (Yukon) has urged that such negotiations be resumed and carried to completion or common agreement before construction activity could raise questions of land occupancy legal rights.

8. Testimony of Mr. Robert Blair, Chief Executive Officer of Foothills Pipe Lines (Yukon) Ltd. before the National Energy Board:

Foothills has taken the position that construction of a pipeline in the Yukon should not proceed until there is a broad acceptance of the project by the residents of that area.

Mr. S.R. Blair's testimony to the N.E.B., 10 December, 1976, transcript pp. 18780-18793.

... as a responsible pipeline operator, we would not proceed to run over the local people where even a significant minority, even 5% or 2% of of responsible local citizens say, "We don't care what permits you have got, we don't care what licence or what legal document you are

holding in your hand; we don't want you in here and get off". For such a particular case I have asserted that we don't go in there; we talk and keep talking and persuading until we can get in and that is a truth of responsible pipeline management.

If matters came to such a pass, as there is good reason to believe might occur in the Mackenzie Valley region based on the positions taken by the elected leaders of the Indian Brotherhood of the Northwest Territories and of chiefs and band councils in the settlements, we would hesitate rather than crash ahead. While a permit could be issued for the construction of the pipeline containing a condition that construction must commence by a certain date or the permit could then be withdrawn by the National Energy Board and while we would be under serious contractual commitments to proceed with construction, we would regard such outright hostility and defiance by a significant representation among the responsible citizens resident in the region as constituting a force majeure which should be referred back to the Board and among the contracted parties for further review.

N.E.B. Exhibit N-FH-5-112,
April, 1977

9. Further testimony by Mr. Robert Blair before the National Energy Board, April, 1977:

One point I want to make with the greatest emphasis at my command is that it would be wrong, morally and politically, to trample roughshod over the claims and aspirations of those Canadians who are members of northern native organizations in the name of expediency. I just do not think that a responsible government would consider doing so ...

10. Mr. Justice T.R. Berger in his report entitled Northern Frontier, Northern Homeland: The Report of the Mackenzie Valley Pipeline Inquiry:

At the heart of my recommendations is the need to settle native claims. This need bears