

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

1074 SCOMM 28: JOINT GAS PIPELINE COMMITTEE, 1981-82

To the extent that the net CAGSL expenditures were irrecoverable by any members of the group, the ultimate loss would be borne in the same percentages shown above, with Alberta Natural Gas Company bearing the balance, 18.55%, of such loss.

In December 1978, Alberta Natural Gas Company determined that it could not recover any of its net CAGSL expenditures and called upon the other three members of the group to reimburse it for their agreed upon shares of such expenditures.

On December 31, 1978, but as of February 1, 1978, Calaska claimed, as pre-partnership expenditures on behalf of the group, all of Alberta Natural Gas Company's net CAGSL expenditures, including AFUDC through January 31, 1978^{11/}. These expenditures totaled \$9,689,376 (Canadian). At December 31, 1978 conversion rates, the American dollar equivalent was \$8,156,517. However, instead of claiming that amount as pre-partnership expenditures, Calaska computed their claim on a hypothetical basis, using conversion rates that were in effect at the time each Canadian dollar payment was made by Alberta Natural Gas Company to CAGSL.

^{11/} Cash reimbursements by the group to Alberta Natural Gas Company also included AFUDC from February 1, 1978 to December 31, 1978, but these amounts were not claimed because Calaska will accrue AFUDC on the claimed expenditures commencing February 1, 1978.

As a result, Calaska claimed pre-partnership expenditures of \$9,456,744, whereas the actual American dollar amount which would have been required at December 31, 1978 to repay Alberta Natural Gas Company for all of its net expenditures to CAGSL through January 31, 1978 was only \$8,156,517, or \$1,300,227 less.

While Calaska's pre-partnership expenditures are overstated by \$1,300,227 because of the improper method used to account for Canadian/American dollar exchange differences, no separate adjustment for this item will be necessary if staff's position with respect to disallowance of all claimed CAGSL expenditures is sustained (see item 1 above).

3. Pacific Interstate Transmission Company (Arctic) -
Interest Reimbursements

Pacific's claimed pre-partnership expenditures include AFUDC on payments made to CAGSL by an affiliated company. However, such expenditures were not reduced by \$23,375 of interest reimbursements received by the affiliated company when various equalization payments were received as new companies joined the CAGSL group. Accordingly, Pacific's claimed pre-partnership expenditures are overstated by \$23,375 and staff proposes that such amount be disallowed. No separate adjustment for this item will be necessary if staff's position with respect to disallowance of all claimed CAGSL expenditures is sustained (see item 1 above).

4. Recovery of CAGSL Expenditures Via Tariff Charges

The parent companies of three of the partners have already recovered significant portions of the claimed CAGSL pre-partnership expenditures through tariff billings to existing customers. Additionally, two of the partners' parent companies have recovered the carrying costs associated with some of the CAGSL pre-partnership expenditures.

a. Northern Arctic Gas Company

As of June 30, 1979, Northern, through the rates charged by its parent, Northern Natural Gas Company, had recovered at least \$2,333,261 of its pre-partnership CAGSL expenditures. These expenditures were allowed in determining Northern Natural Gas Company's cost of service as follows:

<u>Docket No.</u>	<u>Amount</u>
RP74-80	\$ 243,840
RP75-89	243,840
RP77-56	577
R&D Tracker	1,845,004
	<u>\$2,333,261</u>

In addition to the amounts shown above, \$353,289 of expenditures relating to CAGSL regulatory costs, along with other regulatory costs, have been and are being amortized as charges to gas operating expenses. Therefore, there is a presumption that the \$353,289 has been or will be recovered by Northern Natural Gas Company's tariff rates.

Northern's claimed pre-partnership CAGSL expenditures do not give recognition to the recoveries that have been made by its parent company.

Prior to October 31, 1976, all payments to CAGSL, less related accumulated deferred income taxes, were recognized in Northern Natural Gas Company's rate base and rates. Beginning November 1, 1976, only the amounts listed below were allowed in rate base:

<u>Month</u>	<u>Net Amount Reflected in Rate Base</u>
<u>1976</u> - November	\$1,772,277
December	898,562
<u>1977</u> - January	1,037,081
February	1,151,974
March	1,261,157
April	1,321,863
May	1,429,392
June	1,515,412
July	1,623,665
August	1,798,420
September	1,835,996

While various portions of the CAGSL expenditures were included in rate base, and at least \$2,333,261 has been recovered in cost of services through June 30, 1979, AFUDC was accrued and capitalized by Northern based on the total CAGSL expenditures without giving recognition to the rate treatment afforded part of these same expenditures. As a result, AFUDC related to the CAGSL pre-partnership expenditures is also overstated.

b. Pan Alaska Gas Company

As of June 30, 1979, Pan Alaska, through its parent, Panhandle Eastern Pipeline Company, had recovered \$4,160,970 of its pre-partnership CAGSL expenditures. These expenditures were allowed in determining Panhandle Eastern Pipeline Company's cost of service as follows:

<u>Year</u>	<u>Amount</u>
1973	\$ 685,727
1974	1,095,763
1975	1,778,005
1976	206,220
1977	206,220
1978	189,035
	<u>\$4,160,970</u>

Pan Alaska's claimed pre-partnership CAGSL expenditures do not give recognition to the recoveries that have been made by its parent company.

In addition, Pan Alaska has computed AFUDC on the total CAGSL expenditures without giving recognition to the cost of service rate recoveries made by its parent company. As a result, AFUDC related to CAGSL pre-partnership expenditures is overstated.

c. Pacific Interstate Transmission Company (Arctic)

As of June 30, 1979, Pacific, through its affiliate, Pacific Lighting Service Company, had recovered \$1,148,044 of its pre-partnership CAGSL expenditures. These amounts have been recovered since January 1, 1978 through rates established by the California Public Utilities Commission.

Pacific's claimed pre-partnership expenditures do not give recognition to recoveries that have been made by its affiliated company.

In addition, all of Pacific's claimed CAGSL expenditures have been allowed in rate base, on a net-of-tax basis, by the California Public Utilities Commission. However, Pacific has computed AFUDC on total CAGSL expenditures without giving recognition to the rate base treatment allowed its affiliated company for such expenditures. As a result, AFUDC related to CAGSL prepartnership expenditures is overstated.

The staff proposes that the claimed pre-partnership expenditures of Northern, Pan Alaska and Pacific be disallowed to the extent that their parent companies had recovered such expenditures through January 31, 1978, and that any recoveries made after that date be credited against any remaining pre-partnership expenditures.^{12/} However, no separate adjustments for this item will be necessary if staff's position with respect to disallowance of all claimed CAGSL expenditures is sustained (see Item 1 above).

^{12/} By letter dated April 19, 1979, to the Secretary, FERC, the attorney for ANNGTC stated that a portion of the pre-partnership expenditures claimed by Northern and Pan Alaska had been recouped. The letter states that the then outstanding balance for Northern was \$6,427,926 (a reduction of \$3,159,864) and for Pan Alaska was \$4,227,681 (a reduction of \$5,427,447). The reduced claimed outstanding balances reflect the recoveries through tariff billing by the parent companies discussed on pages 21-23 and lower AFUDC claims resulting from the lower outstanding balances. The attorney for ANNGTC proposed that appropriate adjustments, to avoid over-recovery by Pan Alaska and its affiliates and by Northern and its affiliates, be made at such time as the ANNGTC tariff becomes effective, and revenues are generated thereby.

5. Federal Income Tax Benefits Derived from CAGSL Expenditures
Need to be Associated with Claimed CAGSL Pre-Partnership
Expenditures

The parent companies of Pan Alaska, Northern, and Pacific have already claimed the pre-partnership CAGSL expenditures as tax deductions for Federal income tax purposes, thereby reducing their tax liabilities for prior years.^{13/} This procedure will result in higher tax liabilities in future years (deferred taxes).

ANNGTC is a partnership and, as such, will not pay Federal income taxes. However, ANNGTC tariff rates will include allowances for Federal income taxes which will be paid by the individual companies or their parent companies. Such tax allowances should not include any amounts for the higher tax liabilities resulting from the parent companies' use of the tax benefits associated with costs capitalized as part of the ANNGTC project. Accordingly, to assure this result, staff believes that the tax benefits already realized by the parent companies (represented by deferred taxes) should be recorded on the books of ANNGTC.

In addition, the deferred taxes balances represent a reduction in the net cost of CAGSL expenditures. Staff believes that this reduction in cost should be reflected in ANNGTC's AFUDC computations during the construction period and in ANNGTC's rate base during the period of operations by reducing the base for such computations by the deferred tax balances relating to the CAGSL expenditures.

^{13/} IRS has consistently challenged these claimed tax deductions but the dispute has not yet been resolved.

Recommendations

The staff recommends that:

1. \$15,190,609, including AFUDC of \$965,272, of Northwest's pre-partnership expenditures be allowed as charges properly assignable to the ANNGTC project and be determined as qualified for eventual inclusion in the rate base of ANNGTC.
2. \$193,236, including AFUDC of \$12,278, of Northwest's pre-partnership expenditures be disallowed as costs qualified for eventual inclusion in the rate base of the ANNGTC.
3. \$3,664,342, including AFUDC of \$232,847, of Northwest's pre-partnership expenditures be disallowed as costs properly assignable to the ANNGTC project for eventual inclusion in rate base, without prejudice to Northwest's reclaiming them upon submission of appropriate supporting information.
4. All of the \$38,366,833, including AFUDC of \$6,587,916 relating to the CAGSL pre-partnership expenditures of Calaska, Northern, Pan Alaska and Pacific be disallowed as costs properly assignable to the ANNGTC project.
5. \$1,300,227 of Calaska's claimed pre-partnership expenditures, relating to Canadian/United States dollar exchange differences, be disallowed. No separate adjustment for this item will be necessary if recommendation number 4 is adopted, since all claimed CAGSL expenditures would be disallowed.

6. \$23,375 of Pacific's claimed pre-partnership expenditures, recovered by interest reimbursements received, be disallowed. No separate adjustment for this item will be necessary if recommendation number 4 is adopted, since all claimed CAGSL expenditures would be disallowed.
7. The claimed pre-partnership expenditures of Pacific, Pan Alaska and Northern be disallowed to the extent that their parent companies had recovered such expenditures through tariff charges to their customers through January 31, 1978. Any such recoveries by the parent companies after January 31, 1978, should be credited against any remaining pre-partnership expenditures. No separate adjustments for this item will be necessary if recommendation number 4 is adopted, since all claimed CAGSL expenditures would be disallowed.
8. The deferred taxes arising from Pan Alaska, Northern and Pacific's parent companies' use of CAGSL expenditures as deductions for Federal income tax purposes be recorded on ANNGTC's books.

This recommendation becomes moot if recommendation number 4 is adopted, since all claimed CAGSL expenditures would be disallowed.

9. All AFUDC amounts included as pre-partnership expenditures by Pacific, Pan Alaska, Northern and Calaska be recomputed and reduced to reflect the recommendations in this report.

This recommendation becomes moot if recommendation number 4 is adopted, since all claimed CAGSL expenditures would be disallowed.

Alaska Northwest Natural Gas
Transportation Company
Pro Forma Balance Sheet
As of February 1, 1978
With Staff Adjustments Thereto

	<u>Pro Forma Balance 2-1-78</u>	<u>Staff Adjustments</u>	<u>Adjusted Balance 2-1-78</u>
<u>Assets</u>			
Plant in Service	\$ 175,617	\$ -	\$ 175,617
Less: Accrued Depreciation	(1,671)	-	(1,671)
Net Plant in Service	<u>173,946</u>	<u>-</u>	<u>173,946</u>
Construction Work in Progress:			
Northwest Alaskan Pipeline Co. Expenditures	18,974,241	(3,857,578)A/	15,016,663B/
CAGSL Expenditures	<u>38,366,883C/</u>	<u>(38,366,883)</u>	<u>-</u>
Total CWIP	<u>57,241,124</u>	<u>(42,224,461)</u>	<u>15,016,663</u>
Total Assets	<u>\$57,415,070</u>	<u>\$(42,224,461)</u>	<u>15,190,609</u>
<u>Partners' Equity</u>			
Calaska Energy Company	\$ 9,456,744	\$(9,456,744)	\$ -
Pacific Interstate Transmission Co. (Arctic)	9,667,221	(9,667,221)	-
Pan Alaska Gas Company	9,655,128	(9,655,128)	-
Northern Arctic Gas Co.	9,587,790	(9,587,790)	-
United Alaska Fuels Corp.	-	-	-
Subtotal	<u>38,366,883C/</u>	<u>(38,366,883)</u>	<u>-</u>
Northwest Alaskan Pipeline Co.	<u>19,048,187</u>	<u>(3,857,578)A/</u>	<u>15,190,609B/</u>
Total Partners' Equity	<u>\$57,415,070</u>	<u>\$(42,224,461)</u>	<u>\$15,190,609</u>

A/ Includes \$245,125 of AFUDC
B/ Includes \$965,272 of AFUDC
C/ Includes \$6,587,916 of AFUDC

BACKGROUND DATA

CANADIAN ARCTIC GAS STUDY GROUP LIMITED (CAGSL)

CAGSL, also known as the Gas Arctic/Northwest Project Study Group, was a consortium of United States and Canadian energy companies (see Exhibit 3 for a list of the members and their contributions) which attempted to obtain the necessary certificates and permits required of the Canadian and U. S. Governments to build a pipeline transversing Alaska and Canada.

The project had its beginning in 1967 when Trans Canada Pipelines Limited, Michigan Wisconsin Pipeline Company and Natural Gas Pipeline Company of America organized the Northwest Project Study Group (NPSG) to conduct engineering and feasibility studies for a natural gas pipeline system to transport natural gas from the Canadian Northwest Territories to gas markets in the United States. In June of 1969, the NPSG was expanded to include studies for a pipeline from Alaska and the Mackenzie Delta. The consortium membership was expanded to include Standard Oil Company of Ohio, Atlantic Richfield Company and Humble Oil & Refining Company (Exxon).

In 1969, Alberta Gas Trunk Line Company Limited, undertook studies which resulted in its sponsorship of the Gas Arctic Project (GAP). The initial proposal considered was the construction of a 1,550 mile pipeline from Prudhoe Bay, Alaska, to connect with Alberta Gas Trunk Line's facilities near Grande Prairie, Alberta. The other initial members of

this group were Canadian National Railways, Columbia Gas Systems, Inc., Northern Natural Gas Company and Texas Eastern Transmission Corporation. Pacific Lighting Gas Development Company joined the group in 1971.

Studies for both projects were conducted independently until July of 1972. At that time, the GAP (with its six members) and the NPSG (with its six members) merged and became the Gas Arctic - Northwest Project Study Group, better known by its service corporation name of Canadian Arctic Gas Study Limited (CAGSL). At the time of the merger, four additional companies joined CAGSL; Canadian Pacific Investments, Gulf Oil Canada Limited, Imperial Oil Limited, and Shell Canada Limited. When this consolidation took place, NPSG had spent \$11,481,944 (Canadian) while the GAP Group had spent \$7,483,980 (Canadian). The combined expenditures of \$18,965,924 (Canadian) became known as CAGSL pre-inception costs. Under the Joint Research and Feasibility Study Agreement of 1972, \$1,185,370.25 (Canadian) of pre-inception costs were allocated to each of the sixteen members of the Group.

Additional members continued to join, each time causing a reallocation of the total contributions through the respective entry dates. The following companies joined CAGSL in late 1972 and early 1973 bringing the total participants to twenty-eight: Canada Development Corporation, Canadian Superior Oil Limited, Canadian Utilities Limited, Colorado Interstate Gas Company, Pampine Pipelines Limited, Sunoco Exploration and

Production Limited, Transcontinental Gas Pipe Line Corporation, Alberta Natural Gas Company, Consumers Gas Company, Panhandle Eastern Pipeline Company, Polaris Pipelines and Union Gas Limited.

CAGSL divided its corporate organization into four units: CAGSL, Alaskan Arctic Gas Study Company (AAGSC), Canadian Arctic Gas Pipeline Limited (CAGPL) and Alaskan Arctic Gas Pipeline Company (AAGPC).

CAGSL was responsible for completing the necessary research and general studies required to indicate project feasibility and to cause to be prepared an application to the NEB and other Canadian government departments for a permit to construct and operate a pipeline in Canada. It managed the day-to-day activities of the total project and assured coordination between themselves and AAGSC. It provided service to AAGSC on an "as needed" basis.

AAGSC was responsible for carrying out the development activities of the project in Alaska. AAGSC prepared the required application for filing with state and federal authorities for authorization to build a pipeline in Alaska.

CAGPL was responsible for making application for Canadian governmental authorizations necessary for construction and operation of the pipeline in Canada. If the project had been successful, it would have constructed and operated the pipeline as a Canadian Inter-Provincial Pipeline Company.

AAGPC was responsible for making application to the U. S. and Alaskan Governments for authorizations necessary to construct and operate the pipeline in Alaska. If the project had been successful, it would have constructed and operated the pipeline section in Alaska.

On March 24, 1974, when the applications were filed with the Federal Power Commission and the Canadian National Energy Board (CNEB) for certificates and permits to build a pipeline through Alaska and Canada known as the Arctic Project, 27 participants remained in the Arctic project. Only Transcontinental Gas Pipe Line had withdrawn. Shortly thereafter, however, other members began to withdraw. The most significant was the withdrawal on September 16, 1974 of Alberta Gas Trunk Line Company Limited, the original sponsor of the Gas Arctic Project. By November 1975, when Atlantic Richfield withdrew, the CAGSL Group was down to fifteen participants, the number that remained for the duration of the project.

In the Spring of 1975, Alberta Gas Trunk Line joined with Westcoast Transmission Company Limited to prepare the Foothills Project. They developed the Foothills (Yukon) Project (sometimes called the "Alaska Highway Project") to move Alaskan gas reserves to the United States. This project was the successful applicant before the CNEB in July 1977 and now is an integral part of the Alaska Natural Gas Transportation System.

After the CNEB decision in July 1977, the CAGSL Group terminated active operation. By that time, \$148,504,479 had been expended. Subsequent cash calls to cover the finalization payments of the group were \$6,345,000 which brought CAGSL expenditures to \$154,849,479 Canadian, the amount covered by this audit.

CAGSL PARTICIPANTS AND PAYMENTS (CANADIAN DOLLARS)

<u>Participating Companies</u>	<u>Date Withdrawn</u>	<u>Contributions and Fees Through Jan. 31, 1978</u>
Alberta Gas Trunk Line	09/16/74	\$ 2,249,285
Atlanta Richfield Company	11/30/75	4,183,524
Canada Development Corporation	10/31/75	4,000,383
Canadian National Realities	05/31/74	2,004,713
Canadian Pacific Investments	02/28/75	2,657,282
Canadian Superior Oil Limited	07/31/75	3,448,043
Canadian Utilities Limited	05/31/75	3,100,655
Colorado Interstate Gas Company	10/15/74	2,317,357
Exxon Company, U.S.A.	02/28/75	2,657,282
Pembine Pipelines Ltd.	10/21/74	2,332,100
Standard Oil (Ohio)	09/30/74	2,282,035
Sunoco E & P Limited (Numac Oil & Gas)	04/30/75	2,908,625
Transcontinental Gas Pipe Line	12/07/73	1,613,072
Alberta Natural Gas Company	N/A	8,020,533
Columbia Gas Transmission Corporation	N/A	8,020,533
Consumers Gas Company	N/A	8,020,533
Gulf Oil Canada Limited	N/A	8,020,533
Imperial Oil Limited	N/A	8,020,533
Michigan Wisconsin Pipe Line	N/A	8,020,533
Natural Gas Pipeline Company	N/A	8,020,533
Northern Natural Gas Company	N/A	8,020,533
Pacific Lighting Gas Development Co.	N/A	8,020,533
Panhandle Eastern Pipeline Company	N/A	8,020,533
Polaris Pipelines (Northern & Central)	N/A	8,020,533
Shell Canada Limited	N/A	8,020,533
Texas Eastern Transmission Corporation	N/A	8,020,533
Trans Canada Pipelines Limited	N/A	8,020,533
Union Gas Limited	N/A	8,020,533
Gross Contributions and Fees		156,062,351
August 1977 Cash Call Overpayment		(1,212,872)
Net Contributions and Fees through January 31, 1978		<u>\$154,849,479</u>

FILED
OFFICE OF THE SECRETARY
FEB 2 2 57 PM '79
FEDERAL
POWER COMMISSION

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Alaskan Northwest Natural
Gas Transportation
Company

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)
) Docket No. CP78-123, et al.

APPLICATION OF
ALASKAN NORTHWEST NATURAL GAS TRANSPORTATION COMPANY
FOR AN ORDER APPROVING PAST EXPENDITURES AND
TO ESTABLISH PROCEDURES FOR CONTINUING AUDIT AND
APPROVAL OF FUTURE EXPENDITURES AND
MAJOR COMMITMENTS

Alaskan Northwest Natural Gas Transportation Company (the Partnership), pursuant to the Alaska Natural Gas Transportation Act of 1976 (ANGTA), the Natural Gas Act, and the Commission's Order Vacating Prior Proceedings and Issuing Conditional Certificate of Public Convenience and Necessity issued December 16, 1977, hereby applies for an order approving, for inclusion in rate base, expenditures made prior to August 1, 1978 ^{1/} for pre-construction activities necessary to place the Alaskan section of the Alaska Natural Gas Transportation System in service. These expenditures are reflected in the capital accounts of each Partner, Northwest Alaskan Pipeline Company (Northwest), Northern Arctic Gas Co. (Northern), Pan Alaskan Gas Company (Pan Alaskan), Calaska Energy Company (Calaska), ^{2/} Pacific Interstate Transmission Company (Arctic) [Pacific] and United Alaska Fuels Corporation (United). The Partnership also requests that the Commission establish procedures to review and approve, on a continuing basis at regular quarterly intervals, completed activities and both actual and conditionally committed expenditures necessary to place the Alaskan section of the Alaska Natural Gas Transportation System in service.

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- ^{1/} Partnership expenditures from August 1, 1978 through December 31, 1978 will be submitted to the Commission for review and approval as soon as practicable.
- ^{2/} Calaska is successor to the interests of Natural Gas Corporation of California and the interests of Natural Gas Corporation of California were transferred to Calaska as of November 28, 1978.

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In support thereof, the Partnership would show as follows:

I.

Background

The Commission initiated a new phase of the proceedings contemplated in ANCTA by its order dated December 16, 1977, issuing a Conditional Certificate of Public Convenience and Necessity as mandated by the Decision and Report to Congress on the Alaska Natural Gas Transportation System issued by the President of the United States on September 22, 1977, and approved by the Congress on November 22, 1977. 3/

Subsequently, on June 30, 1978, the Commission transferred the Conditional Certificate of Public Convenience and Necessity from Alcan Pipeline Company to the Partnership.

II.

Basis for Authorization Requested Herein

A. In the Decision and Report, the President provided that certain "general terms and conditions shall be appropriately incorporated into any certificate, right-of-way, lease, permit or authorization directed to be made by any Federal Officer or agency" (Section 5, page 26). Among such general terms and conditions is the requirement that the Partnership must "submit to the FPC (FERC) for approval on a timely basis all components of construction work in progress." (Finance Condition, page 37; emphasis added.) The order requested herein is necessary to implement this mandate.

B. In the Commission's order issued December 16, 1977, the Commission recognized that it would have either exclusive or coextensive jurisdiction over the President's terms and conditions concerning finance matters, which included the condition described above. Further, the Commission adopted the Partnership's suggestion that quarterly progress reports are appropriate. Thus, the Commission has already moved toward implementation of the above-cited requirement of the Decision and Report and has recognized that authorization of the type requested herein is appropriate.

3/ Pub. L. 95-150, 91 Stat. 1268.

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C. In its Notice of Succession in Interest and Application for Transfer of Certificate of Public Convenience and Necessity filed April 19, 1978, the Partnership indicated that it "...stands ready to report to the Commission, or its Delegate, on all matters relating to the Alaskan Natural Gas Transportation System, and particularly the status of pre-construction planning, funds expended to date, budgeted and anticipated costs for the balance of 1978, financial planning, and system engineering and design. Such other information and reports as the Commission, or its Delegate, may desire will, to the extent of the Partnership's abilities, be furnished in such form and manner as the Commission, or its Delegate may direct. The Partnership requests the institution of a mechanism for review and approval of cost expenditures and budgets for the Project on a regular and recurring basis."

D. The General Partnership Agreement 4/ (the Agreement) envisions Commission review and approval of actual expenditures. The relevant provisions are found in Sections 4.1.1, 4.1.2, 4.1.3 and 4.1.4, which provide a procedure for determining the Qualified Expenditures 5/ of each Partner. Northwest's Qualified Expenditures are \$19,163,000; those of Northern are \$9,587,790; those of Pan Alaskan are \$9,655,128; those of Calaska are \$9,456,744; and those of Pacific are \$9,667,221. 6/ All of these are expressly subject to review and approval by FERC.

In summary, there is ample basis in the Decision and Report and in prior Commission orders, as well as the Partnership Agreement, for the Commission to consider and grant this application.

4/ Reviewed by the Commission and approved in its Order issued June 30, 1978 (Docket No. CP78-123).

5/ Expenditures to acquire information, knowledge, studies, tests, computer programs or governmental authorizations by any Partner or corporate affiliate of a Partner, in the course of activities reasonably related to the selection of a transportation system for the delivery of Alaskan natural gas, if such expenditures were made by such Partner or corporate affiliate prior to January 31, 1978.

6/ The totals shown include an interest component on funds spent.

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XII.

Authorization Requested

A. The Partnership requests that the Commission review and verify (1) the expenditures made by each Partner incurred prior to the formation date of the Partnership which have been determined to be "Qualified Expenditures" and therefore appropriately included in the Partners' capital accounts; and (2) \$15,174,000 in expenditures of the Partnership for the period of February 1, 1978, through July 31, 1978. The Partnership further requests that the Commission, by order, approve acceptance of all such expenditures for inclusion in rate base, subject only to "completion and commissioning of operation of the system," a necessary precondition specified on page 38 of the Decision. Exhibit 2-1 attached hereto shows in detail the amounts and purposes for which "Qualified Expenditures" were made by Northwest. Exhibit 2-2 attached hereto shows in detail the amounts and purposes for which "Qualified Expenditures" were made by Northern, Pan Alaskan, Calaska and Pacific. Exhibit 2-3 attached hereto shows in detail the amounts and purposes for which Partnership funds were expended from February 1, 1978 through July 31, 1978.

B. The Partnership also requests that the Commission institute procedures to audit and approve actual expenditures on a continuing quarterly basis throughout the pre-construction and construction periods of the project.

C. In addition to the audits and approvals of actual expenditures made, the Partnership also requests the Commission to include within the scope of its reviews, upon specific request of the Partnership, certain major financial commitments that are covered by an executed contract for which payment may be due at some future date subject to certain conditions having been met. 1/ In such cases, the Partnership requests that the Commission by order give provisional approval to the obligation or conditional expenditure, subject to later audit and approval by the Commission

1/ The project management contract, the project labor agreement, agreements for purchase or use of Alyeska camps and/or data, and the contracts for purchase of line pipe are expected to have sufficient impact on project costs to warrant advance regulatory review.

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of actual expenditures made. No commitments of this nature are included in the period from February 1 through July 31, 1978.

The Partnership stands ready to make available its books and records at the convenience of the Commission to permit such reviews and field audits as may be required to issue the order requested herein.

IV.

Justification for the Authorizations Herein Requested

A. Qualified Expenditures

Prior to the formation of the Partnership, substantial funds were expended by the individual companies, or their affiliates, for reasonable and necessary expenditures related to the ultimate construction and operation of the Alaskan segment of the Alaskan Natural Gas Transportation System. Because the factual circumstances surrounding the expenditures made by Northwest differ from the factual background and circumstances relating to the expenditures by Northern, Pan Alaskan, Calaska, and Pacific; each category of pre-Partnership expenditures is treated separately:

1. Pre-Partnership Expenditures of Northwest. Northwest, through its predecessor company, Alcan Pipeline Company, was the original applicant for the route and pipeline proposal ultimately selected by the President and the Congress under the terms and conditions of the Alaska Natural Gas Transportation Act. The reasonable and necessary costs to Northwest of presenting to the Federal Power Commission, and later to the President and the Congress, the Alaska Highway Project through the date of formation of the Partnership, was \$19,163,000, including interest. The details of these expenditures are set forth in Exhibit 8-1 and such expenditures were reasonably and prudently made as necessary to the preparation and presentation of Northwest's application for a certificate of public convenience and necessity, Northwest's presentation to the President and the Congress for selection of the Alaska Highway Project as the desired route, and selection of Northwest as the company to construct the Alaskan segment of the ANGTS. All of such expenditures are appropriate for inclusion in the capital account of Northwest as a Partner, and inclusion in the rate base of the Partnership pipeline project.

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2. Pre-Partnership Expenditures of Others.

Northern, Pan Alaskan, Calaska and Pacific made expenditures prior to the formation of the Partnership through their membership and participation in the Gas Arctic/Northwest Project Study Group (Gas Arctic). Gas Arctic was the result of a combination of two groups which had begun studies long before any other study group was formed, and before any of the subsequent applicants for a certificate of public convenience and necessity to transport Alaskan and Canadian gas to lower U.S. 48 markets made any indication that they would file an application. The total paid by participants in the Gas Arctic Study Group through January 31, 1978 was approximately \$154.8 million. The costs were shared by as many as 26 participants, and after a number of participants had withdrawn, the group narrowed to 15 members. Each of these 15 members had paid in \$8,020,533 (Canadian) through January 31, 1978.

Included in the expenditures of the Gas Arctic Group were the following major categories of costs:

Engineering & Construction Planning	\$65.8 million
Environmental Studies and Research	18.6 million
Finance, Accounting, Legal and Other Advisors	16.7 million
General and Administrative	31.2 million
Sociological	4.3 million

The expenditures for the items listed above include basic research such as that done with respect to an Arctic ditcher, metallurgical questions, cost effects, slope stability, the environmental impact on fish, mammals, birds and vegetation, and training programs which might be used in connection with the use of native labor in the project. In addition, substantial amounts were spent developing computer models to be used in engineering and financial analysis, and some of these are currently in use.

The knowledge and information developed by the Gas Arctic Study Group will be useful and of significant importance to the Alaska Highway Pipeline Project. The design and construction of the Alaska

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project will be materially aided by the basic research which was performed into environmental and engineering issues, and the development of computer analysis techniques which resulted from Study Group activities and expenditures. Relevant portions of the information, data, and computer programs developed will be, as a consequence of the Partnership's approval of the "Qualified Expenditures" of Northern, Pan Alaskan, Calaska and Pacific, available to the Partnership for its continuing use in development of the project.

It must be emphasized that the Arctic Gas Project and the Alaskan Highway Pipeline Project were considered as alternatives by governmental authorities at all levels of the decision-making process in both the United States and Canada prior to the time of the President's Decision and Report in September of 1977. If only a single applicant had proposed an Alaska Natural Gas Transportation System, that applicant would nonetheless have been legally compelled at substantial cost to develop and present information on alternative routes, and such costs would clearly have been includable in the rate base of the authorized project. The costs presented here by the Partners who were members of the Study Group were just as necessary to the decision-making process as the costs of the hypothetical single applicant, and should be afforded the same regulatory treatment.

In accord with the Partnership Agreement, the pre-formation expenditures of Northern, Pan Alaska, Calaska, and Pacific have been reviewed by the Board of Partners and a determination made with respect to whether such constituted "Qualified Expenditures." An extract from the Board of Partners' minutes relating to this is appended to this application as part of Exhibit 8-2.

The nation and U.S. gas consumers have benefited from the thorough analysis of transportation alternatives which the Partners' "Qualified Expenditures" made possible. The hearing process before the Federal Power Commission, and the subsequent Presidential selection of a route that is preferable from an environmental and economic standpoint, were materially advanced by the efforts of Northern, Pan Alaska, Calaska and Pacific. Therefore, it is appropriate that those companies who continue to participate in the development of this project to connect Alaskan natural gas be allowed to include those costs as part of the rate base of the Alaskan portion of the system. These

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costs, although significant in relation to the revenues and assets of each sponsoring company, will be less than one percent of the total investment in the Alaskan system.

The details of the pre-Partnership expenditures by Northern, Pan Alaska, Calaska, and Pacific are set forth in Exhibit 8-2 appended hereto. The pre-Partnership expenditures of the four Partners named above were clearly reasonable and necessary to the Partnership pipeline project, and are properly includable in the capital accounts of each such Partner, and in the rate base of the Partnership pipeline project.

B. Partnership Expenditures

The six Partners who have funded the Partnership's pre-construction activities since the formation date of the Partnership have provided \$21,769,000 in funds which were expended prior to August 1, 1978. 8/ The details concerning such Partnership expenditures are set forth in Exhibit 8-3 appended hereto. All of such expenditures were reasonable and necessary to proper planning for, and design of, the Alaskan segment of the Alaska Natural Gas Transportation System, and securing all necessary governmental authorizations, permits, certificates, and rights-of-way. All of such expenditures are properly includable in the capital accounts of the respective partners, and properly includable in the rate base of the Partnership's pipeline project.

C. "Provisional Approvals"

With respect to the request for "provisional approval" of certain contractual obligations and conditional expenditures, we believe that the Commission has the authority to take such action, which would be entirely consistent with Sections 9(a) and (b) of ANGTA, and the provisions of the President's Decision calling upon the Partnership to "submit

8/ This total includes AFUDC but the Partnership does not seek, through this application, approval of the AFUDC rate inasmuch as the Commission has stated its intention to determine this issue in Docket No. RM78-12, Order No. 17-A, issued January 17, 1979. Expenditures, without AFUDC, through July 31, 1978, total \$15,174,000.

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to the FPC (FERC) for approval on a timely basis all components of construction work in progress. The spirit of the latter requirement reasonably can be construed to include certain major potential expenditures covered by an executed contract for future conditional payment. The Partnership does not in any way expect to seek provisional approval for all future expenditures. Rather, it would make such a request on a selective basis where it appears that such an approval would materially reduce uncertainty, and have a correspondingly salutatory effect on the Partnership's ability to obtain private financing. It is presently contemplated that such major cost items as the project management contract, the project labor agreement, contracts for line pipe, and contracts for the acquisition and/or use of Alyeska camps and data will be of sufficient magnitude and will have sufficient impact on project costs, to warrant advance regulatory review and approval.

V.

Argument

It is essential that the audit and approval process for determination that the expenditures of Alaska Natural Gas Transportation System reasonably and necessarily made be implemented on a current and continuing basis. The magnitude of ANGTS is such that delayed review and approval of expenditures will pose insurmountable administrative problems for the Commission and the sponsors. Periodic, and frequent, review and approval of expenditures will reduce the task to manageable proportions; uncertainty will be reduced; and potential problem areas can be promptly identified and necessary corrections made. The authorizations and procedures suggested here will materially enhance cost consciousness on the part of the government, the sponsors and all interested parties.

Further, it is important that the Commission create a positive regulatory environment in order to help assure realization of private financing of this major undertaking. Banks and other potential institutional lenders are carefully observing the regulatory climate surrounding the early stages of project implementation and a prompt, and favorable, consideration of this application will help reassure not only the sponsors themselves, but also potential lenders, that all that the government can possibly do to reduce uncertainty and support this critically important project is being done.

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The sponsors of the Alaskan segment of the ANOTS have already exposed themselves to substantial risk by the advancement of pre-construction dollars in pursuit of a project still beset by major uncertainties and delays. Reassurance to the project sponsors that their faith in the regulatory process has not been misplaced is important at this juncture, particularly in view of the continuing uncertainties which surround the incentive rate of return procedures under consideration in Docket No. NM78-12.

One final reason exists for the Commission's prompt and affirmative action on this application: such action will serve as tangible evidence to those pipeline companies not presently members of the Partnership that their previous Gas Arctic expenditures may reasonably be considered as appropriate for inclusion in the Partnership's rate base if those companies, or any of them, decide on active participation in support of the project as a partner. The Partnership clearly needs a broader base of membership and equity support, and favorable early action on this application by the Commission would be a positive inducement to other prospective partners who have also expended substantial sums in the development and presentation of alternative systems for North Slope gas transportation to join the Partnership.

VI.

The names, titles and mailing addresses of the persons to whom all correspondence and communications concerning this application should be addressed are as follows:

Darrell B. MacKay
Vice President
Northwest Alaskan Pipeline Company
1801 K Street, N.W.
Suite 901
Washington, D. C. 20006

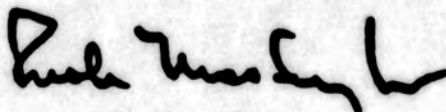
Jack D. Bachman, Esquire
General Counsel
Northwest Alaskan Pipeline Company
P. O. Box 1526
Salt Lake City, Utah 84110

Rush Moody, Jr., Esquire
Vinson & Elkins
1101 Connecticut Avenue, N.W.
Suite 900
Washington, D. C. 20036

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WHEREFORE, the Partnership respectfully requests that the Commission issue an order pursuant to ANOTA, the Natural Gas Act, and the President's Decision, giving final approval to the expenditures described herein for ultimate inclusion in the rate base for the Alaskan section of the Alaska Natural Gas Transportation System. The Partnership further requests that the Commission establish procedures for continuing audit and approval of actual and conditionally committed expenditures.

Respectfully submitted,



Rush Moody, Jr.

Vinson & Elkins
1101 Connecticut Avenue, N.W.
Suite 900
Washington, D. C. 20036
(202) 862-6500

ATTORNEYS FOR
ALASKAN NORTHWEST NATURAL GAS
TRANSPORTATION COMPANY,
A PARTNERSHIP

VERIFICATION

THE DISTRICT OF COLUMBIA §

I, DARRELL B. MacKAY, being first duly sworn on his oath, deposes and says:

That he is Vice President of Northwest Alaskan Pipeline Company and is duly authorized to make this affidavit, that he has read the foregoing and is familiar with the contents thereof, and that the facts and allegations contained therein are true and correct to the best of his information, knowledge and belief.

Darrell B. MacKay
Darrell B. MacKay

Subscribed and sworn to before me this 24 day of February, 1979.

Ann H. Pearlman
Notary Public

My Commission Expires;
MY COMMISSION EXPIRES JAN. 1, 1984

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding in accordance with the requirements of § 1.17 of the Rules of Practice and Procedure.

Dated at Washington, D.C. this 2nd day of February, 1979.



Rush Moody, Jr.

Exhibit 3-1

ALASKAN NORTHWEST NATURAL GAS TRANSPORTATION COMPANY
NORTHWEST ALASKAN PIPELINE COMPANY
QUALIFIED EXPENDITURES 1/

1.	FILING FEE	\$1,671,000	
2.	OFFICE EQUIPMENT	144,000	
3.	TRANSPORTATION EQUIPMENT	30,000	\$1,845,000
4.	COMPANY SERVICES		
	Salaries and Related Benefits	1,347,000	
	Employee Expenses	697,000	
	Office supplies	210,000	
	Equipment Use	1,631,000	
	Recruitment and Relocation	28,000	
	Rents	107,000	
	Other	247,000	
			4,267,000
5.	OUTSIDE SERVICES		
	Legal	3,415,000	
	Executive	188,000	
	Finance	1,524,000	
	Regulatory, Environmental & Civic Affairs	96,000	
	Administration	99,000	
	Public Relations	89,000	
	Engineering	5,996,000	
	Other	153,000	
			11,560,000
6.	DEPARTMENT OF INTERIOR		<u>165,000</u>
	Sub-Total		<u>17,838,000</u>
7.	AFUDC 2/		<u>1,325,000</u>
	Total Qualified Expenditures Including AFUDC		<u>\$19,163,000</u>

1/ Expenditures made prior to January 31, 1978.

2/ Includes only an interest component on funds spent.

**ALASKAN NORTHWEST NATURAL GAS TRANSPORTATION COMPANY
GAS ARCTIC/NORTHWEST PROJECT STUDY GROUP-NOW ANNGTC PARTNERS
QUALIFIED EXPENDITURES 1/**

	Total	Partners			
		PAN Alaska Gas Co.	Alaska Energy Co.	Pacific Interstate Trans. Co.	Northern Arctic Gas Co.
1. GENERAL & ADMINISTRATION					
Direct Operations	\$ 5,275,777	\$1,330,009	\$1,292,140	\$1,331,582	\$1,322,046
Indirect Operations	<u>1,126,398</u>	<u>283,962</u>	<u>275,877</u>	<u>284,297</u>	<u>282,262</u>
	<u>6,402,175</u>	<u>1,613,971</u>	<u>1,568,017</u>	<u>1,615,879</u>	<u>1,604,308</u>
2. OUTSIDE SERVICES					
Legal	1,626,919	410,142	398,464	410,627	407,686
Executive	156,299	39,402	38,281	39,449	39,167
Finance	968,765	244,223	237,269	244,512	242,761
Regulatory, Environmental & Civic Affairs	5,711,181	1,439,774	1,398,779	1,441,475	1,431,153
Administration	501,939	126,537	122,935	126,687	125,780
Public Relations	657,171	165,671	160,954	165,867	164,679
Engineering	<u>13,917,264</u>	<u>3,508,505</u>	<u>3,408,608</u>	<u>3,512,652</u>	<u>3,487,499</u>
	<u>23,539,538</u>	<u>5,934,254</u>	<u>5,765,290</u>	<u>5,941,269</u>	<u>5,898,725</u>
3. TERMINATION AND CLOSE-OUT COST	1,562,191	393,824	382,611	394,290	391,466
4. GOVERNMENT AGENCIES	66,165	16,680	16,205	16,700	16,580
5. OTHER COSTS	<u>208,898</u>	<u>52,663</u>	<u>51,163</u>	<u>52,725</u>	<u>52,347</u>
Sub-Total	31,778,967	8,011,392	7,783,286	8,020,863	7,963,426
6. AFUDC 2/	<u>6,587,916</u>	<u>1,643,736</u>	<u>1,673,458</u>	<u>1,646,358</u>	<u>1,624,364</u>
Total Qualified Expenditures Including AFUDC	<u>\$38,366,883</u>	<u>\$9,655,128</u>	<u>\$9,456,744</u>	<u>\$9,667,221</u>	<u>\$9,587,790</u>

1/ Expenditures made prior to January 31, 1978.

2/ Includes only an interest component on funds spent.

Exhibit 3-2
Page 2

Extract from the Minutes of a meeting of the Board of Partners, Alaskan Northwest Natural Gas Transportation Company, a Partnership, held November 28-29, 1978:

* * *

"(10) The Board of Partners next considered the qualified expenditures of the partners other than Northwest Alaskan. By letter dated November 15, 1978, a copy of which is appended, Calaska Energy Company requested that its capital account be credited with the total of \$9,456,744 pursuant to Section 4 of the Partnership Agreement; a similar request, by letter dated November 16, 1978, a copy of which is appended to these minutes, was made on behalf of Pacific Interstate Transmission Company, with the requested capital account credit for that partner being \$9,667,221. A similar request on behalf of Pan Alaskan Gas Company, by letters dated September 27 and November 27, 1978, copies of which are attached to these minutes, requested capital account credit for that partner of \$9,655,128. A similar request on behalf of Northern Arctic Gas Company by letter dated November 27, 1978, a copy of which is appended to these minutes, requested capital account credit for that partner of \$9,587,790.

"Prior to the meeting of November 28-29, those partners requesting capital account credit for qualified expenditures had submitted to all partners substantiation for the amounts claimed, and had further tendered in support of the request for capital accounts credit summary reports prepared by Arthur Andersen & Co. under dates of October 5, 1977 and November 10, 1978. Copies of these reports are appended to these minutes.

"The Board of Partners discussed fully and completely the nature of the expenditures made, the value to the Partnership of such expenditures, and the reasonableness and necessity of the amounts expended. It was noted that the prior expenditures by Calaska, Pan Alaskan, Pacific Interstate, and Northern Arctic encompassed basic research into environmental and engineering issues, and the development of computer analysis techniques which will be of material benefit to the Partnership's activities. It was further noted that the expenditures by Partners other than Northwest were made in conjunction with the study of an alternative route for the movement of Alaskan gas to the lower 48 states, and such expenditures, if not made by the Arctic gas participants, would have been required of the Partnership prior to final approval of the Alaskan Highway routing; the expenditures relating to an alternative route were of significant benefit to the governmental decision-making process in both the United States and Canada.

Exhibit 2-2
Page 3

"Mr. McMillian made inquiry as to whether the materials developed as a result of the claimed qualified expenditures would be made available to the Partnership, and he was assured that Northwest and the Partnership would have the benefit of such.

"Mr. McMillian reported that Northwest had made a detailed study of the available Canadian Arctic gas design information, and had concluded that there were a number of items of information and data which would be of extreme value to the Partnership in its ongoing efforts; the results of Northwest's preliminary evaluation of the specific gas design information which should prove to be of value to the Partnership is set forth on the appended list denominated "List of Canadian Arctic Gas Design Information," and each item on this listing refers to specific data and/or information which the Partnership will review to insure that no duplication of expenditures for design and research occurs.

"On motion of Mr. McMillian, seconded by Mr. Smith, the Board of Partners unanimously approved the requests of Calaska, Pacific Interstate, Pan Alaskan and Northern Arctic for inclusion in the respective capital account of each such partner the qualified expenditures submitted on behalf of each such partner; in connection with this approval, it was the expressed determination of the Board of partners that the expenditures made by each of such partners was reasonable and necessary to the conduct of the business of the Partnership, that such expenditures were prudently incurred, and that the Partnership received full value, in an amount at least equal to the amounts credited to the capital accounts pursuant to the instant approval. The Board of Partners further determined that the expenditures claimed by each of the four partners named were expenditures to acquire information, knowledge, studies, tests, computer programs or governmental authorizations by one or more of such partners or corporate affiliates of such partners, in the course of activities reasonably related to the selection of a transportation system for the delivery of Alaskan natural gas, and that each such expenditure was made by such partner or corporate affiliate prior to the formation date of the Partnership."

Exhibit 2-3

ALASKAN NORTHWEST NATURAL GAS TRANSPORTATION COMPANY
ACTUAL EXPENDITURES FOR THE PERIOD
FEBRUARY 1, THROUGH JULY 31, 1978

1. OFFICE EQUIPMENT	\$ 470,000	
2. TRANSPORTATION EQUIPMENT	27,000	\$ 497,000
3. COMPANY SERVICES		
Salaries and Related Benefits	2,158,000	
Employee Expenses	345,000	
Office Supplies	129,000	
Equipment Use	887,000	
Recruitment and Relocation	307,000	
Rents	444,000	
Other	315,000	4,585,000
4. OUTSIDE SERVICES		
Legal	1,459,000	
Executive	253,000	
Finance	996,000	
Regulatory, Environmental & Civic Affairs	251,000	
Administration	466,000	
Public Relations	178,000	
Engineering	5,902,000	
Other	73,000	9,578,000
5. GOVERNMENT AGENCIES		
Federal Bureau of Land Management	471,000	
State of Alaska:		
Fish & Game	26,000	
Office Pipeline Coordinator	17,000	
		<u>514,000</u>
Sub-Total		15,174,000
6. AFUDC		<u>6,595,000</u>
Total Actual Expenditures Including AFUDC 1/		<u><u>\$21,769,000</u></u>

1/ This total includes AFUDC but the Partnership does not seek, through this application, approval of the AFUDC rate inasmuch as the Commission has stated its intention to determine this issue in Docket No. NM78-12, Order No. 17-A, issued January 17, 1979.

**REPORT ON
RESULTS OF AUDIT OF EXPENDITURES
BY THE
ALASKAN NORTHWEST NATURAL GAS
TRANSPORTATION COMPANY
WHICH WERE
INCURRED FROM
FEBRUARY 1, 1978 THROUGH DECEMBER 31, 1978
(DOCKET NO. CP78-123, et al.)**

**August 1980
Division of Audits
Office of Chief Accountant
Federal Energy Regulatory Commission**

REPORT ON RESULTS OF AUDIT OF EXPENDITURES
BY THE ALASKAN NORTHWEST
NATURAL GAS TRANSPORTATION COMPANY WHICH
WERE INCURRED FROM FEBRUARY 1, 1978
THROUGH DECEMBER 31, 1978
(DOCKET NO. CP78-123, et al.)

INTRODUCTION

This is the second in a series of reports on the results of audits of expenditures related to the construction of the Alaska Natural Gas Transportation System (ANGTS)^{1/}. The audits and reports are being made pursuant to the directions contained in Administrative Order No. 4, issued April 18, 1979.

The first report conveyed the results of the staff's initial audit of expenditures charged to the Alaskan section of ANGTS. The initial audit covered expenditures incurred prior to the formation of the partnership (Alaskan Northwest Natural Gas Transportation Company (ANNGTC)) on February 1, 1978, for the construction and operation of the Alaskan section of ANGTS. Amounts charged to the Alaskan section for pre-partnership expenditures totaled \$57,415,070, including Allowance for Funds Used During Construction (AFUDC) of \$7,798,313.

^{1/} ANGTS was authorized by the Alaska Natural Gas Transportation Act of 1976 (ANGTA), 15 U.S.C. 719, et seq. and the President's Decision and Report to Congress on the Alaska Natural Gas Transportation System, as enacted into law, H.J. Res. 621, Pub. L. No. 95-108 (November 2, 1977).

In the first report, the staff recommended the disallowance of \$42,224,461, including AFUDC of \$6,833,041 of the total claimed pre-partnership expenditures of \$57,415,070^{2/}.

This report conveys the results of the staff's audit of partnership expenditures charged to the Alaskan section of ANGTS for the period February 1, 1978 through December 31, 1978. Partnership expenditures charged to the gas plant accounts during this period totaled \$44,918,798, including AFUDC of \$13,988,691. The staff's findings and recommendations in this report do not cover the \$13,988,691 of AFUDC claimed during the period. A large part of the AFUDC claimed is related to pre-partnership expenditures which are at issue in our first audit report. Upon disposition of the audit findings and recommendations in that report, AFUDC claimed for the period February 1, 1978 through December 31, 1978 will be recomputed and adjusted as appropriate.

SUMMARY

With respect to the partnership expenditures made during the period February 1, 1978 through December 31, 1978 (\$30,930,107, exclusive of AFUDC), the staff concludes that:

1. Expenditures of \$29,107,087 are properly assignable to the Alaskan section of ANGTS

^{2/} These proposed disallowances have been reflected in Exhibit No. 1.

and are of a nature that would qualify for eventual inclusion in rate base. ==

2. Expenditures of \$652,294 are not of a nature that would qualify for eventual inclusion in rate base and, therefore, should be disallowed.
3. Expenditures of \$1,170,726 may not be properly assignable to the project for eventual inclusion in rate base. Requests to ANNGTC for additional information on these expenditures have not been answered. Therefore, the staff proposes that these expenditures be disallowed without prejudice to ANNGTC's reclaiming them upon submission of appropriate supporting information.
4. Corrective action is needed to eliminate discrepancies between the accounting records and the financial statements.

SCOPE OF AUDIT

The audit covered claimed partnership expenditures charged to the gas plant accounts totaling \$30,930,107, exclusive of AFUDC, for the period February 1, 1978 through December 31, 1978.

The audit included an examination of the accounting and other records to the extent deemed necessary to determine whether:

1. The various financial statements and reports properly reflected the underlying records and documents.
2. The expenditures were adequately documented and supported.
3. The accounting for the expenditures met the requirements of the Uniform System of Accounts and generally accepted accounting principles.
4. The expenditures were properly assignable to the Alaskan section of ANGTS and were of a nature that would qualify for eventual inclusion in rate base.

5. The other accounting and reporting regulations and requirements of the Natural Gas Act, the Decision and the Certificate of Public Convenience and Necessity were complied with.
6. The policies, procedures, and controls appear adequate to ensure the efficient and economic construction of the project.

RESULTS OF AUDIT

ANNGTC claimed partnership expenditures of \$30,930,107, excluding AFUDC. With respect to these expenditures, the staff has determined that:

1. Expenditures of \$29,107,087 were for engineering studies and plans, environmental studies, governmental fees, legal and consultant fees related to the preparation of an application for a Certificate of Public Convenience and Necessity to construct the Alaskan section of ANGTS. These expenditures are properly assignable to the Alaskan section of the ANGTS and are of a nature that would qualify for eventual inclusion in rate base.

2. Expenditures of \$652,294 are not of a nature that would qualify for eventual inclusion in ANNGTC's rate base and should be disallowed. These expenditures fall into the following categories.

- a. Lobbying Activities

Expenditures of \$513,171 relate to payments made to various public relations firms, consultants and legal firms.

Three public relations firms were involved in a campaign to develop public and legislative support for a financial plan proposed by ANNGTC. This financial plan proposal provided for State of Alaska participation in the project through the issuance of \$1 billion in tax-exempt revenue bonds or an equity interest in the project. Legislative action was needed for either proposal.

Three other firms lobbied on the Company's behalf regarding its proposed financial plans, the question of whether Alaskan gas should be incrementally costed, the wellhead prices of Prudhoe Bay gas, and proposed legislation affecting exploration of certain lands in Alaska.

- Another law firm performed services which involved legislative efforts to secure passage of the Natural Gas Policy Act of 1978. This emanated from President Carter's 1977 Energy Plan which proposed substantial changes to the Natural Gas Act. This firm analyzed the President's proposal and contacted members of the House and Senate and their staffs to inform them of the impact of gas pricing legislation on the project. The firm was involved in urging the passage of the compromise bill which was ultimately signed into law in November 1978.

The Uniform System of Accounts requires that expenditures of this nature be recorded in Account 426.4, Expenditures for certain civic, political and related activities, a non-utility expense account.

b. Public Relations

Expenditures of \$91,416 relate to payments made to three public relations firms. One firm, located in Washington, D. C., distributed

information to the press, members of Congress and the public. A consultant was paid a retainer to provide technical expertise in developing and implementing film projects documenting construction activities. The third firm was an agency which monitored the media and handled liaison work in Canada.

The Commission, in various cases, has ruled that public relations-type expenditures are not properly assignable to the plant accounts, but are of a nature that should be recorded in Account 930.1, General advertising expenses.

c. Non-Project Expenditures

Expenditures of \$21,208 represent payments made to a law firm which provided services to ANNGTC and Northwest Alaskan Pipeline Company (Northwest), the managing partner of ANNGTC. Charges for legal services for Northwest were erroneously recorded on the books of ANNGTC as a project construction expenditure.

The Uniform System of Accounts provides for the use of Account 143, Other accounts receivable, to correct this error.

d. Fishing Trip

Expenditures of \$19,363 relate to payments for a chartered fishing trip and riverboat reception held subsequent to an ANNGTC partnership meeting in Fairbanks, Alaska.

The Uniform System of Accounts requires that expenditures of a nonoperating nature be recorded in Account 426.5, Other deductions, a non-utility expense account.

e. Country Club Dues

Expenditures of \$5,221 relate to payments to various country clubs, luncheon and dinner clubs and athletic clubs for membership dues.

NARUC Interpretation No. 49 requires that club dues of this nature be recorded in Account 426.5, Other deductions, a non-utility expense account.

f. Donations

Expenditures of \$1,915 relate to contributions made to the Anchorage Community YMCA, Alaska Foundation of Native Youths and the Iditarod Trail Committee, Inc.

The Uniform System of Accounts requires that expenditures of this nature be recorded in Account 426.1, Donations, a non-utility expense account.

3. Expenditures of \$1,170,726 were not adequately supported; therefore, the staff was unable to determine whether they are properly assignable to the Alaskan section of the ANGTS for eventual inclusion in rate base. Requests to ANNGTC for additional information on these expenditures have not resulted in responses which clearly document the nature and character of the items. These items fall into two general categories:

- a. Amounts paid to a number of law firms for services which appear to include political lobbying efforts designed to influence

public opinion concerning the project and, as such, would not be allowable in the plant accounts under the provisions of the Uniform System of Accounts.

- b. Amounts paid to a number of consultants where sufficiently competent evidential material (i.e. contracts, written agreements, vendor memoranda, etc.) did not exist or were not made available. Therefore, there was no adequate basis upon which to evaluate the propriety of the assignment of the costs to the project or their qualification for eventual inclusion in rate base.

Therefore, the staff proposes that these expenditures be disallowed, without prejudice to ANNGTC's reclaiming them upon submission of appropriate supporting information.

- 4. Monthly financial statements prepared by ANNGTC reported and compared actual project expenditures with budgeted project expenditures. The accounting records supporting

these financial statements did not agree with the reported actual project expenditures in many instances and adequate reconciliations were not available. The scope of the staff's audit was expanded due to the differences noted and the staff was able to satisfy itself as to the validity of the expenditures by additional testing of transactions. However, the staff was not able to attest to the reasonableness of the recorded or reported classification of expenditures by work orders or cost elements. Some improvements were made by ANNGTC the spring of 1979. However, some control deficiencies remain which must be eliminated from the accounting system prior to active construction.

The Uniform System of Accounts requires that the accounting records be maintained in a manner that permits ready analysis by the prescribed accounts and preparation of financial statements directly from the accounting records. Further, since this project will be subject to the incentive rate of return (IROR) mechanism^{3/}, it is imperative that the actual construction costs be readily identifiable and verifiable.

^{3/} Pursuant to Order No. 31, Docket No. RM78-12, issued June 8, 1979.

Otherwise it will be difficult, if not impossible, to audit costs for compliance with the IBOR mechanism and to issue timely audit reports.

RECOMMENDATIONS

The staff recommends that:

1. \$29,107,087 of partnership expenditures be allowed as charges properly assignable to the ANNGTC project and be determined as qualified for eventual inclusion in the rate base of ANNGTC.
2. \$652,294 of partnership expenditures be disallowed as costs qualified for eventual inclusion in the rate base of the ANNGTC.
3. \$1,170,726 of partnership expenditures be disallowed as costs properly assignable to the ANNGTC project for eventual inclusion in rate base, without prejudice to ANNGTC's reclaiming them upon submission of appropriate supporting information.
4. Corrective action be taken to permit the preparation of financial statements directly from the accounting records. Until such corrective action is implemented, ANNGTC should prepare reconciliations of differences

between the recorded and reported actual expenditures.
These reconciliations should list each reconciling
amount, the source of original entry, and explain the
reason for the reconciling item.

EXHIBIT

Alaskan Northwest Natural Gas Transportation Company
Adjusted Balance Sheet
As of February 1 and December 31, 1978
With Staff Adjustments Thereto

	Adjusted Balance 2-1-78 ^{1/}	Activity 2-1-78 Through 12-31-78	Staff Adjustments ^{3/}	Adjusted Balance 12-31-78
<u>Assets</u>				
Plant in Service	\$ 175,617	\$ 411,530	\$ -	\$ 587,147
Less: Accrued Depreciation	(1,671)	(52,840) ^{2/}	-	(54,519)
Construction Work in Progress	15,016,663	44,560,116	(1,023,020)	57,793,759
Total Gas Plant	15,190,609	44,918,796	(1,023,020)	58,286,387
Cash and Other Assets	-	10,607,476	-	10,607,476
Total Assets	<u>\$15,190,609</u>	<u>\$55,526,274</u>	<u>\$ (1,023,020)</u>	<u>\$68,893,863</u>
<u>Partners' Equity and Liabilities</u>				
Partners' Contributions Paid In:				
Calaska Energy Co.	\$ -	\$ 5,675,000	-	\$ 5,675,000
Pacific Interstate Trans. Co. (Arctic)	-	5,675,000	-	5,675,000
Pen Alaska Gas Company	-	5,675,000	-	5,675,000
Northern Arctic Gas Co.	-	5,675,000	-	5,675,000
United Alaska Fuels Corp.	-	5,675,000	-	5,675,000
Northwest Alaskan Pipeline Co.	15,190,609	5,675,000	-	20,865,609
Total Partners' Contributions	<u>15,190,609</u>	<u>34,050,000</u>	-	<u>49,240,609</u>
Partners' Equity:				
Retained Earnings	-	14,317,272	(1,023,020)	12,494,252
Total Partners' Equity	<u>15,190,609</u>	<u>48,367,272</u>	<u>(1,023,020)</u>	<u>61,734,861</u>
Accounts Payable and Other Liabilities	-	7,159,002	-	7,159,002
Total Partners' Equity and Liabilities	<u>\$15,190,609</u>	<u>\$55,526,274</u>	<u>\$ (1,023,020)</u>	<u>\$68,893,863</u>

^{1/} This is the adjusted balance, as shown in the initial staff audit report on ANNGTC, after the proposed disallowance of \$42,324,461 pre-partnership expenditures.

^{2/} Includes APUDC of \$13,988,691.

^{3/} Staff adjustments do not cover APUDC for reasons explained in the introduction of this report.

**REPORT ON
RESULTS OF AUDIT OF EXPENDITURES
BY THE
ALASKAN NORTHWEST NATURAL GAS
TRANSPORTATION COMPANY
WHICH WERE
INCURRED FROM
JANUARY 1, 1979 THROUGH DECEMBER 31, 1979
(DOCKET NO. CP78-123, et al.)**

**October 1980
Division of Audits
Office of Chief Accountant
Federal Energy Regulatory Commission**

**REPORT ON RESULTS OF AUDIT OF EXPENDITURES
BY THE ALASKAN NORTHWEST
NATURAL GAS TRANSPORTATION COMPANY WHICH
WERE INCURRED FROM JANUARY 1, 1979
THROUGH DECEMBER 31, 1979
(DOCKET NO. CP78-123, et al.)**

INTRODUCTION

This is the third in a series of reports on the results of audits of expenditures related to the construction of the Alaska Natural Gas Transportation System (ANGTS).^{1/} The audits and reports are being made pursuant to the directions contained in Administrative Order No. 4, issued April 18, 1979.

The first report conveyed the results of the staff's initial audit of expenditures charged to the Alaskan section of ANGTS. The initial audit covered expenditures incurred prior to the formation of the partnership (Alaskan Northwest Natural Gas Transportation Company (ANNGTC)) on February 1, 1978, for the construction and operation of the Alaskan section of ANGTS. Amounts charged to the Alaskan section for pre-partnership expenditures totaled \$57,415,070 including Allowance for Funds Used During Construction (AFUDC) of \$7,798,313.

The second report conveyed the results of the staff's audit of partnership expenditures charged to the Alaskan section of ANGTS for the period February 1, 1978 through December 31, 1978. Partnership expenditures charged to the gas plant accounts during this period totaled \$44,918,798 including AFUDC of \$13,988,691.

^{1/} ANGTS was authorized by the Alaska Natural Gas Transportation Act of 1976 (ANGTA), 15 U.S.C. 719 et seq. and the President's Decision and Report to Congress on the Alaska Natural Gas Transportation System, as enacted into law, H. J. Res. 621, Pub. L. No. 95-108 (November 2, 1977).

In the first report, the staff recommended the disallowance of \$42,224,461, including AFUDC of \$6,833,041, of the total claimed pre-partnership expenditures of \$57,415,070.^{2/}

In the second report, the staff recommended the disallowance of \$1,823,020 of the total claimed partnership expenditures.^{2/}

The staff's findings and recommendations in that report did not cover \$13,988,691 of AFUDC capitalized during the period.

This report conveys the results of the staff's audit of partnership expenditures charged to the Alaskan section of ANGTS for the period January 1, 1979 through December 31, 1979. Partnership expenditures charged to the gas plant accounts during this period totaled \$53,710,138, including AFUDC of \$11,920,788. The staff's findings and recommendations in this report do not cover the \$11,920,788 of AFUDC claimed during the period. A large part of the AFUDC claimed is related to pre-partnership and other expenditures which are at issue in our first two audit reports. Upon disposition of the audit findings and recommendations in these

^{2/} These proposed disallowances have been reflected on the Exhibit.

reports, AFUDC claimed for the period January 1, 1979 through December 31, 1979 will be recomputed and adjusted as appropriate.

SUMMARY.

With respect to the partnership expenditures made during the period January 1, 1979 through December 31, 1979 (\$41,789,350 exclusive of AFUDC), the staff concludes that:

1. Expenditures of \$40,794,243 are properly assignable to the Alaskan section of ANGTS and are of a nature that would qualify for eventual inclusion in rate base.
2. Expenditures of \$349,691 are not of a nature that would qualify for inclusion in rate base and, therefore, should be disallowed.
3. Expenditures of \$645,416 may not be properly assignable to the project for eventual inclusion in rate base. Requests to ANNGTC for additional information on these expenditures have not been answered. Therefore, the staff proposes that these expenditures be disallowed without prejudice to ANNGTC's reclaiming them upon submission of appropriate supporting information.
4. Corrective action needs to be implemented to eliminate discrepancies between the accounting records and the financial statements.

SCOPE OF AUDIT

The audit covered claimed partnership expenditures charged to the gas plant accounts totaling \$41,789,350, exclusive of AFUDC, for the period January 1, 1979 through December 31, 1979.

The audit included an examination of the accounting and other records to the extent deemed necessary to determine whether:

1. The various financial statements and reports properly reflected the underlying records and documents.
2. The expenditures were adequately documented and supported.
3. The accounting for the expenditures met the requirements of the Uniform System of Accounts and generally accepted accounting principles.
4. The expenditures were properly assignable to the Alaskan section of ANGTS and were of a nature that would qualify for eventual inclusion in rate base.
5. The other accounting and reporting regulations and requirements of the Natural Gas Act, the Decision and the Certificate of Public Convenience and Necessity were complied with.

6. The policies, procedures, and controls appear adequate to ensure the efficient and economic construction of the project.

RESULTS OF AUDIT

ANNGTC claimed partnership expenditures of \$41,789,350, excluding AFUDC. With respect to these expenditures, the staff has determined that:

1. Expenditures of \$40,794,243 were for engineering studies and plans, environmental studies, governmental fees, legal and consultant fees related to the preparation of an application for a Certificate of Public Convenience and Necessity to construct the Alaskan section of ANGTS. These expenditures are properly assignable to the Alaskan section of ANGTS and are of a nature that would qualify for eventual inclusion in rate base.
2. Expenditures of \$349,691 are not of a nature that would qualify for eventual inclusion in ANNGTC's rate base and should be disallowed. These expenditures fall into the following categories:
 - a. Lobbying Activities
Expenditures of \$158,962 to three firms engaged in lobbying

activities on behalf of ANNGTC regarding; D-2 legislation affecting lands in Alaska designated as a national reserve, an amendment to Section 103 of the Internal Revenue Code concerning the State of Alaska issuance of tax exempt bonds, and meetings with members of the U. S. Congress and members of the Alaskan legislature on various legislation affecting the project.

The Uniform System of Accounts requires that expenditures of this nature be recorded in Account 426.4, Expenditures for certain civic, political and related activities, a non-utility expense account.

b. Donations

Expenditures of \$90,002 relate to contributions to the following organizations: Alaskans for the Gas Pipeline, Citizens for Management of Alaskan Lands, Inc., and Close-Up Foundation.

The Uniform System of Accounts requires that expenditures of this nature be recorded in Account 426.1, Donations, a non-utility expense account.

c. Public Relations

Expenditures of \$74,572 to four public relations firms. One firm was located in Washington, D. C. and distributed information to the press, members of Congress and the public. Another firm provided media coverage in New York on the Alaskan gas pipeline. The third firm produced a film documenting progress on the gas pipeline. The fourth firm monitored the media and handled liason work in Canada.

The Commission in various cases has ruled that public relations type expenditures are not properly assignable to the plant accounts but are of a nature that should be recorded in Account 930.1, General advertising expenses, a utility expense account.

d. Photo Prints, Ski Lessons, and Fishing Arrangements

Expenditures of \$14,450 relates to photo prints of the "Old Salmon Cannery",

ski lessons and charter fishing arrangements which were provided to various Board of Partners representatives subsequent to their meetings in February, March and April of 1979.

The Uniform System of Accounts requires that expenditures of a nonoperating nature be recorded in Account 426.5, Other deductions, a non-utility expense account.

e. Country Club Dues

Expenditures of \$8,047 to various country clubs, luncheon and dinner clubs and athletic clubs for membership dues.

NARUC Interpretation No. 49 requires that club dues of this nature be recorded in Account 426.5, Other deductions, a non-utility expense account.

f. Gifts

Expenditures of \$3,658 relate to gifts to satisfy the oriental business custom of exchanging gifts resulting from ANNGTC's business ties with Japan.

The Uniform System of Accounts requires that expenditures of a nonoperating nature be recorded in Account 426.5, Other deductions, a non-utility expense account.

3. Expenditures of \$645,416 were not adequately supported; therefore, the staff was unable to determine whether they are properly assignable to the Alaskan section of ANGTS for eventual inclusion in rate base. Requests to ANNGTC for additional information on these expenditures have not resulted in responses which clearly document the nature and character of the items. These items fall into two general categories:

- a. Amounts paid to a number of law firms for services which appear to include political lobbying efforts designed to influence public opinion concerning the project and, as such, would not be allowable in the plant accounts under the provisions of the Uniform System of Accounts.
- b. Amounts paid to a number of consultants where sufficiently competent evidential material (i.e. contracts, written agreements, vendor memoranda, etc.) did not exist or

were not made available. Therefore, there was no adequate basis upon which to evaluate the propriety of the assignment of the costs to the project or their qualification for eventual inclusion in rate base.

Therefore, the staff proposes that these expenditures be disallowed without prejudice to ANNGTC's reclaiming them upon submission of appropriate supporting information.

4. Monthly financial statements prepared by ANNGTC reported and compared actual project expenditures with budgeted project expenditures. The accounting records supporting these financial statements did not agree with the reported actual project expenditures in many instances and adequate reconciliations were not available. Corrective action implemented by ANNGTC in 1979 were not fully successful in that the new procedures sometimes created a lag in recording a charge to the proper work order and resulted in further reporting discrepancies.

The Uniform System of Accounts requires the accounting records be maintained in a manner that permits ready analysis by the prescribed accounts and preparation

of financial statements directly from the accounting records.

It is imperative on this project that the actual construction costs be readily identifiable and verifiable. Otherwise, it will be difficult, if not impossible, to audit costs and to issue timely audit reports.

RECOMMENDATIONS

The staff recommends that:

1. \$40,794,243 of partnership expenditures be allowed as charges properly assignable to the ANNGTC project and be determined as qualified for eventual inclusion in the rate base of ANNGTC.
2. \$349,691 of partnership expenditures be disallowed as costs qualified for eventual inclusion in the rate base of ANNGTC.
3. \$645,416 of partnership expenditures be disallowed as costs properly assignable to the ANNGTC project for eventual inclusion in rate base, without prejudice to ANNGTC's reclaiming them upon submission of appropriate supporting information.

4. Corrective action be taken to permit the preparation of financial statements directly from the accounting records. Until such corrective action is implemented, ANNGTC should prepare reconciliations of differences between the recorded and reported actual expenditures. These reconciliations should list each reconciling amount, the source of original entry, and explain the reason for the reconciling item.

EXHIBIT

Alaskan Northwest Natural Gas Transportation Company
Adjusted Balance Sheet
As of January 1 and December 31, 1979
With Staff Adjustments Thereto

	<u>Adjusted Balance 1-1-79 1/</u>	<u>Activity 1-1-79 Through 12-31-79</u>	<u>Staff Adjustments 3/</u>	<u>Adjusted Balance 12-31-79</u>
<u>Assets</u>				
Plant in Service	\$ 587,147	\$ 381,453	\$ -	\$ 968,600
Less: Accum. Deprec. and Amort.	(54,519)	(103,823)	-	(158,342)
Construction Work in Progress	57,753,759	53,432,508 2/	(995,107)	110,191,160
Total Gas Plant	58,286,387	53,710,138	(995,107)	111,001,418
Cash and Other Assets	10,607,476	(5,137,625)	-	5,469,851
Total Assets	<u>\$68,893,863</u>	<u>\$48,572,513</u>	<u>(995,107)</u>	<u>\$116,471,269</u>
<u>Partners' Equity and Liabilities</u>				
Partners' Contributions Paid in:				
Calaska Energy Co.	\$ 5,675,000	\$ 5,061,667	\$ -	\$ 10,736,667
Pacific Interstate Trans. Co. (Arctic)	5,675,000	5,061,667	-	10,736,667
Pan Alaska Gas Company	5,675,000	5,061,667	-	10,736,667
Northern Arctic Gas Co.	5,675,000	5,061,667	-	10,736,667
United Alaska Fuels Corp.	5,675,000	5,061,667	-	10,736,667
Northwest Alaskan Pipeline Co.	20,865,609	5,061,667	-	25,927,276
Total Partners' Contributions.	<u>49,240,609</u>	<u>30,370,002</u>	<u>-</u>	<u>79,610,611</u>
Retained Earnings	<u>12,494,252</u>	<u>12,301,507</u>	<u>(995,107)</u>	<u>23,800,652</u>
Total Partners' Equity	<u>61,734,861</u>	<u>42,671,509</u>	<u>(995,107)</u>	<u>103,411,263</u>
Accounts Payable and Other Liabilities	<u>7,159,002</u>	<u>5,901,004</u>	<u>-</u>	<u>13,060,006</u>
Total Partners' Equity and Liabilities	<u>\$68,893,863</u>	<u>\$48,572,513</u>	<u>(995,107)</u>	<u>\$116,471,269</u>

1/ This is the adjusted balance, as shown in the second staff audit report on ANNGTC, after the proposed disallowance of \$42,224,461 pre-partnership expenditures and \$1,823,020 partnership expenditures.

2/ Includes AFUDC of \$11,920,788.

3/ Staff adjustments do not cover AFUDC for reasons explained in the introduction of this report.

SCOMM

28:28



Alaska State Legislature

Joint Gas Pipeline Committee

1024 W. 6th Ave.

Anchorage, Alaska 99501

OIL & GAS NEWSLETTER #1 December 1980

The information presented below is a brief summary of recent oil and gas industry developments of interest to Alaska legislators.

A. North Slope Oil Activity Booms

A new record for drilling activity in Alaska was set this year, led by exploration of the Beaufort Sea, initial development and delineation of the Kuparuk field to the west of Prudhoe Bay, and the development and expansion of the Prudhoe Bay field. As of December 10, 134 drilling permits had been granted, with several more applications expected before the end of the year. The activity includes:

1. Beaufort Sea Exploration - Sohio has spudded an exploratory well at the west end of the Beaufort Sea sale area, and has constructed 2 gravel islands for test drilling in the section of the sale area to the north of Prudhoe Bay. Exxon, Amoco, Tenneco, Phillips, Chevron and Marathon/Amerada Hess all plan to test tracts acquired at the December 1979 sale as soon as wells can be completed (1-3 years). Several of the tracts to be tested were leased under the state's new net profit share bidding system.
2. Other Exploration - Several exploratory wells are being drilled in the areas adjacent to the Prudhoe Bay Unit by a variety of companies. The Milne Pt., Gwyder Bay and Pt. Thompson areas have all displayed possible commercial discoveries. Other areas being actively explored around the state include the Alaska Peninsula, the Arctic foothills west of the National Petroleum Reserve and the Cook Inlet region. New discoveries were reported this fall in Northern Cook Inlet and at Duck Island adjacent to the Beaufort Sea lease sale tracts, by Simasko and Exxon, respectively, but no details are available.
3. Kuparuk Development - ARCO is drilling several wells in this area with the intent of producing 80,000 barrels/day from the field by April 1982. A total of 40 wells will use natural gas to lift the heavy crude from the formation, which lies to the west of Prudhoe Bay at 6000 feet below the surface (compared to 8500 for Prudhoe). ARCO eventually plans to produce 200,000 b/d from the formation, which will be linked to the Alyeska oil pipeline.
4. Prudhoe Bay Development - More than 80 wells were added to the Prudhoe Bay field this year; approximately 300 more will be added during the next decade. The Prudhoe Bay producers also plan to spend two billion dollars on a waterflood program for the field. Designed to maintain field pressure, the secondary recovery program involves the construction of seawater intake, treatment and distribution facilities as well as the drilling of some 150 water injection wells. The additional oil recovery expected from the investment is one billion barrels. Sohio has contracted with the Parsons Co. for the design, engineering and management of the facilities on the western side of the field, while ARCO has retained Bechtel to oversee work for the offshore and eastern field facilities. Several new drill rigs are being constructed in the state to meet the demand for Arctic exploratory drilling and the hundreds of development wells planned for the North Slope area.

B. Alaska Natural Gas Transportation System Moves Forward

1. Prudhoe Bay gas producers, gas pipeline partners and the State of Alaska entered into a cooperative agreement in June 1980 for design and engineering of the Alaska gas pipeline and gas conditioning plant. The costs of the work, estimated at 500 million dollars, are to be split 50/50 between the producers and the pipeline sponsors. Contracts have been awarded to the Parsons Co. for design and engineering of the conditioning plant, and to Gulf Interstate and Baker, Inc. for design and engineering of the gas pipeline.
2. Construction of the southern Canadian portion of the gas pipeline began this summer; construction of the western U.S. leg was initiated this month in northern Idaho. Gas supplies are expected to flow through the line from Alberta to the U.S. West Coast by mid-1981.
3. Financing for the eastern U.S. leg of the pipeline was finalized this month. One billion dollars was raised from a large consortium of Canadian and U.S. banks while the N. Border Pipeline Co. sponsors provided 350 million dollars. Construction of the eastern segment is slated to begin in April 1981. A federal suit against the N. Dakota Public Service Commission, for failure to approve the pipeline route through the state, is not expected to delay construction due to the strength of the federal case.
4. Some progress has been achieved in arrangements for financing of the gas pipeline. Four large gas transmission companies (Texas Eastern, TransCanada, Columbia and Texas Gas) joined the sponsoring partnership led by Northwest Energy Co. this summer. Several sources report that federal legislation will be introduced next year to allow for an equity role by the Prudhoe producers (Exxon, ARCO & Sohio) in the project. Such an investment by the producers would have a significant positive effect on the project.
5. The most recent cost estimates for the Alaskan portion of the gas pipeline are in the 15 - 20 billion (as-spent) dollar range. Total project cost estimates range from 25 - 40 billion dollars.
6. The recent federal Right-of-way permit grant to Northwest Alaska Pipeline was of largely symbolic significance, due to the many uncertainties still remaining for the project. The permit did include strong provisions for the training and hiring of Alaskan natives.

The most optimistic timetable for the gas pipeline:

1981	Financing in place, final key federal regulatory decisions
1982	Civil engineering (pre-construction)
1983	Construction
1985 - 1986	Completion

Key federal regulatory decisions include: revision of cost estimate for pipeline tariff determination; disposition of gas conditioning costs; and reimbursement of local socio-economic impact costs. Significant technical problems for gas pipeline construction may still exist, as evidenced by the recent expansion of the Northwest frost heave testing program.

avg. premium received
(above weighted average
in-value price): 92.57

C. Royalty Oil Auction To Be Held

The first competitive sale of the state's Prudhoe Bay royalty oil will be held on December 19. Approximately 85,000 barrels a day will be auctioned off in lots of 5,000 b/d. The winning firms will receive one year contracts, and will bid a premium above the in-value price currently paid to the state by North Slope producers. Firms which refine or market products in the state will be able to match the lowest of the winning bids. Forty-nine firms have filed successful applications to bid, including the three major North Slope producers - Exxon, ARCO and Sohio.

D. Successful State North Slope Lease Sale Held; Other Leasing News

The Alaska Dept. of Natural Resources leased 77 previously ignored or relinquished North Slope tracts to the oil industry on September 16. The tracts, located to the west, south and east of Prudhoe Bay field, were leased under a bonus bid system, with a 20% royalty and a 30% net profit share reserved to the state. Over 12 million dollars was collected from winning bidders, who included Sohio/BP, Mobil, Phillips, Chevron, Geopole, Amoco, Texaco and various consortiums led by Cliff Burglin. The sale included tracts relinquished last year due to non-development of the leases by the previous owners in the proposed Duck Island Unit extension.

An October 21 eastern Gulf of Alaska OCS lease sale by the federal government was dominated by ARCO, which successfully bid on 23 of the 35 tracts leased at the sale. Two hundred ten tracts were offered; over 100 million dollars in high bids was collected for the 35 tracts. Shell Oil and a consortium led by Chevron picked up the other tracts leased at the sale.

Upcoming state oil and gas lease sales include:

Upper Cook Inlet and Susitna Basin - 2nd quarter 1981
Kenai Peninsula - 3rd quarter 1981
Lower Cook Inlet - 1st quarter 1982

Beyond early 1982, sales are scheduled for the Prudhoe Bay uplands, the Beaufort Sea, Middle Tanana and Copper River Basins, Norton Basin, Bristol Bay Basin and the Minchumina Basin. The state's Division of Mineral and Energy Management has called for comments on possible sales in the Chukchi Sea, Hope Basin and Holitna Basin in 1985.

Glenn Harrison was named director of the Division of Minerals and Energy Management in November, replacing Tom Cook, who resigned last May to take a job with Chevron. Mr. Harrison worked as a roughneck in Cook Inlet, and is a petroleum engineer who has worked for industry and the state in that role. Kay Brown was named deputy director of the division, having formerly served as acting deputy director.

E. Alpetco Changes Name, Continues Work

The Charter Oil Co. has changed the name of its venture, slated to process 100,000 b/d of state royalty crude at Valdez, from Alpetco to the "Alaska Oil Co." The firm began taking 75,000 b/d of state royalty crude in July but has been unable to realize expected profits from the oil. Charter is counting on income from the early taking of the crude to help finance the planned refinery. Approximately 2.5 million dollars was spent on site-clearing activities this year; additional work for soil investigation and process and

- E. facilities design continues. The case "McKinnon, Parker & Akp'ing v. Alpetco & State of Alaska, " which challenges Alpetco's compliance with its contract benchmarks and the legality of the June 1980 contract amendment, will be heard on appeal by the Alaska Supreme Court next year.

F. Dow-Shell Group Petrochemical Production Feasibility Study Underway; Exxon Also Studying Feasibility

A ten-member consortium, led by the Dow Chemical Co. and the Shell Chemical Co. has begun a multi-million dollar study aimed at determining the feasibility of petrochemical development based on Prudhoe Bay natural gas liquids. The study is the result of an agreement between the State of Alaska and the companies signed in September 1980. A detailed progress report on the study effort was mailed to all legislators by the Dow-Shell Group on December 9.

The study group has initiated discussions with the Prudhoe producers concerning procurement of the natural gas liquids, the foundation for any petrochemical development in the state. They are also advising the state in the technical discussions concerning the design of the Prudhoe Bay gas conditioning plant, of central importance to maximizing the volume of natural gas liquids available for the project.

The sites under active consideration in the petrochemical study are Valdez, Pt. McKenzie, Kenai and Seward. The Dow-Shell Group plans to submit a final report to the state in September 1981.

Exxon has announced that it has retained Flour Engineers to assist it in a multi-million dollar effort to determine the feasibility of petrochemical production in Alaska. Exxon expects to complete its evaluation during the latter half of 1981.

G. National News of Note

1. A federal Court of Appeals ruled in October 1980 that the federal government must immediately implement alternative bidding systems, such as net profit share bidding, mandated by the 1978 amendments to Outer Continental Shelf Lands Act. The decision was the result of a suit brought by Energy Action, a consumer group which charged that the government's use of bonus bidding in lease sales blocked competition and failed to return fair value for the resources.
2. The U.S. Supreme Court has agreed to hear a challenge to Montana's 30% (effective rate 27½%) coal severance tax. The suit, brought by a group of electric utilities, charges that the Montana tax places an excessive burden on interstate commerce. The tax was upheld by the Montana Supreme Court.
3. President Carter's signature on the D2 Alaska Lands bill allows seismic exploration of the William O. Douglas (Arctic) Wildlife Range to begin. Leasing in the area, considered one of the most prospective regions of Alaska, is prohibited during the next five years by the legislation.

4. Reagan officials have announced that they hope to speed up the pace of offshore oil leasing in Alaska, and are especially interested in areas such as Bristol Bay, the North Slope Outer Continental Shelf and the W.O. Douglas Wildlife Range.
5. Earth Resources Co. of Dallas, owner of the North Pole refinery, will be purchased by Mapco, Inc., if approval from Earth Resources shareholders is forthcoming. Mapco shareholders have approved the purchase plan.
6. An all-time record count of active drilling rigs in the U.S. was set this fall. The week of December 8 was the fifth straight week that over 3200 units were in operation. Significant oil and gas discoveries reported in recent months include several fields in a 60 mile stretch of the Rocky Mountain Overthrust Belt on the Utah/Wyoming border, and several deep fields in the southcentral Louisiana Tuscaloosa Trend.

* * *

This newsletter was prepared for Alaska legislators by Mark Wittow, staff to the Joint Gas Pipeline Committee, at the request of Speaker of the House Terry Gardiner. If further information on any of the topics discussed above is desired, please leave a message with the Anchorage Legislative Information Office, 278-3668.



JUNEAU ALASKA

Alaska State Legislature

Joint Gas Pipeline Committee
Pouch V
Juneau, Alaska 99811

OIL & GAS NEWSLETTER July 1981 (Vol.2 #1)

The information presented below is a brief summary of recent oil and gas industry developments of interest to Alaska state legislators.

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A. Gasline Progress Uncertain

Alaska gasline progress hinges on negotiations now occurring in Congress and on Wall Street.

Institutional investors are being asked to put up \$22 Billion for the project's debt financing, as proposed in the May 21 financing agreement between the pipeline sponsors and the Prudhoe Bay producers. The gas transmission companies are to provide \$5.25 billion in equity, and the producers \$2.25 billion in equity. For purposes of financing the line, the "as spent" costs of the project are assumed to be:

Conditioning Plant	\$ 6 Billion
Alaskan pipeline	21 Billion
Completion pool	3 Billion

Although the financing agreement represents a major accomplishment, two major uncertainties will delay consideration by potential investors. Deregulation of natural gas prices, which is under active consideration by the Reagan Administration, could have harmful effects on the project, depending on the manner in which it is accomplished. The nature of the "waiver package," to be decided by Congress, is the second major uncertainty which must be resolved

before lenders will consider commitments. Informed observers still disagree over whether or not the project can be financed without federal guarantees, due to its uncertain economic feasibility. Texas Gas Transmission Company, one of the members of the sponsoring partnership, recently announced its withdrawal from the gasline project, citing the high costs of continuing to participate as a partner. By leaving the partnership, the company sacrifices its chance to recover after project completion several million dollars of already-sunk costs.

The project sponsors have asked Congress to approve waivers of several provisions of existing federal regulatory and energy laws. The key aspects of the "waiver package" would:

- a) allow Prudhoe Bay producers to own an equity interest in the project
- b) include the gas conditioning plant as part of the gas pipeline system
- c) expedite the regulatory approval process
- d) allow for commencement of billing the costs of the project to consumers after a major segment of the project is completed.

Key Senators have reached agreement on the above provision and are expected to ask the Reagan administration to submit the package to Congress and urge House adoption. House leaders have balked at the proposed provision to allow early billing to consumers for the costs of building the line, thereby stalling approval of the waivers until compromise is reached with the Senate. Resolution of the issue is expected by September.

Construction is proceeding with the Eastern and Western legs of the project, which will carry Canadian gas to U.S. markets in the Midwest and West Coast until the northern links to Prudhoe Bay gas are completed. Western gas deliveries are expected to begin in October 1981; eastern deliveries are scheduled for October 1982.

Northwest Alaskan Pipeline Company, the project sponsor, is continuing work on technical problems such as frost heave mitigation and proximity to the TAPS oil line, including placement through Atigun Pass. The most optimistic project schedule has construction commencing in 1983, with completion in 1986.

B. Oil Prices Stabilize as Worldwide Production Declines

Although several major oil producers have dropped their price by as much as \$4 per barrel, in response to poor market conditions caused by declining demand and the high rate of Saudi oil production (10 mm b/d), other large producers -- Libya, Nigeria, Kuwait and Algeria -- have instead opted to cut production by over 2 mm b/d, or almost half, in order to maintain their relatively high crude oil sales prices. No major price drops have been announced by any producers since mid-June.

Oil analysts disagree on future oil price movement. Many see the Saudis realizing their goal of stabilizing oil prices in the mid \$30's/barrel range, if they continue to maintain high production rates and if no new crises occur which limit Mideast oil exports. A few commentators expect continuing erosion of world oil prices, based on declining consumption and fuel substitutions. Other analysts point to the current pickup in spot market prices at some trading centers as an indication that contract prices will begin to climb upward late in the year.

The most recent Alaska royalty oil price report (May 1981) shows an average wellhead value of approximately \$23.87, down from the April value of \$25.11 and the March 1981 high of \$25.91. The Department of Revenue's current projections for FY 82 revenues assume an average wellhead value of \$27.74 for the fiscal year.

C. U.S. Supreme Court Upholds Montana's Coal Severance Tax; Congressional Battle Over Energy Resource Taxes Begins.

In a 6-3 decision announced on July 2, the U.S. Supreme Court upheld the constitutionality of Montana's severance tax on coal, which is set at varying rates of up to 30%. The majority opinion, written by Justice Marshall, stated that the legislative, not judicial, arena was the most appropriate forum for determining the rate of taxation, and that, unlike Louisiana's First Use Natural Gas Tax, which the court held unconstitutional in June, the tax was assessed equally on coal destined for use both in Montana and outside the state. "We decline," Justice Marshall wrote, "... to prescribe a test for the validity of state taxes that would require state and Federal courts, as a matter of Federal Constitutional law, to calculate acceptable rates or levels of taxation of activities that are conceded to be legitimate subjects of taxation."

In partial response to the Court's decision, Congress conducted hearings in mid-July on the effect of energy severance taxes on relations between the states. Both critics and defenders of state energy resource taxes spoke during the sessions, which will continue in the fall. Alaska's oil tax collections were specifically criticized at several points during the hearings.

D. Federal OCS Schedule Focuses on Alaska; Approach Challenged by States.

Interior Department Secretary Watt made minor revisions to the OCS oil and gas leasing schedule announced in May. The schedule still includes 16 sales in Alaskan offshore areas during the next five years, more than one-third of the sales, and more than one-half of the acreage of the entire program. The dates for Alaska 1982-3 offerings:

- | | |
|-------------------------------------|-------|
| a) Beaufort Sea | 9/82 |
| b) Norton Sound | 11/82 |
| c) St. George Basin (S. Bering Sea) | 2/83 |
| d) N. Aleutian Basin (Bristol Bay) | 4/83 |

Governor Hammond has publicly strongly criticized the federal schedule. Alaska, along with several other states, has joined a suit brought by California against the federal government which charges the Interior Department with ignoring valid state concerns in a recent California sale. A similar suit has been brought by North Carolina on an upcoming Atlantic sale. On July 27, a federal district court judge issued a permanent injunction against portions of the California sale, agreeing with that state's charges that the federal government had ignored its concerns in the conduct of the sale.

Only eleven oil companies responded to an April 30 solicitation for interest in leasing federal onshore lands for oil and gas. The federal agency expressed surprise at the low level of interest to its request.

Upcoming state oil and gas lease sales are:

- | | |
|---|------------|
| a) Kenai Peninsula (lower eastern & Cook Inlet) | 8/81 |
| b) Lower Cook Inlet | 1/82 |
| c) Prudhoe Bay Uplands | 5/82 |
| d) Beaufort Sea | 5/82, 5/83 |
| e) Middle Tanana/Copper River Basin | 8/82 |
| f) Norton Sound | 1/83 |
| g) Upper Cook Inlet | 9/83 |

The Department of Natural Resources expects moderate interest for the August Kenai sale, which consists entirely of previously offered tracts.

E. Dow-Shell Group Ready to Report on Petrochemicals

An international consortium, led by Dow Chemical and Shell Oil, is in the final stages of a multi-million dollar effort to determine the feasibility of petrochemical production based on Prudhoe Bay natural gas liquids. The group's report will be presented to the Governor on September 9 and will contain a detailed assessment facility costs, including liquids extraction, pipelines and manufacturing plans; expected markets; site reviews; infrastructure and energy needs assessment; environmental and industrial hygiene considerations; evaluation of benzene and methanol manufacture at Fairbanks; construction scenarios; and employment and training benefits. Sites under consideration include Valdez, Kenai, Fairbanks, Seward, Pt. MacKenzie, and Anchorage (Fire Island).

A state inter-agency technical team will review all aspects of the report, including economic, environmental, community and health issues. Related reports in preparation by the state include the findings from a public attitudes and concerns projects initiated by the Dept. of Environmental Conservation and an assessment of instate needs for propane and butane. The Citizen's Petrochemical Advisory Committee will also present a report in October 1981.

All of the above work will be evaluated by the state administration before a decision is made concerning submission of a long-

term contract for the state's natural gas liquids to the legislature. (A trade of royalty methane for producer natural gas liquids is not under consideration by the administration.)

Exxon's chemical division is also completing a multi-million dollar feasibility effort aimed at the feasibility and initial planning for a petrochemical plant. Exxon controls a major portion of Prudhoe Bay natural gas liquids.

If the feasibility of petrochemical manufacturing in Alaska is confirmed, some sort of joint venture between Prudhoe Bay producers and members of the Dow-Shell Group is likely, due to the magnitude of the project and the need for all producers to contribute their share of the natural gas liquids to the project.

F. Royalty Oil Disposition; Auction Oil Returned

The Department of Natural Resources will issue a request in early August for proposals for long-term royalty oil contracts. At least 84,000 b/d will be offered, and another 75,000 b/d will be available if the Alaska Oil Co. (Alpetco) contract is terminated or cancelled in December as expected.

Market conditions have forced firms which purchased royalty oil from the state at its December 1980 auction to return the oil to the state. Effective February 1982, the state will take the oil in value instead of in kind. Until that date, the state will collect approximately \$40 million more than it would have under pre-auction arrangements. Although Shell, Union, Tesoro and Oasis have followed the provisions of their auction contracts in returning the oil, Alaska Petroleum, a subsidiary of Coastal States, has defaulted on its contract for 20,000 b/d and will likely be sued by the state.

G. Alaska Drilling Notes

With several development wells in progress, oil from the Kuparuk reservoir, west of Prudhoe Bay, is expected to begin flowing through an almost-complete 26-mile, 16-inch pipeline to Pump Station One in early 1982. Initial production will be about 80,000 b/d from 40 wells. Arco's initial investment in the field is estimated at \$460 million. If the gas lift and water injection systems designed to increase recovery of the heavy crude are successful, ultimate production from the reservoir could total 550 million barrels. Because the Kuparuk field, like all new fields north of the Arctic Circle, is exempt from the federal Windfall Profits Tax, production from it will be taxed at approximately half the rate of Prudhoe Bay.

Drilling activity to delineate possible commercial fields adjacent to Prudhoe Bay is in progress. Conoco has several wells planned for its Milne Point and Gwyder Bay properties immediately northwest of Prudhoe Bay. Drilling to better define the Duck Island Unit, just west of Prudhoe Bay, and the West Mikkelson Unit, to the south of Duck Island, has been initiated by the major oil companies with interests in those units. Although no definitive plans have

been announced, the Milne Point and Duck Island units may be in commercial production by the end of the decade.

In mid-July, Exxon announced a gas discovery at a well drilled 50 miles east of Prudhoe Bay, just south of the Point Thompson Unit. The Division of Minerals and Energy Management has estimated that the Pt. Thompson Unit contains three to six trillion cubic feet of gas; the characteristics of the new discovery have not been announced. Additional drilling in the area by Exxon and Phillips is planned.

Beaufort Sea exploration will continue this fall, with Amoco, Tenneco, Exxon, Sohio, Chevron and Phillips ready to spud wildcats on state tracts from existing barrier islands and specially-created gravel islands. Chevron is drilling two exploratory wells in the Arctic Foothills for the Arctic Slope Regional Corporation, while Union is drilling a wildcat at Carnery Loop, just east of Kenai.

Prudhoe Bay development activity includes constant increases in the number of production wells, expanded and more sophisticated field facilities and preparations for the initiation of the waterflood secondary recovery program.

A huge flotilla of barges carrying equipment modules destined for increasing Prudhoe Bay production and developing the Kuparuk oil field will begin arriving at the Prudhoe Bay West Dock around August 8, coinciding with the short opening of the Arctic ice pack. The Seattle-based barges will be joined by six smaller barges carrying drill pipe, moving west to Prudhoe Bay from Canada via the Hay and MacKenzie Rivers. Several drill rigs, including one constructed in Anchorage, are in the process of moving to the Slope for fall exploratory activity.

A group of oil companies led by Arco are planning to drill three off-structure test wells in the Bristol Bay area during the next two summers, in preparation for upcoming federal lease sales. Geophysical crews are active at various locations in the Bering and Chukchi Seas, also in preparation for OCS leasing, while the Arctic Slope Regional Corporation is conducting a geophysical survey of potential petroleum properties in the Arctic Foothills.

H. Other Items of Interest

-- Governor Hammond signed a major revision of the state's oil and gas tax structure (FCCSB 524) into law on July 27. The main features of the law repeal the existing oil and gas corporate income tax law, based on separate accounting; adopt a modified apportionment formula for calculating oil and gas corporations' income tax; and increase the effective severance tax rate to 15%. Detailed information on the bill is available from this office or the Department of Revenue.

-- Trans Mountain Pipeline Company has postponed its plans to develop a system for carrying oil, largely produced in Alaska, from the U.S. West Coast to mid-continent, citing declining demand,

production uncertainties in California and Alaska, and high interest rates as the principal reasons for its decision.

-- Two Japanese groups (the Committee for Energy Policy Promotion and the Institute of Energy Economics) were joined by the Atlantic Council of the United States in proposing export of Alaska crude oil to Japan. Mexican oil officials are interested in the proposal, which would send their oil to the U.S. instead of Japan, in exchange for the Alaskan oil. The reduced transportation costs should benefit all parties to the "swap." Reagan officials are studying the proposal, and may introduce it to Congress. Congressional opposition to the oil exchange is expected to be weaker than in previous years.

-- Although both state and federal officials are interested in using Alaska royalty oil to help to fill the Strategic Petroleum Reserve, negotiations have stalled over price and security provisions.

-- U.S. Senator Frank Murkowski will chair hearings by a Senate Energy subcommittee on small hydro regulations in Alaska on August 17. Federal Energy Regulatory Commission licensing procedures will be examined. The Reagan administration has proposed exempting all hydropower projects with a capacity of 15 megawatts or less. FERC now exempts projects of less than 5 megawatts at existing sites.

-- Members of the House Merchant Marine Committee are planning to introduce legislation to share federal OCS oil and gas leasing revenues with coastal states, partially in response to phase-out of the Coastal Energy Impact program. Hearings and markup of the legislation are scheduled for September. In early August, Senator Murkowski plans to introduce legislation to earmark OCS receipts for Arctic Research.

* * * * *

This newsletter was prepared by Mark Wittow, staff to the Alaska State Legislature's Joint Gas Pipeline Committee, for members of the legislature. Background information and further detail on items in this newsletter can be obtained by contacting Mr. Wittow at the following address:

Joint Gas Pipeline Committee
Pouch V
Juneau, Alaska 99811

The next issue of this newsletter is planned for late September or early October.

Alaska State Legislature



POUCH V
JUNEAU, ALASKA 99811

OIL & GAS NEWSLETTER

October 1981
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The information and analysis presented below are a summary of recent oil and gas developments of potential interest to Alaska state legislators. The contents are current as of October 6, 1981. Additional information about this newsletter can be found on page 11.

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Oil Prices Steady; Revenue Projections Down

Sluggish world oil demand has continued the pressure on major oil producers to drop prices in order to expand shrinking sales. The current liquidation of record inventories of oil stocks is expected to strengthen this trend. Most analysts forecast steady oil prices during the next year and beyond, with the Saudis achieving their goal of a \$34/barrel marker crude price at the December OPEC meeting. However, some oil analysts predict further price drops as producers scramble to increase their market share. The possibility of major disruptions affecting the Persian Gulf oil producers is not considered in these predictions.

The average wellhead value for Alaska's royalty oil has dropped from a high of \$25.02 in February to \$22.62 in June and \$21.99 in July. Preliminary figures for August show a wellhead value of approximately \$22.60; however, Sohio announced a significant price drop for its crude, effective Sept. 1, which should bring the September figures back to the July level.

The Dept. of Revenue's figures for the fall revision of their revenue projections:

<u>FY</u>	<u>Unrestricted Revenues</u>	<u>\$ Change from June</u>	<u>% Change</u>
1981	\$3,716,800,000 (actual)	up \$ 56,000,000	1.5%
1982	4,401,700,000	down 493,600,000	11.2%
1983	4,858,600,000	down 907,900,000	18.7%

The Dept. of Revenue's June revenue projections were based on an average wellhead value of \$27.74 for FY 82 and \$33.21 for FY 83. The fall projections assume an average wellhead value of \$22.82 for the 1982 fiscal year, and \$27.81 for 1983. All told, the Department's projections show approximately 1.45 billion dollars less available for appropriation in fiscal year 1983 than was assumed in June 1981. Income from oil and gas production accounts for 89% of unrestricted revenues; 96% of that income is from Prudhoe Bay, with the remainder from Cook Inlet and Kenai Peninsula fields.

Legislative Finance Division analyst Milt Barker estimated expected FY 82 & 83 revenues in early September. Barker's "Medium" figures for those years are each about \$180 million less than the Dept. of Revenue estimates.

Alaska policymakers may be interested in the effect falling oil prices have had on other states with significant oil and gas income. California's oil revenues are derived from royalties from production on state lands, and are traditionally used for non-operational expenditures such as capital improvement projects. Their oil revenue estimates for FY 82 and FY 83 have dropped by 10% and 15%, respectively, since the end of their legislative session, to \$490 million for the current fiscal year and \$510 million for the next. (The total state budget is about \$24 billion.) The drop in revenues will require legislative adjustment of their capital improvement program at the next legislative session.

Texas budget officials refused requests from the state legislature to revise their conservative oil revenue estimates, which did not include increased collections resulting from Reagan's immediate decontrol of oil prices in January. As a result, the Texas December 1980 projections have almost exactly matched current and expected collections, and no legislative action will be needed. The Texas Revenue Estimating Division

expects to collect \$1.487 billion from oil production taxes in FY 82 and \$1.635 billion in FY 83; natural gas production taxes amount to about a billion dollars a year. All royalty receipts are dedicated to permanent funds whose earnings support public schools and the state university. The Texas FY 82 budget is about \$13 billion.

Oklahoma's revenue estimates are constrained by a constitutional provision which limits the estimate, and the amount available for appropriation, to the revenues collected during the previous year, plus an increase equal to the average yearly percentage increase in revenues over the past five years. Because of this limitation, Oklahoma's revenues have consistently exceeded appropriations in recent years.

New Mexico oil revenues are down about 17% from what lawmakers had expected during their writing of the state budget. Their shortfall has been almost exactly balanced by unexpected increases in interest earnings and personal income tax collections.

Federal Windfall Profit Tax revenue projections have declined sharply, further depleting the already-squeezed budget. The July Treasury Department WPT forecast is down about 18% for FY 82 from January expectations, a drop of \$6 billion. Congressional Budget Office officials expect the decline to be upwards of \$7½ billion. FY 81 collections are down by over a billion and a half dollars.

Alaska Natural Gas Pipeline Sponsors Seek Congressional Action

Efforts to build a pipeline to carry Prudhoe Bay natural gas to market are currently focused in the halls of Congress. President Reagan has submitted legislation requested by the gasline sponsors and their financial backers. The measure consists of a number of "waivers" of various legal and regulatory provisions affecting the project. (See the July 1981 issue of this newsletter for a detailed list of the requested exemptions.) The Alaska Natural Gas Transportation Act of 1977 provided for such waivers, requiring the President to prepare and submit them to Congress, which would then have 60 days to approve them, with no amendment permitted.

House and Senate leaders on the issue currently disagree on one key provision contained in the legislation: whether or not the pipeline sponsors should be allowed to bill consumers for the costs of the line before actual delivery of North Slope gas. (Some call this provision "a small risk with a huge price tag.") The pipeline's potential financial backers have declared this to be essential to private financing of the line, and are supported by key Senate members, including the Alaska delegation, and by the chairman and chief counsel of the

Federal Energy Regulatory Commission. Key House chairmen have expressed strong reservations about the provision; two leading Republican Congressmen, Clarence Brown of Ohio and John Broyhill of North Carolina have stated that they would attempt to block passage of the waivers if such a provision is included. Because Congress cannot amend the waivers package, any opposition to its approval must face the charge of "killing" the gasline. The project sponsors, along with potential lenders, have stated that the passage of the waivers is essential to the success of the project.

Natural gas decontrol, which is being pushed by some members of Congress and the administration, could potentially raise additional problems for the line. Although decontrol has the support of the Reagan administration, action this year is unlikely, due to strong objections from virtually all elected officials from the Northeast and Midwest. If decontrol is achieved, a reduction in the wellhead value of the gas during the early years of the pipeline is among the options under consideration for improving the marketability of Alaska gas. This approach could significantly lower revenues to the state from royalties and severance taxes on the gas. Innovative financing and rate structures are also being studied as possible aids to the gasline's viability.

The first shipments of gas through the western pre-build section (Alberta to Southern California) of the gasline began this month. The eastern pre-build section of the line, which will run from Alberta to Illinois, is on schedule and under budget for its startup date next fall. Canadian federal officials have opposed expanding exports to the U.S. unless the Alaska portion of the line is built.

Northwest Alaskan, the project sponsor, is continuing field work which includes test holes, environmental monitoring, reconnaissance and frost heave testing. Several hundred people were employed during the year in Alaska in project-related activities. Pipeline construction is scheduled for startup in 1983, with completion in 1986.

Royalty Oil Disposition Studied; Whither Alpetco?

Alaska will have 159,000 b/d of royalty oil available for disposition, beginning February 1982. The Dept. of Natural Resources solicited proposals for use of the oil in July; 27 were submitted by the September deadline, although 5 have since been withdrawn. The proposals are under evaluation by DNR as part of general study of the state's royalty oil policies. Commissioner Katz is scheduled to meet with all proposers this month. Long-term contracts will be forwarded to the legislature for approval.