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Official Business

# Alaska State Legislature

## House of Representatives

JOINT GAS PIPELINE COMMITTEE

Pouch V  
State Capitol  
Juneau, Alaska 99611

MEMORANDUM

TO: Jt. Gas Pipeline Committee members  
House Finance Committee members

FROM: Rep. Terry Gardiner, Co-Chairman  
Sen. Jay Kerttula, Co-Chairman  
Joint Gas Pipeline Committee

DATE: May 21, 1981

RE: Economic Analysis of Comparative Oil Industry Taxation  
and Profitability

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For your information, we have attached is a brief draft memorandum which analyzes the relative attractiveness of Alaska for oil industry investment in a international context. The report's conclusion can be found on Page 17:

"In comparing the profitability of Alaskan oil with that elsewhere in the world, it is quite clear that it is probably the most profitable investment area in the world. For one thing, the per-barrel profit rate and the DCF profit rate are among the highest in the world. Moreover, other nations intervene in the oil industry much more forcefully through controls on pricing and marketing and limits on management decision-making, and are much less secure sources of oil supply."

DRAFT  
May 11, 1981

Update of 1977 Study of "Impact of Increased  
Taxation On Oil Exploration and Development  
In Alaska"

1. The purpose of this draft memo is to update our 1977 analysis of the impact of taxation on the profitability of oil exploration and development in Alaska compared to other areas of the world. Table 1 contains estimates of present company profitability in various producing countries around the world, which reveals that company profitability in Alaska, under the present tax system, is still the highest in the world.

2. The OPEC countries, which have large potential oil reserves, are generally not a major target for oil company exploration and development. This is largely because most production there is now controlled by the governments and rates of profit per barrel are significantly lower than elsewhere. (Indonesia is to some degree an exception to this, as will be discussed below.) Additionally, investment in many of these areas is considered extremely risky due to problems of political instability and the possibility of an oil embargo.

TABLE 1

Comparative Profitability of  
World Crude Oils (Estimated)

Country	Price*	Capital and Operating Cost	Gross Profits	Company Share of Profits (Rounded)	
				Percentage	Dollars Per Barrel
Saudi Arabia	\$30	\$1**	\$29	1	.25
Venezuela	\$30	\$2**	\$28	1	.25
Nigeria	\$37	\$1.10	\$35.90	2	.80
Indonesia	\$31.50	\$2**	\$29.50	12-15	3.50-4.40
Malaysia	\$36	\$2**	\$34	5-10	1.70-3.40
Egypt	\$36	\$2**	\$34	10	3.40
U.K.	\$37	\$3-6	\$31-34	10-15	3.10-5.10
Norway	\$37	\$3-6	\$31-34	10-15	3.10-5.10
Canada	\$33.50***	\$2-4	\$29.50- \$31.50	5-15	1.50-5.40
Alaska (life of field)				33	
Alaska (1-81)	\$27	\$2	\$25	22	5.60

\*December 1980 Prices

\*\*Assumed for calculation purposes  
(Double that used in 1977 Report)

\*\*\*Heavy oil; price includes export tax

Sources of Data Are At The End of Report.

Note: Company Shares are based on current tax system take.  
The actual take over the life of some fields may be  
less if they went into production during different  
tax regimes.

3. Another major potential area of exploration and development is the North Sea. Although there is less of a problem of political stability and supply disruptions there, the profit rate is significantly lower than that of Alaska -- the governments' takes range from some 85 to 90% of the profits compared to less than 70% in Alaska. Furthermore, much of the production in that area is controlled by government owned companies.

4. Canada has traditionally been the number two area of exploration and development for the U.S. companies, as rates of profit have been significantly higher than elsewhere in the world. However, recent changes in Canadian policy have both reduced the profit rate and looked toward a significant restriction of activities by foreign oil companies. Exploration has fallen 40% during the past year.

5. The non-OPEC developing countries, such as Egypt and Malaysia, are the other major potential production areas for the companies. However, these countries have tended to model their oil policies on those of OPEC or North Sea countries. For instance, in Malaysia, the government's share of the take can be as high as 95%, while in Egypt it can be up to 90%. While other countries may offer the companies somewhat better terms, these are generally in countries without large proven reserves. (The most important new producing country is Mexico, which has closed its borders to the foreign oil companies

since the 1930s.)

6. All in all, it appears that the most secure and profitable area for the companies for oil exploration and development is the United States, with Alaska having the greatest potential. The company's own belief in this can be shown by their "net profits bidding" under the 1979 Beaufort Sea Lease Sale. Thus, for example, in order to win one tract, Amerada Hess bid to pay the state 93.2% of any future net profits; in addition of course, the company's share of the take would be reduced by royalty and income tax payments. Again, Standard Oil of Ohio bid 79.5% for a tract in the Beaufort Sea where recent drilling activity has already yielded signs of commercial reserves of oil (Oil and Gas Journal, April 27, 1981, p. 120).

7. In the following sections, we present some basic data on the recent tax changes and present policies outside the U.S. which account for the fact that Alaska continues to offer among the most attractive exploration possibilities in the world.

8. The industrialized countries of the North Sea have been securing increasingly greater shares of the profits created by oil price increases. Both Norway and the United Kingdom have instituted windfall profits taxes in various forms which end up giving the governments from 85 to 90% of oil production profits. Because these are industrialized countries whose

political, legal and economic systems more closely resemble those of the United States, their oil policies are of special interest.

#### 9. Norway

Norway is an example of a country whose policy has been increasingly to take a larger share of profits created by oil, while at the same time gradually asserting state control and ownership over oil development through a state-owned oil company (Statoil). Despite these openly declared policies, exploration has increased and the international oil companies have continued to show interest in development. In fact, the only limit to exploration and investment has been the government's own depletion policy.

10. Prior to 1973, Norwegian petroleum taxation policy was quite similar to that of the United States, based on a 12.5% royalty and 52% general corporate income tax (divided between the municipalities and the national government). The first concessions, granted in 1965, did not include state participation. With the discovery of large commercial reserves and the 1973 price increases, Norway made some dramatic changes. Since 1973, Statoil has been given 50-85% equity in all blocks granted without having to contribute to exploration costs. In 1975, a special 25%, nondeductable, tax on net oil and gas income, was added to the corporate income tax, and a royalty of 8-16% (depending on production levels) was established. (Moreover, for purposes of calculation of taxable income, the state basically determined the "market

price" of oil.) From 1975 to 1979, this system gave the government 70% of oil profits. Despite a relatively high take for a developed country at that time, exploration activity continued at the rate desired by the government.

11. Due to the more than doubling of oil prices in 1979 and 1980, the Norwegian government raised the special tax on oil revenues to 35% and reduced deductions for capital expenditures. This raised the government's average take to nearly 85%. Due to the deductions allowed under the special tax for capital expenditures and under the corporate tax for dividends, the actual government take is somewhat lower. However, when one includes state participation in production, this raises the take upwards to 85 to 90% (Storting Report no. 53, "Concerning the activities on the Norwegian Continental Shelf". Norwegian Government Ministry of Petroleum and Energy, 1980.)

12. During the period of time when the new tax system was being proposed, the oil companies claimed that it would reduce the profit rate on investment to such a degree as to jeopardize future exploration and development activity (see Platt's Oilgram News, March 17, 1980, p. 3). Two companies, Exxon and France's Elf Aquitaine, warned that they might hold up development of two new fields (PIW, March 24, 1980, p. 4). Mobil complained that the tax would reduce the

discounted cash flow from the Statfjord field, thus making it uncertain whether or not additional development would be undertaken (PIW, March 31, 1980, p. 3).

13. Despite these prophecies of doom, exploration activity and production increased following the institution of the tax. Exxon and Elf went ahead and developed their new fields and Mobil continued the development of the Statfjord field with the construction of a third platform (Petroleum Economist, April 1980, and April 1981). Indeed, the Petroleum Economist reported in April 1981, "Last year saw a significant upturn in exploration work in most sectors of the North Sea -- a trend which, will continue through this year to the next" (Petroleum Economist, April 1981, p. 156). Under these fiscal conditions, two North Slope producers, Arco and Exxon, have continued to bid for additional blocks for exploration in Norway, and have actively continued exploration and development activities in their existing concessions.

14. An instructive comparison of the profitability of Norway versus that of Alaska is provided by Mobil's projection of the profitability of the Statfjord field, Norway's second largest field, with production expected to reach 400,000 b/d. Mobil has stated that the discounted cash flow rate of return over the life of the field is expected to be 16.9% per year, in real dollars (PIW, March 31, 1980, p. 3).

Assuming a 10% inflation rate, this would amount to a DCF profit rate in current dollars of about 29%. This compares to an estimated current dollar rate of return on Prudhoe Bay of about 60-70%.

#### 15. United Kingdom

British oil policy is quite similar to that of Norway, with an even higher tax take on new fields, but with less emphasis on government participation through the British state oil company (BNOC). The British tax system is somewhat more complicated than that of Norway. It consists of four separate taxes:

1. A royalty equal to 12.5% of gross income from production.
2. A petroleum revenue tax equal to 70% of the net profits. (Net profits are defined as gross income, minus royalty, minus operating costs, minus 135% of capital expenditures, minus an allowance and safeguards designed to protect marginal fields.)
3. A corporate income tax equal to 52% of net profits minus the petroleum revenues tax.
4. In 1981, an ~~additional tax~~, supplementing the petroleum revenue tax was added, equal to 20% of gross revenues, minus royalties, minus an allowance and safeguards to protect marginal fields. (This tax is deductible for calculation of the petroleum revenue tax and the corporate income tax.)

All in all, these taxes take some 90% of the profits from larger and new fields. The tax take for other fields varies from 60 to 90%, depending on the size of the field and cost of production. (The system is designed to preserve small marginal fields by lowering the tax rate through allowances and safeguards.)

16. There have been three major tax changes since the original tax law was introduced in 1975. In 1979, the petroleum revenue tax was raised from 45% to 60% and the allowances were reduced, which resulted in increasing the government take from 67% to 75%. At that time, oil executives argued that the increase in the petroleum revenue tax would reduce incentives needed to revive exploration and development (see PIW, March 12, 1979, p. 5). This proved to be untrue as exploration and production increased in both 1979 and 1980 (the limit being the area available for exploration as the government only opened up a small area each year for exploration: see Petroleum Economist, June 1980, p. 233).

17. In January 1980, the petroleum revenue tax was again raised, from 60% to 70%, increasing the government's take to over 80%. The UK Offshore Operators Association again claimed that this increase would hurt the stability needed to encourage exploration in UK waters, and again there was a tremendous outcry about the effect of the tax on marginal

fields and future development (see Oil and Gas Journal, April 7, 1980, p. 39). However, the Petroleum Economist reported in June 1980, "Despite the recent increase in petroleum revenue tax to 70%, it seems likely that all but the smallest of the possible fields will move towards development over the coming years.... Prospects this year, however, are for a good increase in drilling activity... Availability of rigs could prove to be the limiting factor on exploration this year"(Petroleum Economist, June 1980, p. 234-235).

18. In early 1981, a supplementary petroleum revenue tax was introduced along with reductions in deductible allowances, which increased the government take on production from new fields to 85 to 90% (Oil and Gas Journal, March 23, 1981, p. 49). Again, dire warnings were heard from the oil industry. One company, Occidental Petroleum, said it was postponing development plans for the North Claymore field (a marginal, 50 million barrel field). British Petroleum attacked the tax, stating that "although BP hasn't followed other companies in cutting production because of the tax changes, that doesn't mean we won't" (Wall Street Journal, April 3, 1981, p. 24). Although at this time it is very difficult to judge the effect of the most recent tax on oil exploration and development in the U.K. North Sea, the latest round of awards for offshore oil concessions indicates continued interest on the

part of the oil industry. The World Business Weekly reported on March 20, 1981, "Judging by the outcome so far, the new policy seems to be a resounding success." Petroleum Intelligence Weekly reported in December 1980, regarding the new tax, "But, producers complain this is the U.K.'s eighth North Sea tax increase in just 18 months. They claim all the higher 1980 prices have been eroded away in "real terms" by inflation and appreciation of the pound against the dollar... But Wood, Mackenzie notes that Norway's tax terms are still more onerous than the proposed UK structure -- and activity continues to flourish there" (PIW, December 8, 1980, p. 8).

19. Finally, it may be noted that British Petroleum gains almost all of its revenues, profits and production from either the North Sea or the North Slope. Given the nationalization of its fields in Nigeria and Iran, and its declining production elsewhere in the world, British Petroleum has little left outside of these areas. It may be useful to look at British Petroleum's biggest field in the North Sea, the 500,000 b/d Forties field, of which it owns 96%, and which is the most profitable in the whole North Sea. The total government tax take over the life of the Forties field has been estimated to be 88%. With this tax take and the high North Sea production costs, BP will get an estimated constant dollar DCF profit rate of 28.4% (Petroleum Economist,

April 1981, p. 147), or a current dollar profit rate of roughly 40%. In Alaska, on the other hand, where the government tax take is only about 67%, the company will get a much higher profit rate, of between 60 and 70%.

## 20. Canada

Canada has been, in recent years, the number two nation in the world in terms of exploration activity (after the United States). Changes in government policy, announced in late 1980, appear to have reduced at least temporarily, the amount of exploration activity. From March 31, 1980 to March 30, 1981, the number of active drill rigs has declined nearly 40% and many U.S. companies have reduced exploration and development budgets. Probably the greatest cause of this decline in investment has been the government's announced objective to reduce control and ownership of the Canadian oil industry by foreign companies from the present 72% to less than 50%. Included in these policy changes are:

- (1) The state company, Petro-Canada, will automatically be given a 25% net-carried interest, without compensation, on every lease right for oil or gas on federal land.
- (2) Depletion allowances (currently 33-1/3%) will be phased out and replaced by direct government incentives in the form of subsidies. The incentive system will be constructed in such a way to give an important advantage to Canadian-owned companies.

(3) An additional 8% federal tax on gross oil and gas income will be instituted. This tax will be subject to upward adjustment and is not deductible. Analysts have predicted that the tax will result in a 25% reduction in net profits to the companies (Petroleum Economist, December 1980, p. 511). Predictions have been made that the overall energy plan will cut the industry's cash flow by 50% (Platt's Oilgram News, November 20, 1980, p. 5).

(4) Leases to explore federal land could be given only to applicants that are at least 50% Canadian owned.

(5) An as of yet undetermined percentage of goods and services that are used on federal land exploration and drilling will have to be purchased from Canadian sources.

Another investment restraint is Canada's federal price controls which limit the price of oil produced in Canada to \$17.75 per barrel, or about 50% of the market price.

21. Before the new energy policy, the profitability per barrel in Canada has been reported as ranging between \$2 per barrel (by Petroleum Analysis Ltd. in the Autumn, 1980, OPEC Review) to \$6.20 per barrel (by Shell for the year 1980 in the Oil and Gas Journal, March 30, 1981, p. 47). With

the additional tax of 8% per year, the company's profitability per barrel would be reduced to roughly \$1.50 per barrel to \$5.40 per barrel. Taking Canadian heavy oil, with a market price of \$33.50 per barrel, the total government take would range between 85 and 95%.

## 22. Indonesia

Indonesia is of special interest when comparing the investment climate of Alaska to other countries since it is the source of most of the oil imports landed on the West Coast (some 300,000 barrels per day). Also, in Indonesia, two of the North Slope producers, Arco and Exxon, produce some 135,000 and 30,000 barrels per day respectively. Until 1976, exploration and development activity was flourishing under the government's production sharing system, where the government took 65% of the oil produced leaving 35% for the companies. (The shares were calculated after the company recovered its costs by taking up to 40% of annual production.)

23. Changes in both U.S. government and Indonesian government oil policy, in 1976, were followed by a decline in exploration activity. For one thing, the U.S. Internal Revenue Service ruled that U.S. companies operating in Indonesia could no longer deduct the government's share of production for purposes of computing U.S. income taxes. In addition, the

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Indonesian government changed oil policy so that the share of profits going to the government increased, from 65% to 85%, (and also decreased the percentage of annual production available for cost recovery, from 40% to roughly 25%). All in all, the companies were left with only about 12% of the profits. (after taking into account that the companies had to sell some oil to the government at below market prices.) The end result was a decline in exploration drilling in 1977 of 20% (Petroleum News, January 1979, p. 14). However, despite threats by the companies to reduce production, in 1977 it actually increased by over 10%.

24. To encourage exploration, in 1977 the government improved the cost recovery provisions, introduced a number of exploration incentives and altered the terms for sales of the company oil to the government for domestic use. Perhaps more importantly, the Internal Revenue Service ruled, in 1978, that the companies could deduct the government's production share for purposes of calculation of U.S. income tax. Thus, even though the Indonesian government capitulated on a few points, its take has increased significantly compared with 1976, from 65% to 85-89% at present (depending on allowances and oil sale terms : see Oil Daily, December 22, 1980, p. 15).

25. Since 1978, there have been no significant changes in Indonesia's oil policy, despite the fact that prices more than

doubled, increasing the profitability of the companies dramatically. Thus, their per barrel profits have increased to roughly \$4 per barrel, from \$1.25 to \$1.50 in 1976, and Indonesia is now one of the most profitable oil exploration and development areas in the world. Consequently, Indonesia is now in the middle of an impressive oil boom, with exploration at record levels and a record number of new exploration contracts signed. (In 1980 the number of exploration wells drilled was 150% greater than in 1976; see Petroleum News, January 1981, p. 31.)

#### 26. Malaysia

Unlike neighboring Indonesia, Malaysia has acted to reap a greater share of profits created by the major price increases of 1979. The country uses a complex tax system, which includes a 10% royalty, a 70:30 production sharing split after royalty and cost recovery, a 45% tax on the company's profits, a 25% export tax, and a 70% windfall's profit tax (which closely resembles that of the U.S.). The net result is that the government's take is 90 to 95% of oil profits, depending on the field and pricing assumptions. Yet, under these arrangements, Exxon, which produces 1/3 of Malaysia's crude, has continued exploration work. (Tax information and government split are from a report by Walter Levy Consultants "Comparative Analysis of Exploration Arrangements of Selected Countries: Appendices", New York, 1981.)

27. In comparing the profitability of Alaskan oil with that elsewhere in the world, it is quite clear that it is probably the most profitable investment area in the world. For one thing, the per-barrel profit rate and the DCF profit rate are among the highest in the world. Moreover, other nations intervene in the oil industry much more forcefully through controls on pricing and marketing and limits on management decision-making, and are much less secure sources of oil supply.

## Sources of Data for Table

### Prices

All prices from Weekly Petroleum Status Report, 12-5-80, p.21 except Egypt; from Petroleum Intelligence Weekly, 1-12-81, p.11; Canada, from Oil and Gas Journal, 3-30-81, p.46 ; and Alaska, from Petroleum Intelligence Weekly, 3-16-81.

### Saudi Arabia

All data from Petroleum Intelligence Weekly, 5-19-80, p.10.

### Venezuela

All data from Petroleum Intelligence Weekly, 11-19-79, p.5.

### Nigeria

All data from Petroleum Economist, 2-81, p. 54.

### Indonesia

Data from Oil Daily, 12-22-80, p. 15, and Petroleum News, 1-81, pps.20-32.

### Malaysia

Data from Petroleum Intelligence Weekly, 6-2-80, p.4-5 and W.J. Levy Consultants Corp. , Comparative Analysis of Exploration Arrangements in Selected Countries, (New York; W.J. Levy Consultants, 1981) tables A-7 to A-10.

### Egypt

All data from Petroleum Economist, 1-80, p.35.

### Norway

Costs range from Dillar P. Spriggs of Petroleum Analysis Ltd., "Oil Tax Policy in the North Sea and North America", OPEC Review, Autumn 1980, p.63, Petroleum Intelligence Weekly 7-16-78, p.63 and Petroleum Intelligence Weekly, 12-8-80, p.8. Division of profits from OPEC Review, op. cit. and Storting Report no. 53: Concerning the Activity on the Norwegian Continental Shelf (Norwegian Government Ministry of Petroleum and Revenues, 1980)

United Kingdom

Costs are from same sources as Norway.

Division of profits from, Major Features and Trends in Contracts and Agreements in the International Petroleum Industry (New York; United Nations Centre on Transnational Corporations, 2-81) adjusted for new tax and OPEC Review op. cit. p. 61, and Oil and Gas Journal, 3-23-81, p. ~~119~~ 67

Canada

Costs from OPEC Review, op. cit. p.59 and Alaska Legislature, Nonpartisan Research Bureau (via telephone).  
Division of profits from Petroleum Economist, 12-80 p.511.

Alaska

Data from Petroleum Intelligence Weekly, 3-16-81 ,  
and Memorandum to Hon. Ed Dankworth, from Milt Barker,  
1-16-81, "Revisions in Petroleum Taxation"  
Alaska State Legislature .

U.K. and Norway costs are assumed to be roughly the same.

MEMORANDUM

To: Jt. Gas Pipeline Committee Members  
From: Mark Wittow, Professional Staff (907/465-4844) *MW*  
Date: November 5, 1981  
Re: Congressional Consideration of the Alaska Natural Gas Pipeline

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In mid-October, President Reagan submitted a proposal to Congress to waive several provisions of law for the benefit of the Alaska Natural Gas Transportation System (ANGTS). On October 21, Congress began hearings on the proposed waivers, which by law must be either approved or rejected by late December. The pipeline sponsors have unequivocally declared that passage of the waivers are necessary for them to move forward in securing private financing for the project.

If the waivers do not pass both houses of Congress, the gasline is dead for the near future. If they do pass Congress, and if some progress is made on arranging financing for the project, the state will almost certainly be asked early next year to participate. Key members of Congress, federal agencies and the project sponsors and their bankers have all pointed to Alaska as a project beneficiary with a resulting obligation to seriously consider investment in the gasline. Since the size of the project will test the limits of international capital markets, Alaska's possible financial participation will likely be seen as vital by other proponents of the project.

I. THE WAIVERS

To date, the pipeline sponsors have been unable to obtain private financing. To improve their ability to raise private funds for the project, they have asked for several exceptions to existing statutes. Under the provisions of the 1976 Alaska Natural Gas Transportation Act, the President may submit specific waivers of law for the project to Congress, which then must be approved by joint resolution in both houses within sixty days. Although the waivers contain a variety of technical provisions, they are largely designed to accomplish the following purposes:

1. Permit equity participation in the project by the North Slope producer.

2. Include the conditioning plant as part of the gas transportation system.
3. Preclude the Federal Energy Regulatory Commission (FERC) from changing the tariff in a manner that would impair the repayment of project debt.
4. Permit FERC to approve tariffs that allow the sponsors to bill consumers before gas is delivered. Billing could only commence after a date to be set by FERC, after an entire segment (Canadian, Alaskan or conditioning plant) of the line is completed and could only cover debt and operating charges, not equity return. The Canadians could collect full cost of service once their segment is complete.

The provision to allow pre-billing (#4 above) has caused the greatest discomfort in Congress. It represents the first time that U.S. gas consumers are being asked to pay the costs of a project before receiving benefits from it, as well as creating the possibility of consumers paying part of the costs of a project that is never completed. The cost of the provision has been roundly estimated at 4 to 30 dollars a year for each average residential consumer until gas begins to flow.

Both the banks and the Canadians have declared the pre-bill provision essential to the project's success. The banks flatly state that debt for the project cannot be raised without it. They originally asked for gas consumers to be billed during construction, after small portions of the line had been completed. However, that proposal was too extreme to win any support in Congress, so the more modest pre-billing provision described above (originally suggested by Senators Stevens, Jackson, McClure and Murkowski) was adopted. The Canadians asked for the provision because they do not wish to construct their segment of the pipeline without a guarantee that they can bill for operating and debt costs once the work within their country is complete.

The Reagan Administration submitted the waivers with great reluctance, and consequently may not lobby for the waivers. Some administration officials see gas decontrol as a higher priority that would be hurt by the gasline, with its need for low-cost, controlled gas to help cushion its high-priced deliveries in the early years of the line. Others feel that the pre-bill provision is a subsidy undeserving of support in a free-market administration. Still others view the project as a Carter administration boondoggle that has no call on the loyalties of the new administration. Reagan finally decided to submit the waivers because of U.S. obligations to Canada, and as a

result of hard lobbying by project supporters, including the Alaska delegation. William Niskanen, a member of the President's Council of Economic Advisors, stated that the White House sent the waivers to Congress "to get the Canadians and senators off our backs."

## II. CONGRESSIONAL CONSIDERATION

President Reagan submitted the waivers to Congress on October 15. House and Senate hearings on the proposal began the following week.

The Senate hearings on the waivers are being conducted by the Committee on Energy and Natural Resources, chaired by Senator McClure of Idaho. Senators McClure and Jackson, the two senior members of that committee, have both expressed strong support for the package. (Indeed, the package as submitted is virtually identical to the waivers proposed by Senators McClure, Jackson, Setvens and Murkowski in July.) Although some members of the committee have questioned the wisdom of the pre-bill provision, final passage in the Senate is considered likely due to the support of the four Senators. A committee vote is scheduled for November 10.

The House hearings on the waivers are being conducted jointly by the Subcommittee on Fossil and Synthetic Fuels of the Committee on Energy and Commerce, chaired by Rep. Phil Sharp of Indiana, and by the Subcommittee on Energy and Environment of the Committee on Interior and Insular Affairs, chaired by Rep. Mo Udall of Arizona.

Chairman Sharp posed the questions of concern to the House in his opening statement of October 21, 1981:

- Is the project still an economically sound venture?
- Should considerations of domestic source, secure supply, or environmental cleanliness of Alaskan gas offset any economic drawbacks?
- What is the risk of project failure, and why must that risk be assumed by the customers of the companies involved in the project?
- Does the kind of ratepayer-backed financing contemplated by the waiver proposal truly qualify as the "private financing" which has always been promised for this project and which has always been seen as a market test of its worth?

- What are our outstanding commitments to Canada and must we adopt the waiver proposal in order to live up to them?
- How will this project and its delivered gas relate to a natural gas market that will probably be partially or totally deregulated before the Alaska gas pipeline is complete?

Informed observers hold differing opinions on the waivers' chances for passage in the House, which reflect the uncertain answers to the questions posed above. The two senior Republicans on the Energy Committee, John Broyhill of North Carolina and Clarence Brown of Ohio, have both expressed strong opposition to the pre-billing component of the waiver package, and have been joined by other colleagues in the Northeast-Midwest Congressional Coalition. Their concerns are also shared by several other Democrats serving on the Energy and Interior Committees. Other committee members have challenged the ability of the pipeline sponsors to market the Prudhoe gas; have worried that the project would get in the way of gas decontrol; and have expressed dismay at the lukewarm support of the Reagan administration for the waivers.

The strongest testimony against the project has come from the Energy Action Educational Foundation. The group focused its criticism on the pre-billing provision, charging that it was a consumer subsidy of a project that was supposed to be financed solely in the private market. Additional criticism is expected to come from some state public utility commissions, which see the pre-bill as an override of their traditional authority to judge the fairness of consumer charges.

Support for the waivers has come from the Alaska delegation in Congress and the governor, the pipeline sponsors, the Secretary of Energy, the North Slope producers, the lead banks and the chairman of the Federal Energy Regulatory Commission, Michael Butler. Mr. Butler made one of the strongest cases for the waivers in his testimony. He pointed out the following facts:

1. Substantial declines in gas production from the Gulf of Mexico region are expected in the mid-1980's; Alaska gas could be a hedge against gas shortages in the post-1985 timeframe.
2. Failure to build a gas transportation system from Alaska will impede further exploration and production in Alaska.

3. The long-run cost of Prudhoe gas is competitive with other supplies.
4. The pre-billing provision of the waivers places a very small risk on consumers, and one that is justifiable given the nature of the project and of the gas transmission industry.

Other witnesses have cited studies which showed that the national economic benefits from displacing foreign oil with Alaska gas would amount to several billion dollars a year.

Northwest Alaskan Pipeline Co. has mounted an aggressive lobbying campaign to win House support for the waivers, enlisting Walter Mondale and a good chunk of the Washington lobbying community in their cause. Their efforts are having some results, reportedly bringing House Speaker Tip O'Neill into the fold of waiver supporters. Congressman Udall has spoken favorably on the waivers (in contrast to his D2 companion John Seiberling), citing the importance of previous U.S. commitments to Canada.

Although approval by the House Interior Committee is predicted by most observers, the House Energy Committee's ultimate decision is far from certain at this point. Opponents are likely to let the waivers head for a final showdown on the House floor, where a large majority of the 435 Congressmen voting on the waiver package may know almost nothing about it.

### III. FINANCE

Even if the waivers pass Congress, the pipeline sponsors face a formidable task in arranging financing for the project. The witnesses who have addressed the Congressional committees - Secretary of Energy Edwards, John McMillian, representatives of Arco, Exxon and Sohio, and representatives of the nation's largest banks - have all clearly stated that while the waivers are necessary for the project to have any hope of obtaining private financing, they by no means guarantee it.

The project costs (in 1980 dollars, exclusive of inflation and interest charges):

Alaska pipeline	\$10.8 Billion
Gas Conditioning Plant	3.6 B
Canadian segment	5.8 B
"Pre-build" (East & West legs)	2.8 B
<hr/>	
Total Cost, Alaska Natural Gas Transportation System	23.0 Billion

Adding in inflation (7 to 11% annually) and interest charges (10 to 14%) results in a total project cost of 38.7 to 47.6 billion dollars.

The two pre-build segments have already been financed. The Canadian segment will be financed by the Canadian sponsors, NOVA of Alberta and Westcoast Transmission Co. of British Columbia (through a subsidiary, Foothills, Ltd.). The Canadian companies expect to have no difficulty in arranging debt financing if the waivers are passed. Because of high costs and intemperate climate, the Alaska segments are considered to pose the only significant financing problem.

The bankers testified that the capital requirements for the project will "test the limits of the world's capital markets." The capital reserves of U.S. and Canadian institutions are insufficient to finance the project, and even the international resources potentially available will only flow to the project if lenders are confident of its economic viability and receive some sort of completion assurances yet to be negotiated.

In May 1981, the producers and the pipeline sponsors circulated a financing plan to potential lenders. The plan called for the North Slope producers to supply a 30% share of the financing, and for the project to have a 75/25 debt/equity ratio. It also proposed a "pre-completion pool" to handle the problem of cost overruns. Although most of the plan may be followed in arranging financing, the lead banks have declared certain portions of it unacceptable. (A detailed analysis of the May 1981 financing plan by Peter Lewis of Lazard Freres is attached as Appendix D.)

Many observers still feel that some type of government guarantee will ultimately be necessary if the project is to be built during this decade. Because of the huge amount of debt required, and the nature of the assurances the bankers are seeking, no clear path to the private financing of the project stands out. Given this situation, the State of

Alaska has been cited frequently as a potential source of capital that could put the project over the top. Whatever the merits of that proposal, many members of Congress see the state's oil billions, and the billions and benefits that will purportedly accrue to the state once Prudhoe gas begins to flow, as a reason for the state to come to the aid of the gasline. (The state's earlier commitment to aid the El Paso Trans-Alaska LNG proposal reinforces this view.) Secretary Edwards stated that the Reagan administration had not contacted the state to discuss the possibility of state aid for the line. However, John McMillian of Northwest did state that the project sponsors would be seeking state assistance. When the governor testified, he responded to questions concerning state participation in the project by promising to review the possibility. (A copy of the Governor's testimony is attached as Appendix B.)

Secretary of Energy Edwards repeatedly stated that the current administration does not intend to provide any federal loan guarantees, funds or subsidies for the Alaska gas pipeline.

#### IV. MARKETING

Part of the hesitation of potential lenders, and of the Congress in their consideration of the waivers, stems from the uncertain marketability of Prudhoe Bay gas. The high cost of the transmission system (\$40 Billion +) will result in an extremely high transportation tariff during the early years of pipeline operation.

Northwest estimates that the first year delivered cost of Alaska gas will be in the neighborhood of \$9.50/mcf in 1980 dollars, which is the equivalent of \$60/barrel oil. They also estimate that the cost will decline to about \$3.00/mcf in the twentieth year of the project, for an average cost of less than \$5.00/mcf (1980 dollars). Current gas imports are priced at about the same range, although not all the gas available is being sold at that price. Northwest's figures have not been independently verified or checked, and some analysts feel that their numbers may be optimistic.

The sponsoring gas transmission companies have stated that they will need additional supplies for their systems during the late 1980's and beyond, and that they believe that the Alaska supplies will turn out to be among the most economical new supplies. On the other hand, the marketability of Alaska gas is not certain enough, given the huge costs of the gasline, to enable the project to be privately financed without the waivers and possibly even with them. Nor is the project of such obvious national

importance, at this point, that either the administration or leading members of Congress are willing to consider federal guarantees to ensure the project's construction and completion.

Several members of Congress asked about the possibility of transforming the gas into methanol or LNG as an alternative method of transporting it to market. Both the Secretary of Energy and the North Slope producers stated that those options were even more expensive methods of delivering the gas than the Alaska Highway route. Preliminary Congressional studies support that conclusion. However, more detailed analyses of those options will likely be performed if the current project fails to obtain financing during the next six to eight months.

\* \* \* \* \*

This memorandum was prepared at the request of Senate President Jalmar Kerttula, Co-Chairman of the Joint Gas Pipeline Committee. I would be pleased to answer any questions pertaining to material presented above.

Appendices:

Project History	-	A
Project Map	-	B
Testimony by Governor Hammond before Congress	-	C
Financing Report by Peter Lewis of Lazard Freres	-	D

## APPENDIX A: PROJECT HISTORY

Between 1974 and 1976, three different consortia applied to the Federal Power Commission (now the Federal Energy Regulatory Commission or FERC) for the right to transport Prudhoe Bay natural gas to market. One proposal, Arctic Gas, would have transported the gas by pipeline across the Arctic Wildlife Range and down the MacKenzie Valley through northern Canada. The El Paso proposal, which was strongly supported by the State of Alaska, would have carried the gas to a tidewater site near Valdez via a pipeline paralleling the existing TAPS oil line; at tidewater, the gas was to be liquified and transported in tankers to a West Coast terminal. The Alcan (now Northwest) consortium proposed to parallel the TAPS line to Fairbanks and then follow the Alaska Highway through Canada to Alberta, where an eastern and western leg would deliver the gas to Midwest and West Coast pipeline systems.

In 1976, Congress passed the Alaska Natural Gas Transportation Act to establish a procedure for selection of the best route by the President, and for expeditious regulatory treatment of the project's construction and operation. In 1977, President Carter selected the Northwest group; his decision was ratified by Congress as provided for in the 1976 act. During that year, the Canadian National Energy Board certified the Canadian portion of the Northwest route, and the United States and Canada signed a treaty and agreement designed to clear the way for the gasline.

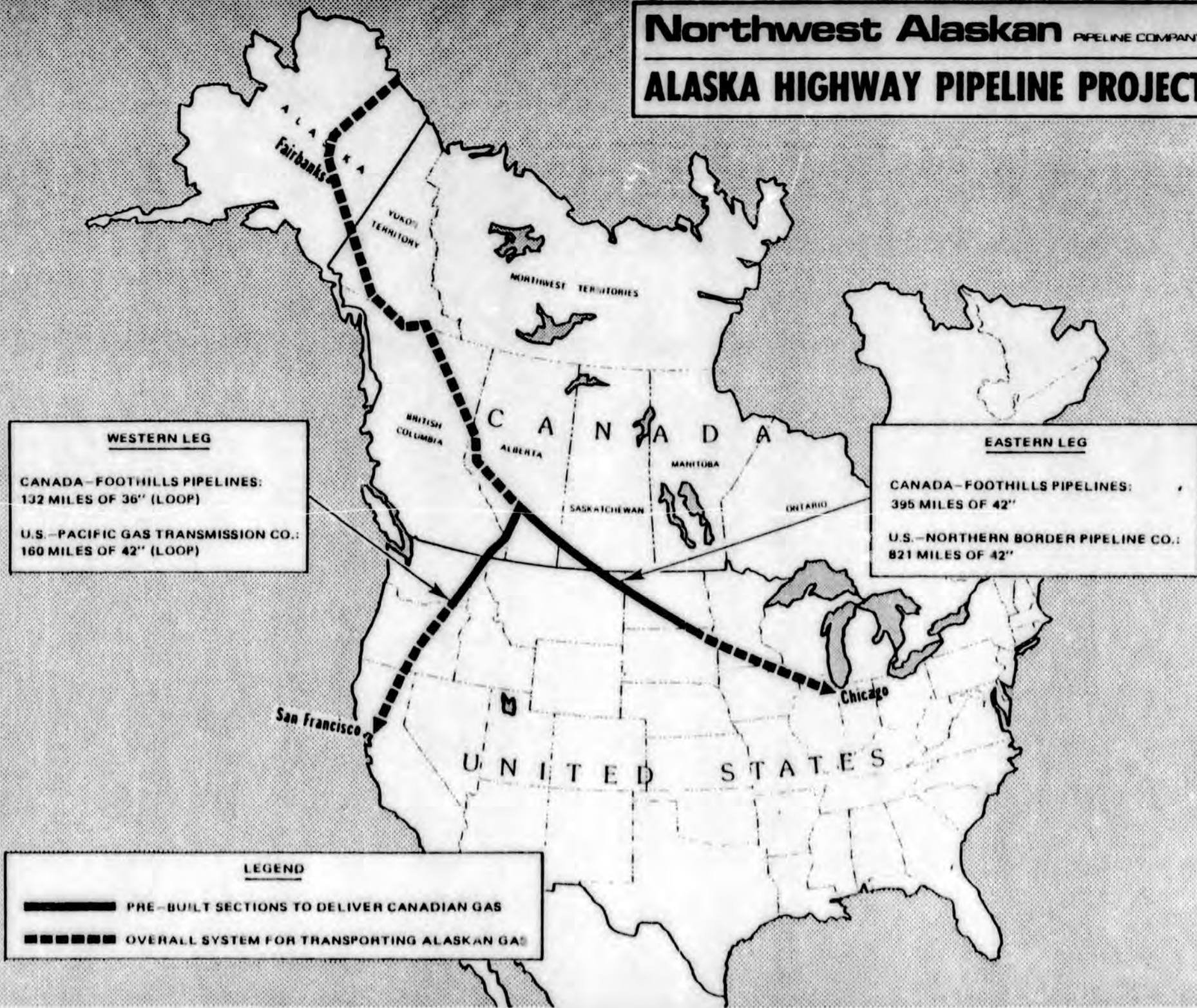
The Presidential Decision, which was ratified by Congress, clearly stated that the project was to be privately financed and that there was to be no pre-billing of consumers. It also prohibited North Slope producers from making an equity investment in the project.

In 1980, Canada authorized "pre-build" of the sections of the project running from Alberta to the Midwest and West Coast, along with additional gas exports, after receiving assurances from the U.S. that it still supported construction of the rest of the project. The western leg was completed this fall, and gas is now flowing through it. The eastern leg is proceeding on schedule towards its fall 1982 completion date.

(M. Wittow, 10/28/81)

# Northwest Alaskan PIPELINE COMPANY

## ALASKA HIGHWAY PIPELINE PROJECT



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MEMORANDUM

To: Joint Interim Natural Gas Pipeline  
Financing Committee

Date: July 27, 1979

THE ALASKA NATURAL GAS PIPELINE:  
CURRENT PROSPECTS FOR FEDERAL  
ASSISTANCE

This report is in response to the Committee's request that we examine the issues involved in possible federal financial support for or participation in the Alaska Natural Gas Pipeline project. The specific areas of inquiry suggested by the Committee include:

1. What would be the most likely forms of federal participation?
2. What is the overall likelihood of federal participation?
3. If federal participation occurs, when is it likely to come about?
4. What events must occur in order to make federal participation a reality?
5. What steps could the State of Alaska take in order to convince the federal government that such financial support or participation is necessary?
6. In the event the State chooses to actively solicit federal participation in the project, what areas of the federal government and what methods of approach would be most likely to achieve favorable results?

The remainder of this memorandum discusses these questions. By way of preliminary comment, it should be noted that since the Committee requested the analysis of these points (at its meeting of June 4, 1979), there has been a significant upheaval with

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regard to the domestic energy policy situation and with regard to international energy prices. The result of the major OPEC price increase of July 1, President Carter's domestic policy summit at Camp David, and the subsequent attempt by the President to initiate major personnel and policy changes within his Administration, have all combined to make this report somewhat more speculative than might otherwise be the case. Consequently, where these major events have influenced our analysis, we have so noted. We have also added analyses of President Carter's latest energy proposals where appropriate.

#### Possible Forms of Federal Financial Participation

As evidenced by the President's recent proposals on synthetic fuels, the range of possible federal support for the proposed Northwest Alaska Natural Gas Pipeline is great. The material provided to Congress describing the President's proposal to establish an Energy Security Corporation (to promote synthetic fuels and unconventional natural gas supplies) contained the following financial authorities which would be provided to the Corporation:

1. Direct loans to companies that produce or manufacture synthetic fuels or unconventional natural gas supplies.
2. Loan guarantees for such projects.
3. Authority to guarantee prices of synthetic fuels or unconventional natural gas supplies.
4. Authority to guarantee federal government purchases of such materials.
5. Direct government ownership of a maximum of three synthetic fuels projects.

Specifically excluded, however, is authority to make equity investments, enter into joint ventures, engage in lease or lease-backing arrangements, or make grants.

Based on our conversations with Congressional staff and Executive Branch officials, we believe that provision of loan guarantees for at least a portion of the Alaska Natural Gas project is the most likely alternative in the event the federal government decides that financial assistance for the project is

appropriate. Based on our conversations, we believe guarantees would be seen as a distinctly preferable alternative to direct government loans because guarantees involve only a contingent liability for the federal government and involve the smallest risk of involving actual federal cash outlays. Because the government has yet to change its position that the project can and will be privately financed, the exact nature of any loan guarantee program is necessarily speculative. However, we again believe the general parameters of the loan guarantees proposed in the President's latest energy program may be illustrative:

1. No guarantee shall be extended unless the chairman of the Energy Security Corporation finds that credit is otherwise unavailable to carry out the project on reasonable terms and conditions and that adequate provision is made for servicing the loans on reasonable terms.

2. The guarantee shall not exceed 75% of the project cost, as estimated at the time the guarantee is issued. The guarantee amount may be increased, at the discretion of the chairman to cover 60% of that portion of the actual total project's costs which exceed the project costs of such facilities as estimated at the time the guarantee is first issued.

3. The chairman will seek to the maximum extent practicable to grant guarantees on a competitive basis.

4. The chairman shall charge and collect fees for guarantees in amounts sufficient, in his judgment, to cover applicable administrative costs and probable losses on guaranteed obligations, but in any event not to exceed one percent per annum of the outstanding indebtedness covered by such guarantees. Such fees may, however, be waived with respect to specific projects.

5. The loan to be guaranteed shall be secured by such collateral and additional security as may be reasonably required by the chairman for the protection of the corporation.

6. The chairman may provide for the payment to holders of the obligation guaranteed for and on behalf of the borrower, the principal and interest which become due if the chairman finds that:

- a. the borrower is unable to meet such payments;
- b. it is in the interest of the corporation to permit the borrower to continue to pursue the purposes of such project;

c. the probable net benefits to the corporation in paying such principal and interest will be greater than that which will result in the event of default; and

d. that the borrower agrees to reimburse the corporation for such payment on terms and conditions, including interest, which are satisfactory to the chairman.

7. With respect to any obligation which is guaranteed, the interest paid and received by the purchaser (excepting tax-exempt entities) shall be included in the gross income of the purchaser for the purpose of Chapter 1 of the Internal Revenue Code of 1954, as amended.

8. The chairman shall consult with the Secretary of the Treasury as to the timing, rate and terms of loans or loan guarantees.

A second and much more remote possibility would involve provision of purchase guarantees for some or all of North Slope natural gas production. Essentially, such an approach would attempt to address the marketability problem for Alaska natural gas; i.e., that even with rolled-in pricing the delivered price of this gas may be too high to make it economically attractive. Under a purchase guarantee system, the government could conceivably contract to purchase North Slope natural gas at the higher "uneconomic" rate and then resell such gas at a lower price (the BTU-equivalent price for No. 2 home heating oil, for example), absorbing the difference as a subsidy loss to the Treasury. As we stated previously, however, we think such an alternative is extremely unlikely. Not only is this alternative more complex than provision of loan guarantees (hence, more difficult to shepherd through Congress), it also exposes the federal Treasury to a continuous drain. In the event that marketability as opposed to assumption of risk becomes a problem for the project, we believe a more likely federal approach might be a combination of loan guarantees and more stringent rate of return controls, both in terms of pipeline rates and, possibly, wellhead prices.

What is the probability of federal participation?

Based on our conversations with both Congressional and Executive Branch sources, we believe that the eventual provision of federal financial assistance to the Northwest Alaska Natural Gas pipeline project has become quite likely. As evidenced by recent statements by the President, a renewed and very strong commitment to a major national energy program is underway. The proposed Northwest pipeline represents the energy equivalent of

700,000 barrels per day of oil imports -- 28% of the proposed 2.5 million barrels per day of energy production called for from synthetic fuels and unconventional gas sources by 1990 in the President's program. Unlike synthetic fuels and unconventional gas sources, the North Slope reserves are known and can be produced and brought to market utilizing existing -- if expensive -- technology. Thus, in the event that the project fails to finance privately, as now seems likely based on numerous expressions from the financial and energy community, federal financial support would seem to be very likely in that federal assistance to the project would result in the easiest, least expensive (to the federal government), earliest, largest, and -- most importantly -- surest single increment to the nation's energy supply of any of the options available to the federal government.

The likelihood of federal support has been bolstered recently by the energy speeches delivered by Vice President Mondale and then President Carter (in Kansas City) during the Camp David and post-Camp David periods. While neither confronted the possibility of any type of government subsidy, both indicated that the Alaska Gas Pipeline is considered part of the fabric of our energy planning for the mid-1980's. Neither referred to the gasline as a prospect, but rather as a fait accompli. Specifically, the Carter quote was: "one major project will be the new pipeline to be built from Alaska through Canada to bring natural gas to the lower 48 states. By 1985 Alaskan and Canadian natural gas can displace almost 700,000 barrels of imported oil per day." Moreover, it is noteworthy that the Alaska gasline is the only new energy source that can produce a consequential amount of oil-equivalent by the middle of the next decade, rather than at decade-end.

Under what circumstances is federal participation likely to occur?

Despite this summer's gasoline crisis which has whipped the Congress into an at least temporary frenzy of enthusiasm for new approaches to solve the nation's energy problems, we have found no evidence at the federal level of a change in policy toward financing the gas pipeline. Despite this summer's disruption of the gasoline markets and despite the dozens of bills introduced in the Congress calling for major federal assistance to synthetic fuels projects, the Congress continues to view the Alaska Natural Gas project as a separate entity that must be privately financed.

On the whole, those whom we contacted in Congress demonstrated a low level of knowledge regarding the financing difficulties of the project and expressed the view that since Congress had already acted in approving the Alaska Natural Gas Transportation Act, as well as the President's decision selecting the Northwest project,

that the subject was essentially closed. Of the offices contacted, the clearest response was provided by Senator Henry Jackson, Chairman of the Energy & Natural Resources Committee. According to Jackson's staff, his position with respect to federal assistance for the project has not changed: "The till is closed." In the judgment of Jackson's staff, this position will not change unless and until Northwest concedes that it cannot finance the line privately (as promised to Congress) and either directly or via the Administration requests federal assistance. Jackson's staff predicted that such a request could open the entire project to an intensive Congressional and federal review and indicated that it might prove very difficult given the record to push such federal support through the Congress.

Despite the apparent analogy between the Alaska Gas Pipeline and the massive federal support program for synthetic fuels now being considered, it appears that the pipeline project is unlikely to be a recipient of federal guarantees or support as an "add-on" to any legislation currently in Congress. Congressional feeling on this is illustrated by the results of contacts with Senator Lloyd Bentsen's office. Bentsen recently introduced the Energy Mobilization Act of 1979 (S. 1516). Title IV of this Act would establish an expedited procedure by which major natural gas pipelines would be automatically considered "significant energy projects" and thus, subject to accelerated FERC review processes. Federal financial assistance for such major pipelines in the form of loan guarantees would also be available. However, the bill explicitly limits both the expedited review procedures and federal financial assistance to those pipelines located in the Lower 48 United States.

According to Bentsen's office, the Alaska Gas Pipeline was specifically and intentionally excluded from Title IV. According to the staff, this was done because, in their view, the question of providing federal guarantees to natural gas pipelines was sufficiently controversial without adding Alaska. They stated that any legislation dealing with Alaska automatically becomes "controversial" and attracts great attention and opposition from environmental groups and other lobbying organizations. In their view, if Alaska had been included in the provision, the chances for passage would have been significantly decreased. According to his staff, Bentsen believes that any action providing loan guarantees for a natural gas pipeline in Alaska must be considered as a separate proposal that stands or falls on its own merits, and that attempts to "fold-in" such assistance as a part of any of the major energy proposals now being considered in Congress will, in all likelihood, fail.

Outside of Congress, the public position with respect to federal assistance for the project remains unequivocally negative.

John Adger, Director of the Alaska Gas Project Office of the Federal Energy Regulatory Commission adamantly denied the existence of even a possibility of federal assistance. He indicated that the gas pipeline project will be privately financed and that any federal involvement would be limited to heavy Presidential pressure on the oil companies to participate in the debt financing. He emphasized that there has been no indication from the President in his recent energy speeches or proposals that federal participation is being considered. Similarly, he pointed out that there has been no such proposal contained in Congressional Energy Mobilization Board-type legislation.

Despite the political turmoil of the last few weeks, we spoke with several senior officials in the Department of Energy. While they indicated to us that the "regular" policy process was in some disarray because of the Cabinet reshuffle and that communications with the White House were not the best, the federal policy with respect to providing financial assistance had not been changed. Hence, if any policy initiative to change federal financing policy is underway, it must be occurring at the White House. While we cannot state categorically that such an initiative is not being considered, we have found no evidence of it.

Based on our conversations with federal officials, we concur with the estimate provided by Senator Jackson's staff: namely, that far and away the most important prerequisite for getting the federal government moving forward on a program of providing federal guarantees or other financial assistance to the project must be a decision by the management of the Alaska Gas Pipeline project that the private financing approach cannot work. If and when project management makes such a decision, the project in its current form can officially be laid to rest, a crisis atmosphere created, and alternative proposals formally considered. Given the fact that the federal government, from the President through the Congress, has endorsed and supported the concept of private financing, we believe it is extremely unlikely that an initiative in favor of federal support will be forthcoming from either the Executive Branch or the Congress until the private sector sponsors concede that the initial formulation of private financing is no longer a workable solution.

When might Northwest call for federal assistance?

Northwest continues to pursue a course that pays at least lip service to private financing. We must presume that Northwest management is privy to at least as much information regarding private financing prospects for the project as are we and the Committee, and therefore, that they are fully aware of the deep and increasing difficulties the project faces in achieving

private financing. Consequently, the question must be considered: Why, when private financing appears to be a small and diminishing hope, has not the company changed its position with respect to federal assistance?

In our judgment, there are two plausible reasons for this:

1. As Northwest is aware of its probable difficulties with private financing, it must also be aware that requesting federal assistance will create major political problems for the project and for the existing project management. Senator Jackson, a key figure in any federal financing assistance scheme, has made no secret of his continuing reliance on White House and corporate protestations that private financing is a viable alternative. As his staff indicated, were Northwest to return to the Congress asking for federal assistance, it would be "a whole new ballgame". Consequently, we believe one major motivating factor for Northwest's not throwing in the towel on the private financing approach at this time is the fact that they must appear to have foreclosed every reasonable alternative to federal financial assistance before they return to the Congress. Under any set of assumptions, it is likely that some in Congress will accuse the company of having falsely represented the possibility of private financing in order to obtain the North Slope pipeline franchise, with the intent of seeking federal guarantees when their initial proposal failed. Thus, if Northwest returns to Congress asking for major federal assistance prior to having completed virtually all attempts to gain favorable regulatory approvals from FERC and without attempting to formally obtain the necessary financial backing, it seems likely that they will run grave political risks. These risks could, in the event Congress felt they had been taken advantage of, even result in the loss of Northwest's franchise -- an outcome which the company surely wishes to avoid. In a somewhat related vein, Northwest achieves some advantages by pursuing its current regulatory course in the most aggressive manner possible, even with the knowledge that private financing is likely to fail. Specifically, if Congress "federalizes" the project, the possibility exists that Federal Energy Regulatory Commission rulemaking authority over the project might be limited or suspended. Consequently, the existing public record with respect to rates of return and tariff issues might be incorporated, at least in part, in any Congressional action taken on the project. Hence, it might very well redound to Northwest's advantage to achieve the most favorable regulatory treatment possible in the current proceedings with a view toward preserving such regulatory decisions in future Congressional deliberations on federal assistance.

2. Since the initial FERC rulemaking proceedings with regard to the incentive rate of return question were initiated last year,

Northwest has adopted an unyielding posture. Virtually every document submitted by Northwest to the Commission has indicated that the project will fail if the Commission does not adopt regulatory approvals substantially in keeping with those suggested by the partnership. This trend has been continued with Northwest's petition for reconsideration of Order No. 31 (the incentive rate of return and tariff order). In our view, this represents an effort by Northwest not only to get the most favorable decisions on the record prior to any consideration of federal assistance, but also an effort to establish a public record which makes clear that any failure to finance privately has not been due to shortcomings of the project sponsors. Rather, we believe that every effort will be made to place the blame for project failure, in the event that it occurs, upon the federal regulatory process, thus minimizing potential criticism of project management. Given recent statements by the President regarding his intention to bring increased pressure to bear upon the oil companies to provide financial assistance to the project, it is also possible that their "intransigence" may be portrayed as an additional reason that the project failed to finance in the private sector. It is also not difficult to see how the State of Alaska might easily be included with the oil companies in the event that project failure degenerates into a round of finger-pointing.

Based on the foregoing discussion, it seems that the timing of any Northwest decision to call for federal assistance will be heavily influenced by both the speed and content of actions by the Federal Energy Regulatory Commission with respect to the issues before it. As noted, the Commission is now considering Northwest's petition for reconsideration of Order No. 31 which is the regulatory "centerpiece" of the project. In the event FERC rejects Northwest's petition, the opportunity for a major change in policy for the company could occur relatively soon. In the event that the Commission accepts the petition and a further round of negotiation between FERC and the sponsors occurs, the final decision could be delayed until next year. In any event, based on our discussions with Congressional staff, we believe it is extremely doubtful that the Congress could pass federal assistance legislation prior to the spring of 1980, considering the current Congressional agenda and the fact that we believe any such legislation will be the subject of at least moderately extensive hearings and debate. A further complicating factor is the fact that any 1980 Congressional consideration of federal guarantees to the project coincides with both a Congressional and Presidential election year. While it is not possible to make any precise prediction regarding the effects of election year politics on the decisionmaking process, it is safe to say that this factor complicates the situation and in Washington, complications almost

always translate into delay. Thus, we believe the spring of 1980 is the earliest possible date for provision of federal financial assistance to the project and that such assistance is more likely to be seriously considered in 1981.

What steps might the State take in support of federal financing?

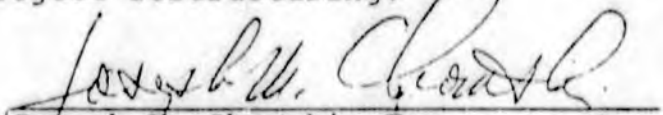
After having observed the great political inertia which exists with respect to this issue, we doubt that a direct lobbying campaign by the State of Alaska will have much effect on the speed with which Congress and/or the Executive Branch changes its current posture on federal financing. Our conclusion is based on the fact that the current "bind" facing the project is largely political rather than substantive. In short, we do not believe that provision of "better information" to Congress or the Executive Branch is a critical factor in speeding the process.

We do believe, however, that there are several steps the State can take which will at least minimize whatever delay is inherent in the process and which may assist in protecting the State's interest if and when Congressional consideration of federal guarantees is initiated. These steps include:

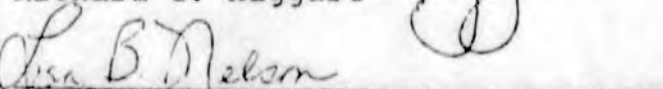
1. A concerted and coordinated effort, both by the Legislature and the State Administration, to provide a current information flow on positive State actions taken with respect to the project. This would include regulatory, environmental and right-of-way actions, even of a minor nature. This process would help establish a public record with Congress and senior Energy officials that evidences the State's good intentions toward the project. Such a campaign consisting, for example, of monthly mailings to the Congress and senior Energy officials could incrementally create an impression of the positive nature of the State's attitude toward the pipeline project. Such a perception in Washington could be of great value to the State in the event Congress engages in a minor league "witch hunt" in order to assign blame for project failure.
2. As we indicated above, we do not believe direct lobbying in Washington would be of significant benefit in speeding federal assistance for the project. It is not so clear, however, that private and frank discussions with senior Northwest officials regarding the need to request federal assistance from Congress in order to speed the project might not be productive. To the extent that such discussions may have already occurred, at least informally, it is logical that they would have involved senior members of the State Administration.

3. To the extent that Northwest may in the end attempt to lay the blame for the failure of private financing at the door of other parties, it may become increasingly important for the State to take some steps to protect itself by positive action on its own program of financial assistance. We believe general approaches such as those suggested by Arlon Tussing in his memorandum to Senator Mike Colletta and Representative Bill Miles of May 14, 1979 should be carefully considered. In our view, even the most minimal and contingent sort of commitment to the project could have important value to the State as the question of financial assistance is considered in Washington. The very real possibility must be considered that Congress may demand a "pound of flesh" in return for federal financing -- and it is possible that the pound of flesh would be exacted at the wellhead and/or in the pipeline rates of return to operating companies. If the State is on the record as having taken at least minimal steps across the board to support the project, it will be able to come to the proceedings in Washington with clean hands; alternatively, and absent evidence of such State action, the Congressional response could be to take action to penalize those parties, including the State, which it perceives as having failed to adequately support the project. Such an approach would almost certainly be disguised as a "proconsumer" step (i.e., lowering or taxing the wellhead value or reducing pipeline tariffs in some fashion) and would undoubtedly be termed an appropriate price to exact in return for guarantees provided by the nation's taxpayers. The current proposal to impose an excess profits tax on Alaska oil, despite the fact that this oil only recently reached previous federal price ceilings, is illustrative of the ability of Congress to impose new and contradictory conditions on energy production, if it wishes.

We recognize the great difficulty that the State and the Legislature have in attempting to move forward on this project, given the great confusion and disarray that currently exists in Washington. Nonetheless, we believe taking at least minimal steps and publicizing those positive actions to the Congress and the federal bureaucracy could provide the State with some protection against possible punitive Congressional action at the time federal guarantees are considered. Such a program will improve, although by no means guarantee, the prospects for equitable treatment of the State of Alaska in future Washington consideration of federal loan guarantees and project restructuring.

  
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Joseph M. Chomski, Esq.

  
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Richard G. Haggart

  
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Lisa B. Nelson

TESTIMONY OF JOSEPH M. CHOMSKI

Legal Counsel to the

JOINT NATURAL GAS PIPELINE COMMITTEE

March 12, 1981

Testimony of Joseph M. Chomski

March 12, 1981

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

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

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

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

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

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

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

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

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

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

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

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

## CURRENT STATUS - 1981 EVENTS

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

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

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

their response will be something like: "It may be possible to raise the monies involved if certain nonnegotiable conditions are met."

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

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

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

Our December, 1980, report to the Committee details the process at some length, so I will not restate it. However, I will highlight some key 1981 events.

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

FERC will then await submission by Northwest of the remainder of its Certificate Application. The unfiled portions are pivotal to the project, since they include the financing plan, marketability projections, a national economic benefit section (this requires Northwest to demonstrate that the project costs do not "materially and unreasonably exceed the comparable cost estimate filed by Northwest in April, 1977. FERC may not issue a

final certificate if Northwest fails this test.)<sup>\*</sup>, and Northwest's cost of service data. There is no firm date when Northwest is expected to complete its application, but sometime this summer might not be a bad guess. Obviously, completion of the application depends on the outcome of the current negotiations.

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

Ultimately, we think the FERC Pipeline Office may be able to produce a draft report with recommendations on final certification by the end of the year or more likely, early 1932. If the recommendations and the Commission's actions are both favorable, final certification of the Alaska Gas Pipeline will at long last occur.

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

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

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

With regard to the Alaska segment, the critical operational event this year involves procurement for the North Slope

conditioning plant. In order to maintain the Gas Line's current construction and completion schedule, significant progress on the conditioning plant must occur this year. Northwest states that purchase orders must be made by this summer or a year will be lost.

## REAGAN ADMINISTRATION POSITION

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

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

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

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

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

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

## CONGRESSIONAL ACTION

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

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

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

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

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

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

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

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

## CANADA

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

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

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

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

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

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

NATURAL GAS PRICE DECONTROL AND  
NORTH SLOPE GAS MARKETABILITY

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

The Congressional side is where the impact lies for the Gas Pipeline. The Natural Gas Policy Act provided one pricing structure for North Slope gas<sup>1</sup> and a separate one for most U.S. natural gas. North Slope gas was priced at \$1.45 per Mcf, plus inflation from April, 1977. More importantly, Congress provided that the wellhead price and the transportation costs of this gas shall be rolled into the other gas purchased by interstate pipelines.

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

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

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

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

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

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

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

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

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

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

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

This potential problem might be solved if the State can do one of several things, such as trade its royalty gas for gas liquids, enter into an underlifting agreement with North Slope

producers, store its royalty gas until the wellhead price rises to satisfactory levels, invest in the Gas Pipeline to dilute State risks, or somehow maximize in-state use of royalty gas during the early years of production.

## ALASKA'S FINANCIAL ROLE

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

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

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

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

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

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

As to the exact nature of the financial participation that might be requested of Alaska, or the possible alternatives, I will leave that for the State's financial consultants. What I can say is that debt rather than equity is purportedly the consortium's greatest need. Finally, with regard to the oft-discussed proposal for the State to finance the conditioning plant,

it would appear to me that rolling the conditioning plant into the Pipeline, which the producers still require, might make it more difficult for the State to finance the conditioning plant alone, but probably not preclude it.

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

**PLEASE NOTE: THE FOLLOWING PAGES WERE TREATED  
AS A UNIT IN THE ORIGINAL DOCUMENT**

STATUS OF FINANCING

ALASKA NATURAL GAS TRANSPORTATION SYSTEM

C O N F I D E N T I A L

Much of the material included in this report has been based upon confidential sources.

This report should be handled in the context that delicate negotiations are still under way between Sponsors and Producers on the one hand, and potential lenders on the other hand, as well as various branches of the Federal Government.

The positions taken by various parties and reported herein may be altered over time, and preliminary public discussions of these tentative positions may, in fact, adversely influence the success of the negotiations.

DATED: JULY 31, 1981

## Status of Financing Alaska Natural Gas Transportation System (ANGTS)

### Background Financing

On May 21, 1981, John McMillian, Chairman of the Alaska Natural Gas Transportation partnership, forwarded to Secretary Edwards of the Department of Energy a conceptual financing plan for the Alaska segment of the ANGTS, including the conditioning plant. The plan had been negotiated between the pipeline sponsors and the major gas producers in the Prudhoe Bay Field. The plan which was presented to the financial community was an outline for the purpose of eliciting a reaction from prospective lenders.

### The Plan

The key elements of the Plan follow:

1. For purposes of financing, the "as spent" cost of the Alaskan pipeline will be \$21 billion, and of the plant will be \$6 billion. In addition, a pre-committed completion assurance pool of \$3 billion will be formed.
2. The debt/equity ratio for all capital investment will be 75:25.
3. The investment limits of all participating companies will be defined from the outset. As a group, the transmission companies will provide equity in an amount not to exceed \$5.25 billion. As a group, the producer companies will provide equity in an amount not to exceed \$2.25 billion, and be further responsible for arranging for an amount of debt not to exceed \$6.75 billion.
4. The Alaskan Northwest partners will own 70% of the pipeline and the plant, and the producing companies will own 30% of the pipeline and the plant. Equity commitments to the completion assurance pool will be made on the same 70:30 ratio.
5. Debt funds (pipeline and plant) will be sought on a project credit basis. The transmission group will be responsible for arranging for \$15.75 billion in project debt. The producer group has accepted responsibility for arranging for \$6.75 billion in additional project

debt. The debt which the producers are responsible for arranging will be accorded terms and conditions equivalent to those accorded other project debt.

6. Each company's participation will be subject to satisfaction of conditions precedent, namely
  - - - The conditioning plant will be included as part of the Alaska segment of the ANGTS.
  - - - Each company's investment will be limited to a sum certain defined in the financing plan.
  - - - All debt and equity participants will issue firm commitments, acceptable to all other participants, prior to construction of the pipeline or plant.
  - - - All necessary governmental approvals and authorizations will be issued and accepted by the participants.
  - - - All parties are assured that the project is economically viable.
  - - - All parties are assured that the Canadian segment will be financed and completed without U.S. company involvement.
  - - - Each financing layer will be afforded equal terms and conditions.

A further summary of the Plan may be found in Exhibit A.

This Plan does not include financings for the other three segments of the pipeline, i.e., Canada, U.S. Western leg and U.S. Eastern leg.

The Plan has been developed after more than one year of discussion among the Alaska Northwest partners and the producers, as well as their bankers. Agreement on the Plan occurred only after new project cost estimates were developed by Fluor Engineers.

The producers had consistently taken the position that no approach to prospective lenders could be made nor could a financing plan be developed until new cost estimates had been finalized. The new estimates became available in May 1981 and the financing concept was agreed upon by the sponsors and producers shortly thereafter.

Background Cost Estimates

The Certification Cost estimate was filed with FERC on July 1, 1980 for the Alaska Pipeline and amended in October, 1980. The cost estimates were then reviewed by FERC, and the office of the Federal Inspector. FERC retained Williams Brothers Engineering Company to make their analysis.

The following table compares the estimate as filed and FERC's recommendation:

Certification Cost Estimate Comparison  
(Amounts in million 1980 dollars)

<u>Cost Element</u>	<u>Filed CCE</u>	<u>WBEC Evaluation</u>	<u>Increase (Decrease)</u>
Compressor and Metering Stations	\$ 693	\$ 584	\$( 109)
Operations and Maintenance Facilities	54	51	( 3)
Temporary Facilities and Services	927	853	( 74)
Communications and Supervisory Systems	97	95	( 2)
Pipeline	4,285	3,450	( 835)
Project Directorate	<u>1,246</u>	<u>884</u>	<u>( 362)</u>
Subtotal	\$ 7,302	\$5,917	\$(1,385)
Contingency	876	<u>1,013</u> (2)	<u>137</u>
Subtotal	\$ 8,178(1)	\$6,930	\$(1,248)
Center Point	<u>2,304</u>	<u>1,424</u>	<u>( 880)</u>
<b>Total</b>	<b>\$10,482(1)</b>	<b>\$8,354</b>	<b>\$(2,128)</b>

Note: (1) These costs will increase by \$140 million due to a one year delay in schedule from the fall of 1985 to the fall of 1986.

(2) Includes \$303 million assigned to contingency from Center Point.

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

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

#### Background Marketability of Gas

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

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

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

#### Reaction of the Financial Community

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

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

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

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

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

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

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

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

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

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

#### Political Negotiations

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

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

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

#### Conclusion

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

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

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

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

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

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

ANGST FINANCING PLAN

S U M M A R Y

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

\* \* \*

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

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

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

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

(a) Producers

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

(b) Pipeline Sponsor/Partners

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

GRAND TOTAL:                      \$30 BILLION

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

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

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

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

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

\* \* \* \*

MARKETABILITY/JENSEN REPORT

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

Introduction

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

Summary and Conclusions

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

TABLE 1

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

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

Source: Jensen Associates, Inc.

TABLE 2

SUPPLY AND DEMAND FOR U.S. NATURAL GAS

1980 - 1990

(Trillion Cubic Feet)

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

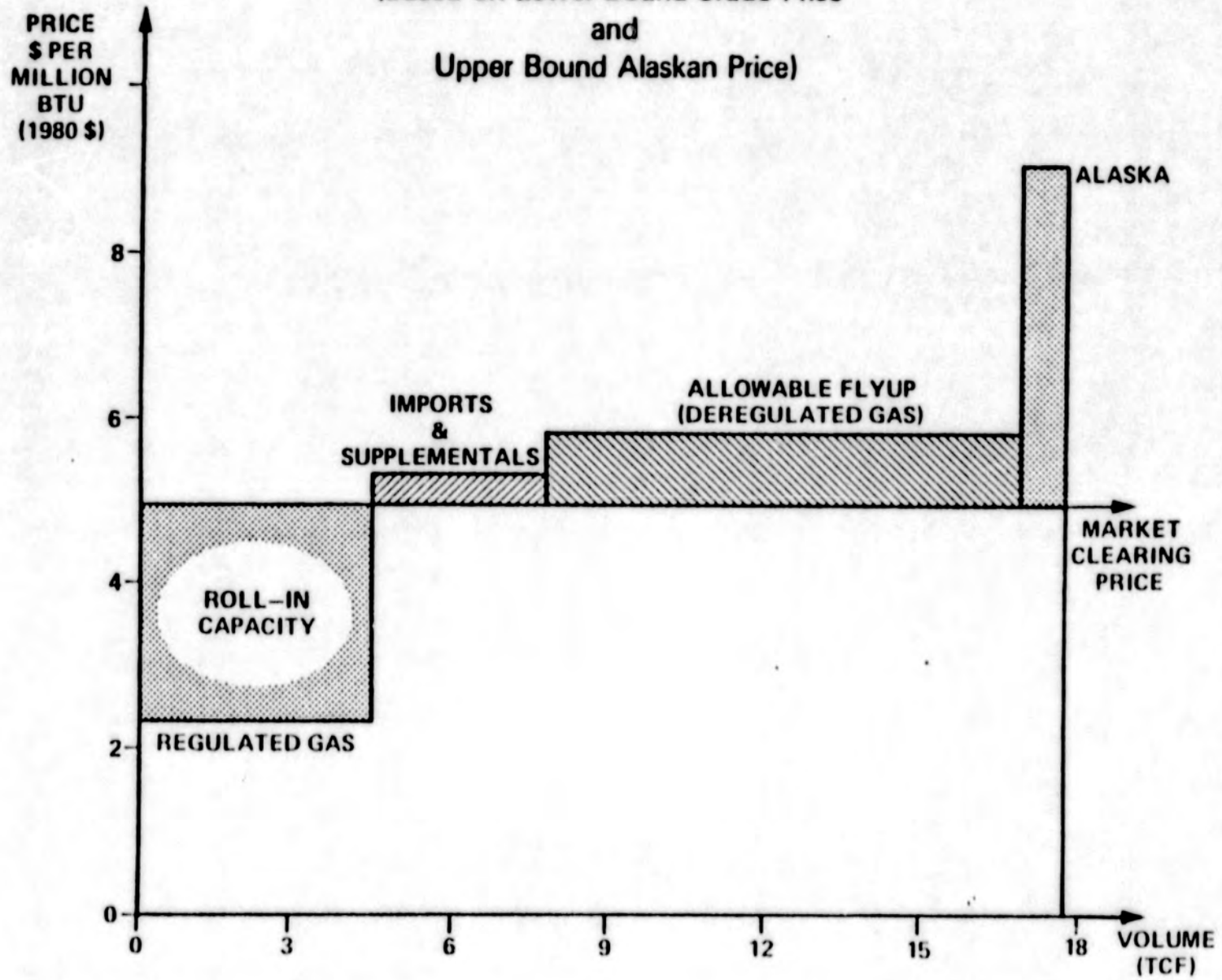
\* The 1990 demand forecast is based on a cleared market for natural gas.

Source: Jensen Associates, Inc.

U. S. Department of Energy

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

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



-78-

FIGURE 1

Dates of Deregulation

Exhibit C

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

June 3, 1981

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

Dear John:

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

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

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

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

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

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

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


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

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

Very truly yours,

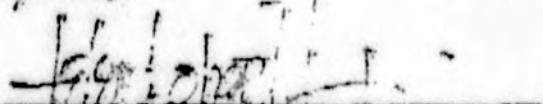
BANK OF AMERICA NATIONAL TRUST  
& SAVINGS ASSOCIATION

By

  
Vice President

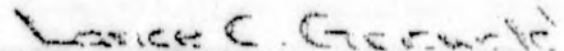
THE CHASE MANHATTAN BANK (NATIONAL  
ASSOCIATION)

By

  
Vice President


CITIBANK, N.A.

By

  
Vice President

MORGAN GUARANTY TRUST COMPANY OF  
NEW YORK

By

  
Vice President

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

I. Billing Commencement

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

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

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

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

2. Producer Equity

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

3. Conditioning Plant

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

4. Regulatory Consistency

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

5. Regulatory Reform to Achieve Expedition

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

6. Rolled-in Pricing

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

# # # #

Exhibit F

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

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

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

Draft Waiver Package  
(July 10, 1981 Senate Proposal)

1. Producer Ownership Participation

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

2. Conditioning Plant

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

3. Evidentiary Hearing Requirement

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

4. Authority to Modify or Rescind Orders

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

5. Regulatory Status as a "Natural Gas Company"

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

6. Import and Export Authority

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

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

Congress of the United States

House of Representatives

Exhibit G

Washington, D.C. 20515

July 22, 1981

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

Dear Senator McClure:

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

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

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

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

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

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

The Honorable James A. McClure  
July 22, 1981

3

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

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

Sincerely,

John D. Dingell  
Chairman  
Energy and Commerce Committee

James T. Broyhill  
Ranking Minority Member  
Energy and Commerce Committee

Philip R. Sharp  
Chairman  
Fossil and Synthetic Fuels  
Subcommittee

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

Morris K. Udall  
Chairman  
Interior and Insular Affairs  
Committee

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

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AS A UNIT IN THE ORIGINAL DOCUMENT.**