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TESTIMONY OF JOSEPH M. CHOMSKI

Legal Counsel to the

JOINT NATURAL GAS PIPELINE COMMITTEE

March 11, 1981

Testimony of Joseph M. Chomski

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

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

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

(2) an analysis of federal financial assistance options,

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

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

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

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

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

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

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

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

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

CURRENT STATUS - 1981 EVENTS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

REAGAN ADMINISTRATION POSITION

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

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

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

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

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

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

CONGRESSIONAL ACTION

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

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

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

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

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

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

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

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

CANADA

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

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

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

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

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

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

NATURAL GAS PRICE DECONTROL AND
NORTH SLOPE GAS MARKETABILITY

Natural gas decontrol as it effects the Alaska Natural Gas Transportation System is difficult to analyze because the Reagan Administration has introduced no gas deregulation legislation. This puts all of us in the position of trying to grab hold of a cloud, there is just nothing solid to latch onto yet. The Administration has, however, made a public commitment to ask Congress to accelerate deregulation of the price of natural gas. In fact, David Stockman recently announced that the Administration will launch a two-pronged effort to accelerate decontrol. 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 effort is where the impact lies is for the Gas Pipeline. The Natural Gas Policy Act provided one pricing structure for North Slope gas¹ and a separate one for most U.S. natural gas. North Slope gas was priced at \$1.45 per Mcf, plus inflation from April, 1977. More importantly, Congress provided that the wellhead price and the transportation costs of this gas shall be rolled into the other gas purchased by interstate pipelines.

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

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

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

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

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

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

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

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

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

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

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

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

ALASKA'S FINANCIAL ROLE

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

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

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

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

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

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

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

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

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

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

ALASKA

STATE LEGISLATURE

MEMORANDUM

May 14, 1981

To: Members of the Jt. Gas Pipeline Committee

From: Mark Wittow, Staff (465-4844)

MW

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

LAW OFFICES

BIRCH, HORTON, BITTNER AND MONROE

A PROFESSIONAL CORPORATION
1140 CONNECTICUT AVENUE, N.W.
SUITE 1100
WASHINGTON, D.C. 20036
(202) 659-5800

MEMORANDUM

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

From: Joseph M. Chomski
May 7, 1981

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

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

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

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

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

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

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

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

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

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

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

JMC:skp

LAW OFFICES

BIRCH, HORTON, BITTNER AND MONROE

A PROFESSIONAL CORPORATION
1140 CONNECTICUT AVENUE, N.W.
SUITE 1100
WASHINGTON, D.C. 20036
(202) 659-5800

rec'd
5/14/81

MEMORANDUM

To: Joint Pipeline Commission

From: Joseph M. Chomski
C. Floyd Mathews

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

INTRODUCTION

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

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

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

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

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

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

The Adger-Berman Report

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

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

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

3. related incentive rate of return issues.

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

The Draft Report recommends as follows:

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

The Last Estimate

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

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

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

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

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

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

The Center Point

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

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

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

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

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

Related IROR Issues

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

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

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

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

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

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

The Response

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

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

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

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

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

Conclusion

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

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

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

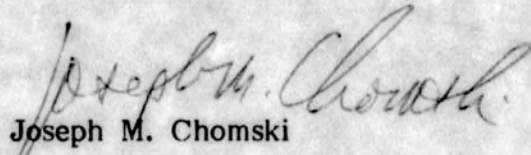
In general, most applications to Federal regulatory agencies for cost estimate approvals, rate of return decisions, and other similar economic adjudications contain some exaggerated or nonessential items. This is done to allow the Federal regulatory agency to fulfill its mandate by making certain cuts,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

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

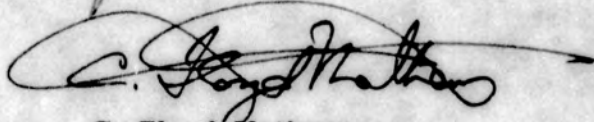
The recent delays in the regulatory process and in concluding the financing talks makes it more difficult to acquire Congressional approval this year for any necessary changes to the statutory framework under which the Alaska Gas Pipeline is administered. As we have stated to the Committee before, the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

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

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



Joseph M. Chomski



C. Floyd Mathews

JMC:skp

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

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

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

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

Respectfully submitted,


Joseph M. Chomski

JMC:skp

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LAW OFFICES

BIRCH, HORTON, BITTNER AND MONROE

RONALD G. BIRCH*
HAL R. HORTON*
WILLIAM H. BITTNER*
W. BRUCE MONROE*
SUZANNE C. PESTINGER*
LLOYD V. ANDERSON*
RODNEY B. CARMAN*
MICHAEL R. SPAAN*
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E. BUDD SIMPSON
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PATRICK H. OWEN
DANIEL W. WESTERBURG
C. FLOYD MATHEWS*
WILLIAM P. BRYSON
KATHRYN A. BLACK
PAUL L. DILLON
STANLEY T. LEWIS
MARC W. JUNE
SUSAN P. BEHLKE
PAUL E. CLIFFORD*
MICHAEL V. REUSING
ALICEMARY CLOSUIT

*ADMITTED IN D.C.

A PROFESSIONAL CORPORATION

1140 CONNECTICUT AVENUE, N.W.

SUITE 1100

WASHINGTON, D.C. 20036

(202) 659-5800

May 7, 1981

1127 WEST 7TH AVENUE
ANCHORAGE, ALASKA 99501
(907) 276-1550
TELEX 25-356

130 SEWARD STREET
JUNEAU, ALASKA 99801
(907) 586-2890

711 GAFFNEY ROAD
FAIRBANKS, ALASKA 99701
(907) 452-1666

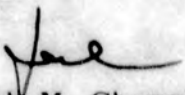
Mr. Mark Wittow
Professional Staff Member Natural Gas Pipeline Committee
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Mark:

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

With best regards,

BIRCH, HORTON, BITTNER AND MONROE


Joseph M. Chomski

JMC:skp
Attachment

LAW OFFICES

BIRCH, HORTON, BITTNER AND MONROE

RONALD G. BIRCH*
HAL R. HORTON*
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MICHAEL V. REUSING
ALICEMARY CLOSUIT

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1140 CONNECTICUT AVENUE, N.W.
SUITE 1100
WASHINGTON, D.C. 20036
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Mr. Mark Wittow
Joint Pipeline Commission
Alaska Legislature
Pouch V
Juneau, Alaska 99811

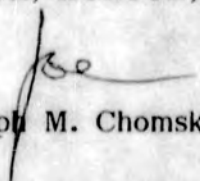
Dear Mark:

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

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

With best regards,

BIRCH, HORTON, BITTNER AND MONROE


Joseph M. Chomski

JMC:skp
Enclosures

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SUITE 1100
WASHINGTON, D.C. 20036
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ANCHORAGE, ALASKA 99501
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TELEX 25-356
-
130 SEWARD STREET
JUNEAU, ALASKA 99801
(907) 586-2890
-
711 GAFFNEY ROAD
FAIRBANKS, ALASKA 99701
(907) 452-1666

*ADMITTED IN D.C.

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

Dear Terry:

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

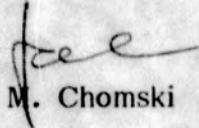
If this report raises any questions or if you have any other inquiries regarding the Gas Pipeline, please feel free to call. The material in the attached report should add to the information before the Legislature regarding the project and shed some light on the events of the upcoming six-nine months.

The Honorable Terry Gardiner
May 7, 1981
Page Two

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

With best regards,

BIRCH, HORTON, BITTNER AND MONROE



Joseph M. Chomski

JMC:skp
Enclosures
cc: The Honorable James Kerttula

LAW OFFICES

BIRCH, HORTON, BITTNER AND MONROE

RONALD G. BIRCH*
HAL R. HORTON*
WILLIAM H. BITTNER*
W. BRUCE MONROE*
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FAIRBANKS, ALASKA 99701
(907) 452-1666

*ADMITTED IN D.C.

The Honorable Jalmar Kerttula
President
Alaska State Senate
Pouch V
Juneau, Alaska 99811
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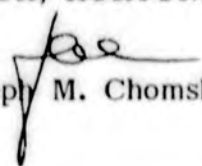
Dear Senator Kerttula:

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

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

With best regards,

BIRCH, HORTON, BITTNER AND MONROE


Joseph M. Chomski

JMC:skp
Enclosure
cc: Terry Gardiner

LAW OFFICES

BIRCH, HORTON, BITTNER AND MONROE

RONALD G. BIRCH*
HAL R. HORTON*
WILLIAM H. BITTNER*
W. BRUCE MONROE*
SUZANNE C. PESTINGER*
LLOYD V. ANDERSON*
RODNEY B. CARMAN*
MICHAEL R. SPAAN*
JOSEPH M. CHOMSKI*
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JOSEPH W. EVANS
E. BUDD SIMPSON
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PATRICK H. OWEN
DANIEL W. WESTERBURG
C. FLOYD MATHEWS*
WILLIAM P. BRYSON
KATHRYN A. BLACK
PAUL L. DILLON
STANLEY T. LEWIS
MARC W. JUNE
SUSAN P. BEHLKE
PAUL E. CLIFFORD*
MICHAEL V. REUSING
ALICEMARY CLOSUIT

A PROFESSIONAL CORPORATION
1140 CONNECTICUT AVENUE, N.W.
SUITE 1100
WASHINGTON, D.C. 20036
(202) 659-5800

April 13, 1981

1127 WEST 7TH AVENUE
ANCHORAGE, ALASKA 99501
(907) 276-1550
TELEX 25-356

130 SEWARD STREET
JUNEAU, ALASKA 99801
(907) 586-2890

711 GAFFNEY ROAD
FAIRBANKS, ALASKA 99701
(907) 452-1666

*ADMITTED IN D.C.

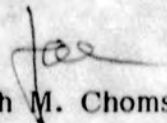
The Honorable Terry Gardiner
Chairman
Joint Natural Gas Pipe Line Committee
Alaska Legislature
Pouch V
Juneau, Alaska 99801

Dear Representative Gardiner:

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

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

With best regards,


Joseph M. Chomski

JMC:kkf
Enclosure

cc: Honorable Jalmar Kerttula
Mark Wittow



Northern Pipeline Agency
Canada

Administration du pipe-line du Nord
Canada

Commissioner

Directeur général

8th Floor, Victoria Building
140 Wellington Street

April 3, 1981

Dear Mr. Chomski,

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

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

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

Yours sincerely,

Mitchell Sharp

Mr. Joseph M. Chomski,
Birch, Horton, Bittner and Monroe,
1140 Connecticut Avenue, N.W.,
WASHINGTON, D.C. 20036
U.S.A.

Suite 1100

RONALD G. BIRCH*
HAL R. HORTON*
WILLIAM H. BITTNER*
W. BRUCE MONROE*
SUZANNE C. PESTINGER*
LLOYD V. ANDERSON*
GREGORY C. TAYLOR
RODNEY B. CARMAN*
MICHAEL R. SPAAN*
JOSEPH M. CHOMSKI*
GORDON F. SCHATZ
CAROL A. JOHNSON
GERALD D. STOLTZ*
RONALD E. NOEL*
JOSEPH W. EVANS
WINSTON S. BURBANK*
E. BUDD SIMPSON
JAN S. OSTROVSKY
CONSTANCE E. BROOKS*
DOUGLAS J. SERDAHELY*
JACK D. CLARK
GARY J. FINNELL
PAUL H. GRANT
NANCY J. SHAW
PATRICK H. OWEN
PERCY R. LUNNEY*
DANIEL W. WESTERBURG

*ADMITTED IN D.C.

LAW OFFICES

BIRCH, HORTON, BITTNER AND MONROE

4400 JENIFER ST., N. W. - SUITE 300

WASHINGTON, D.C. 20015

(202) 244-4250

TELEX 9-89-2591

1127 WEST 7TH AVENUE
ANCHORAGE, ALASKA 99501
(907) 276-1550
TELEX 25-356

180 SEWARD STREET, SUITE 411
JUNEAU, ALASKA 99801
(907) 586-2890

711 GAFFNEY ROAD
FAIRBANKS, ALASKA 99701
(907) 482-1666

November 12, 1980

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


Dear Mark:

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

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

Cordially,

BIRCH, HORTON, BITTNER & MONROE


Joseph M. Chomski

JMC:brk

Encl.

LAW OFFICES

BIRCH, HORTON, BITTNER, MONROE,
PESTINGER AND ANDERSON, P.C.

A PROFESSIONAL CORPORATION

4400 JENIFER STREET, N.W. - SUITE 300

WASHINGTON, D.C. 20015

(202) 244-4250

November 12, 1980

1127 WEST 7TH AVENUE
ANCHORAGE, ALASKA 99501
(907) 276-1550
TELEX 25-356

180 SEWARD STREET, SUITE 411
JUNEAU, ALASKA 99801
(907) 586-2890

711 GAFFNEY ROAD
FAIRBANKS, ALASKA 99701
(907) 452-1666

RONALD G. BIRCH*
HAL R. HORTON*
WILLIAM H. BITTNER*
W. BRUCE MONROE*
SUZANNE C. PESTINGER*
LLOYD V. ANDERSON*
RODNEY B. CARMAN*
MICHAEL R. SPAAN*
JOSEPH M. CHOMSKI*
DOUGLAS J. SERDAHELY*
WINSTON S. BURBANK*
CAROL A. JOHNSON
JOSEPH W. EVANS
E. BUDD SIMPSON
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JACK D. CLARK
PAUL H. GRANT
NANCY J. SHAW
PATRICK H. OWEN
PERCY R. LUNEY*
DANIEL W. WESTERBURG
C. FLOYD MATHEWS*
WILLIAM P. BRYSON

*ADMITTED IN D.C.

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

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

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

10.2 B

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

Memo to Mark Wittow
November 12, 1980
Page Two

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

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

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

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

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

Memo to Mark Wittow
November 12, 1980
Page Three

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

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

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

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

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

Memo to Mark Wittow
November 12, 1980
Page Four

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

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

Memo to Mark Wittow
November 12, 1980
Page Five

Mr. Carl Spaetzler, a private consultant to Alaska Northwest, discussed his calculations for Alaska Northwest's proposed center point of 1.292. The proposed CCE of \$7,900,000,000 includes certain known contingencies. Mr. Spaetzler explained that the 1.292 center point value was not a provision to cover known contingencies, but to cover the inevitable unknown factors which would increase the actual cost of the pipeline. He explained how his firm used a "Monte Carlo computer simulation" to develop a "composite probability distribution for the entire project cost", which derived the center point value. His theory for calculation of the center point is based on his experience that most, if not all, cost estimates for previous large projects (which included dollars for known contingencies) were below actual cost of construction because of the effect of unknown and unforeseeable events.

Alaska Northwest expects that the Design Board will issue a final design as a supplement to the application in November or December of 1980, but this date appears to be optimistic. The Office of the Federal Inspector, not FERC, will have final authority over the design of the pipeline constructed by Alaska Northwest. Alaska Northwest anticipates that the Commission will issue a final certificate order in March of 1981 which will delegate to the Office of the Federal Inspector the authority over the final design of the pipeline to be constructed by Alaska Northwest. The March, 1981 date, promised by FERC Chairman Charles Curtis, may be optimistic since Northwest's financial plan may not be submitted until early 1981. Mr. Adger stated that the technical conferences were not intended to resolve all design issues, and that the Office of Federal Inspector would ultimately resolve many design issues during construction. Adger stated that the technical conferences were to determine only the certificate cost estimate, and how certain changes in the final design would affect the cost estimate. The technical conferences would consider only the cost effects of major design changes. The Commission's staff complained that it had inadequate cost data because Alaska Northwest had admittedly considered and rejected some design alternatives without first preparing full cost estimates.

On October 9, 1980 the conference continued discussion of certain design alternatives (which Alaska Northwest argued were unlikely) and discussions of ambient air temperatures. During a break in the conference Mr. Cuba Wadlington of Alaska Northwest talked about the financing plan and transportation of natural gas liquids. Mr. Wadlington stated that financing would be obtained from conventional lending institutions (banks, insurance companies, etc.) plus some equity participation by North Slope Producers.

Memo to Mark Wittow
November 12, 1980
Page Six

Mr. Wadlington reiterated his confidence that such legislation could be obtained easily. He admitted that even if a final FERC order is not obtained by March of 1981, Alaska Northwest would nevertheless proceed with the application (Northwest had once threatened to abandon the project if approval could not be garnered by that date). He also stated that the Design Board and Exxon are considering possible transportation of some natural gas liquids in the proposed Alaska Gas Pipeline. Darrell Mackay, Vice-President of Regulatory and Governmental Affairs at Northwest, subsequently informed us that the issue of transportation of natural gas liquids would depend upon the final design of the pipeline which is now being prepared by the Design Board. At present it appears that at least some of the natural gas liquids would not be transported in the pipeline, but would be used as fuel to operate the sales gas conditioning facility and other facilities at Prudhoe Bay.

The next technical conference in Washington, D.C. was held October 16, 1980. This conference lasted about five hours and Mr. Spaetzler gave an extended explanation of his calculation of the proposed center point of 1.292. A final technical conference was scheduled for October 28, 1980 in Washington, D.C. to discuss center point, possible design changes, project directorate, and remaining design issues. However, these subjects were covered at a subsequent conference in Irvine, California and the October 28 D.C. conference was cancelled.

Numerous technical conferences have been held at Fluor Corporation's headquarters in Irvine, California since August, 1980. We have not attended any of these conferences, but from conversations with the Commission's Staff and other parties, we understand that these conferences have discussed primarily the issues of design alternatives and cost estimates, including the following specific issues: compressor and metering facilities, operation and maintenance facilities, temporary facilities and services, communications and supervisory systems, frost heave problems and mitigation techniques, and pipeline installation productivity (i.e., the "lay rate").

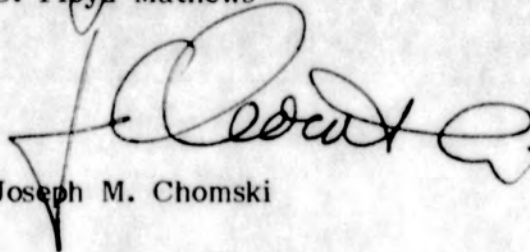
The next technical conference is scheduled for November 10-21, 1980 at Fluor Corporation Headquarters in Irvine, California. This eleven-day conference will discuss the following issues: project directorate, center point and contingency and finance charges, (including the effect of normal contingency of the alternative lay rate discussed at the October 22, 1980 conference), cost estimate changes due to realignment of the gas

Memo to Mark Wittow
November 12, 1980
Page Seven

pipeline, Atigun Pass alternatives, embankment versus trench modes studies, and snow pad studies. After the November 10-21 technical conference, there possibly may be additional technical conferences. Alternatively the Alaskan Delegate Mr. Adger may issue a second and final report to the Commission. After receiving the Alaskan Delegate's final report the Commission will then issue notice and request written comments from the public regarding a proposed certificate order.



C. Floyd Mathews



Joseph M. Chomski

CFM:skp

LAW OFFICES

BIRCH, HORTON, BITTNER AND MONROE

RONALD G. BIRCH*
HAL R. HORTON*
WILLIAM H. BITTNER*
W. BRUCE MONROE*
SUZANNE C. PESTINGER*
LLOYD V. ANDERSON*
RODNEY B. CARMAN*
MICHAEL R. SPAAN*
JOSEPH M. CHOMSKI*
WINSTON S. BURBANK*
CAROL A. JOHNSON
JOSEPH W. EVANS
E. BUDD SIMPSON
CONSTANCE E. BROOKS*
JACK D. CLARK
PAUL H. GRANT
PATRICK H. OWEN
DANIEL W. WESTERBURG
C. FLOYD MATHEWS*
WILLIAM P. BRYSON
KATHRYN A. BLACK
PAUL L. DILLON
STANLEY T. LEWIS
MARC W. JUNE
SUSAN P. BEHLKE
PAUL E. CLIFFORD*
MICHAEL V. REUSING
ALICEMARY CLOSUIT

A PROFESSIONAL CORPORATION
1140 CONNECTICUT AVENUE, N.W.
SUITE 1100
WASHINGTON, D.C. 20036
(202) 659-5800

1127 WEST 7TH AVENUE
ANCHORAGE, ALASKA 99501
(907) 276-1550
TELEX 25-356

130 SEWARD STREET
JUNEAU, ALASKA 99801
(907) 586-2890

711 GAFFNEY ROAD
FAIRBANKS, ALASKA 99701
(907) 452-1666

April 9, 1981

*ADMITTED IN D.C.

The Honorable Terry Gardiner
House of Representatives - State of Alaska
Alaska Legislature
Pouch V
State Capitol
Juneau, Alaska 99811

Dear Representative Gardiner:

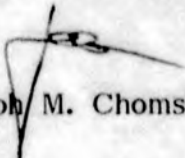
The man nominated this week by President Reagan to head the Federal Energy Regulatory Commission is Mike Butler, who wrote the Administration's Transition Paper on the Alaska Natural Gas Pipeline. He was one of the people I met with prior to my recent testimony before the Joint Natural Gas Pipeline Committee. Excerpts from Butler's Transition Paper were included in the testimony.

In my opinion, his level of knowledge of the project, and in particular his familiarity with financing obstacles and innovative tariffs, will provide a boost to the project's future. Alaska is probably fortunate to have Mike Butler as the prospective new Chairman of FERC.

If you have any questions regarding Butler's specific opinions on the Gasline, please call.

With best regards,

BIRCH, HORTON, BITTNER & MONROE


Joseph M. Chomski

JMC:skp
cc: Mark Wittow

LAW OFFICES

BIRCH, HORTON, BITTNER AND MONROE

RONALD G. BIRCH*
HAL R. HORTON*
WILLIAM H. BITTNER*
W. BRUCE MONROE*
SUZANNE C. PESTINGER*
LLOYD V. ANDERSON*
RODNEY B. CARMAN*
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JOSEPH M. CHOMSKI*
WINSTON S. BURBANK*
CAROL A. JOHNSON
JOSEPH W. EVANS
E. BUDD SIMPSON
CONSTANCE E. BROOKS*
JACK D. CLARK
PAUL H. GRANT
PATRICK H. OWEN
DANIEL W. WESTERBURG
C. FLOYD MATHEWS*
WILLIAM P. BRYSON
KATHRYN A. BLACK
PAUL L. DILLON
STANLEY T. LEWIS
MARC W. JUNE
SUSAN P. BEHLKE
PAUL E. CLIFFORD*
MICHAEL V. REUSING
ALICEMARY CLOSUIT

A PROFESSIONAL CORPORATION
1140 CONNECTICUT AVENUE, N.W.
SUITE 1100
WASHINGTON, D.C. 20036
(202) 659-5800

April 9, 1981

1127 WEST 7TH AVENUE
ANCHORAGE, ALASKA 99501
(907) 276-1550
TELEX 25-356
-
130 SEWARD STREET
JUNEAU, ALASKA 99801
(907) 586-2890
-
711 GAFFNEY ROAD
FAIRBANKS, ALASKA 99701
(907) 452-1666

*ADMITTED IN D.C.

C. M. Butler, III
Administrative Assistant to
Senator John Tower
142 Russell Senate Office Building
Washington, D.C. 20510

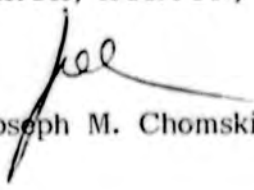
Dear Mike:

Congratulations on your nomination to be Chairman of the Federal Energy Regulatory Commission. I am sure that you will have no trouble receiving confirmation from the Senate.

As legal counsel to the Alaska Legislature on the Alaska Natural Gas Pipeline, your nomination is particularly gratifying. I believe the State of Alaska is fortunate that someone with your level of expertise on the project will be in a position to deal with it during the next few critical years. If there is any assistance that we can lend you with regard to the Gas Pipeline that does not violate FERC's ex parte rules, please call on us. Otherwise, best of luck in your extremely challenging new position.

With best regards,

BIRCH, HORTON, BITTNER & MONROE


Joseph M. Chomski

JMC:skp

bcc: The Honorable Terry Gardiner

LAW OFFICES

BIRCH, HORTON, BITTNER, MONROE, PESTINGER AND ANDERSON, P.C.

A PROFESSIONAL CORPORATION

4400 JENIFER STREET, N.W. - SUITE 800

WASHINGTON, D.C. 20015

(202) 244-4250

RONALD G. BIRCH*
HAL R. HORTON*
WILLIAM H. BITTNER*
W. BRUCE MONROE*
SUZANNE C. PESTINGER*
LLOYD V. ANDERSON*
RODNEY B. CARMAN*
MICHAEL R. SPAAN*
JOSEPH M. CHOMSKI*
DOUGLAS J. SERDAHELY*
WINSTON S. BURBANK*
CAROL A. JOHNSON
JOSEPH W. EVANS
E. BUDD SIMPSON
CONSTANCE E. BROOKS*
JACK D. CLARK
PAUL H. GRANT
NANCY J. SHAW
PATRICK H. OWEN
PERCY R. LUNEY*
DANIEL W. WESTERBURG
C. FLOYD MATHEWS*
WILLIAM P. BRYSON

*ADMITTED IN D.C.

December 17, 1980

1127 WEST 7TH AVENUE
ANCHORAGE, ALASKA 99501
(907) 276-1880
TELEX 85-886

180 SEWARD STREET, SUITE 411
JUNEAU, ALASKA 99801
(907) 886-2890

711 GAFFNEY ROAD
FAIRBANKS, ALASKA 99701
(907) 452-1666

Mr. Mark Wittow
Executive Director
Joint Natural Gas Pipeline Committee
1024 W. 6th Avenue
Anchorage, Alaska 99501

Dear Mark:

Attached is a report that I have long promised you covering the Northwest certificate application and other related documents. Per your request, we have added a section on FERC procedure. I hope the report is satisfactory to you. We are available to answer questions at any time. A copy has been forwarded to Mike Colletta.

I hope you had a nice vacation and look forward to meeting you early in 1981.

Warmest personal regards,

BIRCH, HORTON, BITTNER & MONROE



Joseph M. Chomski

JMC:brk

Attachment

To: Joint Natural Gas Pipeline Committee/Governors
Natural Gas Task Force

Re: Analysis of Final Certificate Application for the Alaska
Segment, Cooperative Agreement and Related Matters

INTRODUCTION

In a memorandum dated July 29, 1980 our firm outlined a proposal to prepare a report regarding certain aspects of the final certificate application of Alaska Northwest Natural Gas Transportation Company (Alaskan Northwest) for the Alaska segment of the Prudhoe Bay natural gas pipeline (FERC Docket No. CP80-435) and of the Cooperative Agreement between Alaskan Northwest, the Prudhoe Bay Natural Gas Producers (Atlantic Richfield Company, Exxon Corporation and Sohio) and the State of Alaska. This report will examine the content of these documents, and where possible analyze their impact upon prospects for development of a petrochemical plant in Alaska using North Slope natural gas liquids and upon general State interests in the development of the Alaska segment of the pipeline.

The certificate application consists of eight volumes, and several sections of the application have not yet been filed with FERC. Much of the information is technical in nature and will require analysis of an engineer and lawyer-engineer dialogue to determine its full implications for the State's interest. Due to these reasons and the time available, this analysis should be considered preliminary.

The following documents are discussed below:

1. The U.S. Court of Appeals for the District of Columbia Circuit January 3, 1980 decision in Earth Resources Company of Alaska, et al. v. FERC (D.C. Cir. No. 79-2191).
2. The FERC Final Environmental Impact Statement dated July, 1980 for the Prudhoe Bay Project in Docket No. CP78-123 et al.
3. Alaskan Northwest's application for the final segment of the Alaska gas pipeline and application for export permit filed July 1, 1980 in FERC Docket Nos. CP80-434 and CP80-435.
4. The Ralph M. Parsons Company September, 1978 study for the Prudhoe Bay Sales Gas Conditioning Facilities.

5. Alaskan Northwest's Supplement filed June 30, 1980 to its application to the Department of Interior for right-of-way grant for the pipeline, and the Interior grant of right of way of December 1, 1980.
6. Comments of the State of Alaska Office of the Pipeline Coordinator filed July 24, 1980 with the Department of Interior regarding Alaskan Northwest's supplement to its right-of-way application.
7. The Cooperative Agreement dated June, 1980 between Alaskan Northwest, the Prudhoe Bay Natural Gas Producers and the State of Alaska.

The road to pipeline construction remains somewhat uncertain, but the documents filed this year evidence substantial progress toward resolution of many problems (some of them quite sticky) and lead us to a somewhat improved outlook for 1981. As has been the case since 1976, the primary problem continues to be financing for the project. Of course, the submission and approval of each successive document or filing narrows the alternatives, be they routes, pipeline pressure, throughput composition or others. In turn, the opportunities for the State of Alaska to protect its interests by restructuring the pipeline or guaranteeing an instate gas liquids supply also diminish. (While the instate petrochemical project remains a live option today, it can be eliminated if firm contractual commitments for the North Slope liquids are made by the producers with out-of-state interests. While we know of no such arrangements or pending negotiations, we remain concerned that Alaska is not yet protected from such a prospect.

I. BACKGROUND

In September, 1977, in accordance with procedures established by the Alaska Natural Gas Transportation Act (15 U.S.C.A. §719, hereinafter ANGTA), the President approved a general proposal for the nature and route of the Alaska Gas Pipeline. The President's decision, subsequently ratified by Congress (Pub. L. No. 95-158), left many specifics of the pipeline design open for future final decisions by FERC and other agencies. Following the President's decision, FERC granted a conditional certificate of public convenience and necessity for the construction of the Alaska segment of the system, but this certificate did not specify the pipeline design. On March 2, 1979 Alaska Northwest applied to FERC for a final order approving certain pipeline design specifications; Alaska Northwest requested a 48 inch diameter pipeline with 1260 psig (pounds per square inch gage) maximum working pressure. The FERC gave notice of the application, invited and received comments, and on August 6, 1979 issued an order approving Alaskan Northwest's proposed pipeline diameter and pressure. After unsuccessfully petitioning FERC for rehearing, Earth Resources Company of Alaska and the State of Alaska appealed to the U.S. Court of Appeals for the District of Columbia Circuit. The D.C. Circuit issued its decision on January 3, 1980 which dismissed the appeals as premature under ANGTA. The pipeline pressure decision virtually assured that the gas conditioning plant would be

located on the North Slope, due to the apparent technical difficulties associated with transporting the heavier fractions in the 1260 psig line. As has been widely noted, locating the plant at Prudhoe Bay significantly limits state options with respect to utilization of gas liquids.

The Court's decision (Slip page 5) states as follows:

"Complainants claim that the Commission violated due process by deciding the pressure issue in isolation from decisions on such related issues as carbon dioxide content and conditioning plant design. By foreclosing options on these related issues, complainants contend, the Commission's piecemeal decision on the pressure issue has rendered any future hearing on the related issues meaningless, . . . The State of Alaska's desire to develop a petrochemical industry, which it says will be frustrated by the Commission's order, is far removed from the sort of legitimate claim to entitlement necessary to demonstrate a liberty of property interest." [footnote omitted]

The Court's dicta do not bode well for future State attempts to gain access to the natural gas liquids, if such access results in conflicts with federal authority and policy. While the dicta of the Court cannot be considered absolutely dispositive of the issue, it is a clear indication of potential problems ahead, especially given the constraints imposed on judicial review by the ANGTA. In this regard it may be the wisest policy for the State to seek a program for utilizing the natural gas liquids which to the greatest extent possible accomodates itself to the federal regulatory and policy framework rather than placing heavy reliance upon court-ordered modifications.

1. THE FERC FINAL ENVIRONMENTAL IMPACT STATEMENT (FEIS) FOR THE SALES GAS CONDITIONING FACILITY (SGCF)

The staff's FEIS analyzed a proposed SGCF design which was originally conceived by the 1978 R.M. Parsons Study discussed below. The Parsons Study was based on a number of assumptions*/ which, in hindsight, may not be correct. However, the FEIS does state that two critical issues

*/ The Parsons Study assumed that pipeline pressure would be 1,440 psig and that carbon dioxide maximum would not exceed one percent.

(pipeline pressure in the Alaska segment and the maximum allowable carbon dioxide concentration) will determine the percentage of the heavier NGL's that can be transported through the pipeline without operational problems. These two considerations will influence both the type of conditioning process chosen and the location of the SGCF. As indicated above, on August 6, 1979 the Commission decided that the pipeline's operating pressure should be set at 1260 psig. The FEIS discusses treatment of NGL's at the following pages: ii-iii, and v, 1-3, 7, 105-106, 131, 197, 205, 227-231. The FEIS concentrates primarily upon the environmental impact of construction and operation of the SGCF at various locations. The FEIS recommends however that the Prudhoe Bay site is environmentally acceptable, and is probably the best location for the SGCF. On the location issue the FEIS concludes that alternative sites for the SGCF would be technically feasible only if the decision were made to construct a pipeline capable of sustaining a higher maximum pressure than the presently authorized 1260 psig (page 205).

The FEIS also concludes that some of the NGL's should be used for fuel at the SGCF and for other fuel requirements at the Prudhoe Bay complex. These NGL's of course would not be available for any future petrochemical plant. The NGL's produced by the SGCF would include separate streams of ethane, propane, butane and pentanes plus. The FEIS states that these separate streams could be blended into fuel streams to control heating value, or blended into pipeline gas to the hydrocarbon dew point limitation (propane or butane), or blended into the crude (butane or pentanes plus) as limited by the vapor pressure specification (p. 231).

As was noted previously the location of the sales gas conditioning facility at Prudhoe Bay is largely an artifact of pipeline pressure and design specifications. And has also been previously noted, the location of the conditioning facility significantly limits the geographic scope of the State's ability to acquire natural gas liquids. Consequently, we believe it may be appropriate for the Committee to retain an consulting engineer to analyze the proposed SGCF to identify the specific technical limitations on transportation of NGLs which exist, alternative modes of transportation and utilization, and the possibility of using other fuels and the NGLs at the conditioning facility and the Prudhoe Bay complex. As pointed out above with respect to the decision by the Court of Appeals, modification of the conditioning facility or its relocation seems to be an unrealistic goal at this stage in the proceedings. Consequently, planning for utilization of the NGLs instate probably must proceed on the assumption that availability, both geographically and in terms of quantity, will be fixed within the broad perimeters outlined in the FEIS.

II. NORTHWEST ALASKA'S CERTIFICATE APPLICATION FOR THE FINAL SEGMENT OF THE ALASKA GAS PIPELINE AND APPLICATION FOR EXPORT PERMIT

I. THE STREAMLINED CERTIFICATE APPLICATION PROCEDURE AT FERC

The FERC has ordered special expedited procedures for consideration of Alaskan Northwest's application. The Commission's normal procedure is described in the paragraph below.

Under the Natural Gas Act (15 U.S.C.A. §717) it is unlawful for anyone to construct or operate any interstate natural gas pipeline in the United States without first obtaining a certificate of public convenience and necessity from the FERC. The required contents of the certificate application are usually quite voluminous, including designs for the proposed pipeline, evidence of economic feasibility of the proposed pipeline, financing plans, estimated future rates, environmental impact and other matters. The Commission normally publishes notice in the Federal Register of the filing of the application, and invites any interested persons to intervene and participate in future proceedings. If the application is for a small pipeline addition and is unopposed, the Commission in a few instances has issued the requested certificate without conducting full evidentiary proceedings. However, for a major contested application the Commission usually assigns the case to an administrative law judge to conduct evidentiary hearings. The presiding judge usually schedules prehearing conferences for the purpose of reaching stipulations of the parties, expediting discovery among the parties, and scheduling dates for filing prepared written testimony and hearings. After the close of all evidentiary hearings, the parties file briefs with the presiding judge setting forth their positions in favor of or in opposition to the proposed pipeline. The judge then issues an initial decision recommending that the Commission either issue a certificate (possibly with conditions) or deny the application, depending upon how the proposal affects the public interest. The parties then file briefs on exception to the initial decision with the Commission, and the Commission subsequently issues a decision either granting the certificate (with or without conditions) or denying the certificate.

Since the above procedure is usually time consuming, particularly when adverse parties wish to defeat or delay a project, the Congress passed the ANGTA to expedite all federal regulatory approvals for the Alaska Gas Pipeline Transportation System. Section 9(a) of ANGTA requires any certificate, right of way or other permit required by law from a federal agency, to be issued for the Alaska Natural Gas Transportation System on an expedited basis. Under Sections 9(c), (d) and (e), federal agencies may include terms and conditions for any certificates issued for the Alaska Gas Pipeline, but not if the terms and conditions would compel a change in the basic nature and general route of the approved transportation system.

On July 1, 1980 Alaska Northwest filed its application with FERC in Docket No. CP80-435 for a certificate under the Natural Gas Act and ANGTA authorizing construction and operation of the Alaska segment of the Alaska Natural Gas Transportation System. In an order of August 1, 1980 the FERC published notice of the application and established expedited procedures for its consideration of the application in keeping with section 9(a) of ANGTA. The Commission decided to utilize simple notice and comment procedures normally used in rulemaking proceedings. Instead of requiring the parties to file prepared written testimony and present witnesses at evidentiary hearings for cross examination, the Commission decided to hold a series of technical conferences to be presided over by the Commission's Alaskan Delegate, John Adger, in conjunction with the Office of the Federal Inspector. The Commission's Alaskan Delegate will issue a series of interim reports to the Commission reporting on the progress of the technical conferences. After conclusion of the technical conferences */ the Commission will issue a notice to the public requesting written comments on the Commission's proposed certification of the pipeline. The Commission, after review of any comments filed in the future, will issue its order on certification.

The Commission's August 1, 1980 order in Docket No. CP80-435 noted that the applicant requested, among other things, the following action from the Commission:

- (1) review and approval of the applicant's certification cost estimate (\$7.9 billion in 1980 dollars) and proposed center point of 1.292 ;
- (2) issuance of a final unconditional certificate of public convenience and necessity after review and approval of the applicant's financing plan for the pipeline;
- (3) approval of certain issues related to implementation of the incentive rate of return mechanism;
- (4) approval of the applicant's plan for financing of the Alaska segment; ?
- (5) a determination that the project costs do not "materially and unreasonably exceed" those considered as part of the President's decision.

*/ In late October, 1980, we supplied the Committee with a summary of certain of these technical conferences held in Washington, D.C.

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The Commission's August 1, 1980 order noted that the application omits all materials related to financing and cost of service analysis for the Alaska segment of the pipeline. The application contemplates that, after the final design of the Alaska segment and conditioning facilities are completed, a final financing plan will be filed. As of December 22, 1980 no financing plan, cost of service data, shippers tariffs or final design of the pipeline have yet been filed by Alaskan Northwest. The Commission's August 1, 1980 order noted that certain matters could not be decided by the Commission until the applicant submits its financing plan, such as the issues of the marketability of the gas, the continuing relationship of the proposed project to the national interest, and the relationship of the project's estimated cost to those considered at the time of the President's decision. Accordingly, the August 1, 1980 order deferred consideration of these issues, and also deferred issuance of a final certificate, until after the applicant files its proposed financing plan. However, the August 1, 1980 order directed the Alaskan Delegate to proceed with technical conferences on the remaining issues of the applicant's proposed certificate cost estimate, center point value, and the incentive rate of return mechanism.

2. FERC PROCESS: 1981

The last technical conference was held November 20, 1980. The Commission Staff's comments on the incentive rate of return, center point, cost estimate and certain design issues were filed with Mr. Adger on December 15, 1980; the Staff proposed center point and cost contingency figures lower than those in the application. Alaskan Northwest's reply comments were filed with Mr. Adger on December 22, 1980, and as expected, Alaskan Northwest opposed the Staff's position. It is anticipated that Mr. Adger will issue a draft report on the pending issues about mid-January or early February, 1981. Another technical conference will be convened within about ten days for the purpose of correcting minor mathematical or technical errors in Mr. Adger's draft report. Mr. Adger would probably issue his final report on the pending issues to the Commission in February, 1981. The Commission would then probably issue a notice requesting comments on Mr. Adger's final report. A final Commission order on the issues of incentive rate of return, cost estimate, center point and design issues would probably issue, at the earliest, in late March, 1981. However it is more likely that the Commission's final order on these issues will not be rendered until the spring of 1981.

In conversations with Alaskan Northwest spokesmen and FERC staff personnel, we have learned that Alaskan Northwest intends to supplement its application in the future with final designs (prepared by the Design Board) for the SGCF and Alaska segment. At present, it is expected that the Design Board may issue a preliminary design for the SGCF in February, 1981, and this is not expected to delay the pending proceeding at FERC. Alaskan Northwest also will file a supplement describing a proposed financing by the Producers; this will require new authorizing legislation but Alaskan Northwest is confident such legislation can be easily and quickly obtained from Congress.

The Commission previously (in Order No. 45) excluded the SGCF from the jurisdictional facilities to be covered by the final certificate. However the Commission could exercise some indirect control over the final design of the SGCF by conditioning the certificate in such a way as to specify the content or quality of natural gas to be introduced and transported through the pipeline.

When Alaskan Northwest files its proposed financing plan, it is anticipated that the Commission will issue another order directing the Alaska Delegate to expeditiously commence further technical conferences and prepare another report to the Commission regarding the deferred financing and cost of service issues discussed above. It is not yet known when Alaskan Northwest will make these supplemental filings, but the filings may possibly be made in the first half of 1981.

Because of the large number of issues being considered, it is probable that the FERC will not issue final orders granting the certificate exactly as requested by Alaskan Northwest. Instead the Commission is more likely to grant a certificate with conditions slightly modifying the project. Mr. Adger's final report to the Commission in February, 1981 should be a good indicator of the contents of any Commission final order.

After the Commission issues its last order granting a certificate and resolving all issues in this proceeding, any party may file with the Commission a petition for rehearing. The Commission's order on such petitions for rehearing would be subject to judicial review under Section 10 of ANGTA in the United States Circuit Court of Appeals for the District of Columbia.

There appears to be little or no opposition to the proposed pipeline in the pending FERC proceeding. However, if FERC imposes numerous or harsh conditions in its final order, Alaskan Northwest (and possibly other parties) may appeal in the future.

3. CONTENTS OF THE APPLICATION

The present application on file at FERC does not include specific designs for the SGCF or the Alaska segment of the pipeline. The Cooperative Agreement (discussed below) establishes a Design Board which will finalize designs for the SGCF and the Alaska segment of the pipeline. The application (Volume I, page 7; Volumes IV, VI, VII and VIII) states that the Alaska segment will have a diameter of 48 inches at a pressure of 1260 psig. The application does incorporate by reference the earlier 1978 R. M. Parsons Study (discussed below) for a proposed SGCF, but contains no specific final design for the SGCF or the Alaska segment.

As discussed above, the pending application also does not contain any specific proposal for financing the pipeline (Volume I, Exhibit L). As FERC staff has repeatedly stated in comments, this lack of financing plan continues to raise the question of whether the project can be certificated at all.

A consulting engineer should analyze Volumes IV, VI, VII and VIII to determine the effect of the proposed project on the potential for petrochemical development in Alaska. ✓

Volume I of the application requests the following action from the Commission prior to issuance of a final certificate:

- (1) Commission approval of the certification cost estimate and center point;
- (2) approval of the applicant's plan for private financing to be filed in the future;
- (3) a determination that the project costs are not unreasonably different from those considered as part of the President's decision and report.

The application states that the following matters will require Commission action prior to construction of the Alaska segment: establishment of the carbon dioxide content of the gas to be transported, and final resolution of Commission Order No. 45 which found that construction and operation of the Prudhoe Bay Gas Processing Facilities were the responsibility of the Alaska North Slope Producers. The application states the following matters will be the subject of future filings by Alaskan Northwest: shipper tariffs; downstream transportation and exchange agreements; to export and import Alaskan gas; and the remaining portions of the ANGTS eastern and western legs not previously certificated in the prebuilding proceedings (Volume I pg. 5). ✓

The application states that the financing plan could not be submitted in July, 1980, because Alaskan Northwest has recently entered into a cooperative agreement with the principal North Slope Producers (Exxon, Arco and Sohio). The Joint Statement of Intention in this agreement defines the process for developing a financing plan for the Alaska segment, including significant producer participation. Alaskan Northwest intends to submit the financing plan in the "future" (Vol. 1, pg. 6). At present, our best guess is that the financing plan will not be finalized and submitted until May, 1981 at the earliest. 7 ✓

The certification cost estimate and the risk analysis which support the requested center point are submitted as exhibits K and Z-7 (discussed below).

Exhibit E of the application (Vol. I) states that Alaskan Northwest has four other filings pending before FERC in Docket No. CP78-123 et al. which are related to the application for the Alaska segment.

Exhibit F (Vol. I) contains two maps and gives a very generalized description of the proposed pipeline. The pipeline route is intended to utilize existing rights of way as much as possible.

Exhibit G (Vol. I) contains flow diagrams showing daily design capacity, both with the proposed additional nine compressor stations and with the initial Alaskan segment of only seven compressor stations.


Exhibit H (Vol. I) shows total estimated reserves and deliverability of the Prudhoe Bay Gas Field. Exhibit H states that the applicant will be a transporter of natural gas, and as such will not buy or sell natural gas. The FERC has found that, based on the best available data, the estimated reserves in place are between 40.4 Tcf to 42.8 Tcf, and recoverable reserves are approximately 25 Tcf. Nine natural gas companies have gas purchase contracts or letters of commitments from the three major producers in the Prudhoe Bay field, which represent 85 percent of the available gas. Six of the nine purchasing companies are members or affiliates of members of the Alaskan partnership. Exhibit H also states that production levels of the Prudhoe Bay field are governed by decisions of the Division of Oil and Gas Conservation of the Department of Natural Resources of the State of Alaska. This Division is presently considering amending the authorized production levels. The state may wish to monitor developments in this area, since a certificate conditioned on minimum levels of reserves and/or deliverability could significantly impair the State's ability to manage the reservoir. 

Exhibit I will be filed in the future, and will describe market data for sale of the gas. The application (Vol. I, Exhibit I) states that the shippers will be submitting this market data in the future.

Exhibit J (Vol. I) states that the shippers will also file information in the future to supplement the application regarding applications for facilities for the transportation and/or sale of the Prudhoe Bay gas.

Exhibit L regards financing and, as indicated above, the application states that financing data will be filed in the future. This is the major deficiency of the application at present.

Exhibit M (Vol. I) describes the applicant's management plan for construction, operation and management of the pipeline. The project management contractor will be Fluor Engineers and Constructors, Inc. of Irvine, California. Alaska Northwest will monitor Fluor's activities, but the actual detailed management of design and construction will be performed by Fluor and subcontractors. Exhibit M-4 states that Northwest Alaska Pipeline Company (a member of Alaska Northwest) will retain direct responsibility for coordination with all government agencies, obtain all government authorizations, and monitor compliance with government regulations.

Exhibit N (Vol. I) will be filed in the future with Exhibit L. Exhibit N will describe estimated revenues, expenses and income of the pipeline.

Exhibit O (Vol. I) describes the depreciation rate which will be used in the pipeline tariff, which was previously approved by the FERC by orders of June 8 and September 6, 1979 in Docket No. RM78-12.

Exhibit P (Vol. I) will be supplemented in the future with cost of service data in conjunction with the filing of Exhibit L. Exhibit P will describe Alaska Northwest's tariff as approved by FERC orders of June 8 and September 6, 1979 in Docket No. RM78-12. The FERC previously approved the applicant's tariff provisions with respect to billing commencement date, interim rate, service interruption, billing procedures, cost allocation and availability of transportation services. In those orders the FERC required Alaska Northwest to submit for FERC approval 12 months prior to the commencement of operations a modified tariff which will conform to the requirements of the Commission's rate orders.

Exhibit K gives the certification cost estimate of \$7.9 billion and is contained in Volume II. A matter of some concern to the state is contained in Exhibit K; viz., Northwest's inclusion for some \$203.4 million in proposed "impact assistance" payments to the State of Alaska to mitigate a variety of pipeline construction impacts. In their comments of December 15, 1980 (p. 32) Staff has opposed inclusion of this amount in the certification cost estimate, stating in part, "These costs are not required by statute, have been traditionally disallowed in other cases, and may be more properly supported by tax and royalty revenues from the project. Their inclusion would open Pandora's Box."

In discussions with FERC staff on this issue, we were informed that Alaskan Northwest had obtained the impact cost estimate of \$203.4 million from the State of Alaska and had included it in their application without further supporting evidence. Staff indicated that the state had undertaken to provide the justification for this amount to FERC. However, the deadline for filing such information was December 15, 1980, and as of December 29, 1980, the Staff had received no further information from Alaska on the subject.

Two issues appear to exist now with respect to the allowance of impact costs in the rate base: first, the basic policy question of whether impact assistance costs should be included in rate base; and second, the evidentiary issue of whether the state can supply sufficient factual justification to permit a favorable decision from FERC. The latter question is paramount at this point, since it is highly unlikely that the Commission will approve such a major cost item for inclusion in the rate base without additional supporting evidence. The state's best chance for collecting these impact assistance funds from Alaskan Northwest is to persuade FERC to allow inclusion of these costs in the certificate cost estimate. Therefore, submission of supporting information

with respect to the \$203.4 million is imperative at the earliest possible date. We believe that any attempt by the state to collect such costs, without FERC approval, will be opposed by Alaskan Northwest. Any future litigation of this issue is well beyond the scope of this report, it is safe to say that the state may have difficulty demonstrating that such charges are permissible exercises of the state's police power.

Another possibility is that the state has determined not to pursue this issue at FERC. If so, such a decision has not been communicated to FERC staff with whom we have spoken.

Exhibit Z-1 is contained in Volume III and is the applicant's proposed environmental engineering manual for construction and operation of the pipeline.

Exhibit Z-2 describes the proposed gas conditioning plant at Prudhoe Bay and is contained in Volume IV. Exhibit Z-2 states that the general location and layout of the gas conditioning plant will be in agreement with the information contained in the Commission's staff Prudhoe Bay Project Final Environmental Impact Statement discussed above. Exhibit Z-2 also states that the proposed gas conditioning plant design, construction and operation plans proposed in the R. M. Parsons Study discussed above are adopted by reference for the purposes of the application. However, as indicated above, the Parsons Study describes several general design alternatives, and was not a specific final design for the gas conditioning plant. (The final design for the gas conditioning plant, as well as the final design for the Alaska segment of the pipeline, should be completed by the Design Board in early 1981.) Page 3 of Exhibit Z-2 describes the composition of the sales gas, and indicates that the sales gas will contain small amounts of NGL's. The proposed sales gas composition will include 4.425 percent ethane which might possibly be utilized in a petrochemical plant if extracted from the Alaska segment somewhere in Alaska. Exhibit Z-2 should be analyzed by a consulting engineer to determine its impact on the potential for development of a petrochemical plant in Alaska.

The application reserves Exhibit Nos. Z-3, Z-4 and Z-5 for descriptive information relative to other segments of the ANGTS, and states that additional descriptive information will be submitted in conjunction with the Exhibit L financing plan. It is possible that these exhibits will be used for filing the final design of the sales gas conditioning facility and Alaska segment of the pipeline.

Exhibit Z-7 (Vol. V) describes Alaska Northwest's center point justification. The Commission previously directed that an incentive rate of return mechanism be used to provide an incentive for cost control during construction of the Alaska Natural Gas Transportation System. Under the incentive rate of return (IROR) mechanism the project sponsors will earn either higher or lower rates

of return depending upon their ability to control project costs. If actual costs are greater than estimated costs, sponsors will earn a lower rate of return on equity. If actual costs are below those estimated, the sponsors will earn a higher rate of return on their equity. The certification cost estimate includes a normal contingency of 12 percent to cover normal uncertainties of estimating future costs. Uncertainties from abnormal events which might raise future costs are covered by raising the estimates to a higher cost, which is termed the "center point." The applicant requests that the center point be set at 1.292, which means that if the actual cost of the project is exactly 1.292 times the certification cost estimate, there would be no penalty or downward alteration in the proposed rate of return. The applicant argues that there is convincing evidence that the potential for cost increases beyond the certification cost estimate, due to abnormal events, is substantial and therefore the center point must be substantially greater than 1.

Exhibit Z-9 (Vol. VI) is Alaska Northwest's design summary. This is not the final design of the pipeline, but is a generalized overview of the proposed pipeline as presently planned. Exhibit Z-9 should be analyzed by a consulting engineer.

Exhibit Z-9.1 through Z-9.5 (Vols. VII and VIII) describe and summarize design proposals for parts of the pipeline. These exhibits should be analyzed by a consulting engineer. Exhibit Z-9.1 is the proposal for the Alaska segment pipeline design. Exhibit Z-9.2 describes proposals for the compressor station designs. Exhibit Z-9.3 describes proposals for the Alaska segment communications system. Exhibit Z-9.4 describes the operations and maintenance facility to be located in Fairbanks Alaska. Exhibit Z-9.5 describes the design of temporary facilities to be utilized for construction of the gas pipeline, compressor stations, metering stations, and other elements of the pipeline system.

4. RALPH M. PARSONS COMPANY 1978 STUDY

The Ralph M. Parsons Company 1978 Study describes various proposals for a SGCF. This study was completed before the FERC limited the Alaska segment pressure at 1260 psig. Therefore several basic assumptions in the Parsons Study (Volume I, page 2-1) are probably no longer valid. As indicated above, the Design Board will complete a preliminary design of the SCGF in early 1981, and the final design should render the Parsons Study largely obsolete.

The Parsons Study discusses natural gas liquids at the following pages:

1978 Study - pages 2-2 to 2-3, 3-1 to 6-5.

February, 1979 CO2 Specification Study - pages 4-4 to 4-5, 4-9 to 4-10, 4-21 to 4-23.

III. NORTHWEST ALASKA JUNE, 1980 SUPPLEMENT TO APPLICATION TO THE DEPARTMENT OF INTERIOR RIGHT-OF-WAY

Under the Mineral Leasing Act of 1920, as amended, (30 U.S.C.A. §185) the Department of Interior has authority to issue grants for rights of way for certain natural gas pipelines to traverse federal lands, subject to approval of Congress. An original application for the Alaska segment right of way was submitted July 5, 1977 to the Department of Interior. The June, 1980, five volume supplementary application sought a right-of-way grant from the Department of Interior (DOI) for the portions of the pipeline to be built on "Federal land." The supplement stated (Volume I, p. 2) that the right-of-way, if granted, would be subject to Federal laws and regulations, and that the applicant would be subject to Federal regulation under the Natural Gas Act.

The supplement (Volume I, pp. 6-7) included as "Federal lands" certain land selections by the State of Alaska pursuant to the Alaska Statehood Act for which patents have not been issued by DOI. Also included as "Federal lands" were certain Native corporation selections and Native allotment applications under the Alaska Native Claims Settlement Act for which final Federal administrative approval had not been issued. Alaskan Northwest correctly included the selected but unapproved or unconveyed Federal lands in Alaska as being subject to the Secretary's powers to issue Federal rights-of-way grants. See, §6(g) of Alaska Statehood Act, 48 U.S.C. Prec. 21; §17(b)(1) of ANCSA, 43 U.S.C. 1616(b)(1).

The basic Alaskan Northwest Federal right of way grant was approved December 1, 1980. Since the right of way application was approved before the Alaska Lands Bill was signed into law, all lands conveyed or approved in the bill will be subject to this right of way. Secondly, Section 1327 of the Alaska Lands Bill contains several provisos to the effect that no provision in that legislation was to effect or impede the Alaska Natural Gas Pipeline process.

As additional assurance that the state, as a land owner, could not interfere in the right of way grant, Section 906(1) of the Alaska Lands Bill expressly preserves all existing rights of way permits or grants over state land. All subsequently issued conveyance documents must reflect the right of way and the Secretary shall continue to administer the right of way once it is reserved to the United States. This will ensure continued federal control, although

after tentative approval the receipts are to be paid to the State. Section 906(n) provides yet another safeguard by stating that no provision regarding the conveyance of state land shall alter or affect the rights or obligations of any party under the Alaska Natural Gas Transportation Act.

North Dakota's recent lawsuit which challenged federal decisions on siting of the Eastern leg of the Northern Tier Pipeline without seeking approval from the state's Public Service Commission brought into sharper focus the need for the foregoing provisions. The drafters of the Alaska Lands Bill attempted to limit third party lawsuits challenging the right of way grant as much as feasible. However, one kind of land grant conflict may not be as easily resolved. When Congress passed ANCSA in December, 1971, more than 1000 applications for land grants under the Alaska Native Allotment Act were pending. While the allotment act is also repealed under ANCSA, allotment applicants can still elect to receive a certificate of allotment, a kind of equitable title, for land personally used. A land survey was previously required before approval could be obtained, so it is altogether possible that allotment applications overlay the pipeline right of way. There is very little caselaw governing the Secretary's authority to grant rights of way across allotment applications, but general principles of public land law lead to the tentative conclusion that allotments will be subject to the right of way grant. However, this may be a troublesome issue in the months to come as all pending allotments were approved in the lands bill, and could provide a basis for litigation.

The final December 1, 1980, grant also requires Alaskan Northwest to enter into an indemnification agreement with Alyeska to pay for any damages caused by the construction and operation of either the natural gas pipeline or the oil pipeline in and adjacent to the federal rights-of-way. Lastly, Interior anticipates negotiating a memorandum of understanding with the state to resolve certain issues raised by the state's July 24, 1980 comments discussed below, and which are intended to facilitate acquisition of rights-of-way across remaining state and native lands.

VI. THE COMMENTS OF THE STATE OF ALASKA OFFICE OF THE PIPELINE COORDINATOR ON ALASKAN NORTHWEST'S RIGHT-OF-WAY APPLICATION

These comments dated July 24, 1980 indicate that the State of Alaska intends to attempt to exercise some regulatory control over pipeline construction and right-of-way.

The State's comments raised the following significant issues the final resolution of which will affect the State's interests:

- cover letter, page 2 - The application ignores NGL's, and contemplates possibly misusing them as fuel.
- cover letter, page 3, 4-5 and enclosure pages 23-24 - The State intends to apply State law on Federal land; the comments also note that stipulations of the Federal grants should be consistent with conditions of State right-of-way leases for the pipeline over State-owned land.
- cover letter, page 4 - The State requests a joint State/Federal cooperative agreement be included in the right-of-way grant in order to eliminate any inconsistencies between Federal and State regulatory authority.
- cover letter, pages 5-6 - The State opposes the application's position that unconveyed State and Native land selections should be included in the Federal grant.

In conversations with DOI staff we have learned that the December 1, 1980 right-of-way grant has not resolved all of these issues and DOI will seek to enter into a memorandum of understanding with the State of Alaska in the future regarding resolution of some of these issues. It is clear that such a memorandum could have significant impacts on state authority to regulate the pipeline right-of-way and related matters.

VII. COOPERATIVE AGREEMENT BETWEEN ALASKAN NORTHWEST,
THE PRUDHOE BAY NATURAL GAS PRODUCERS AND THE STATE OF ALASKA

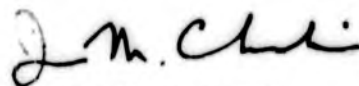
This agreement forms a Design Board to finalize designs for the SGCF and the pipeline in Alaska. As indicated above, preliminary designs will be filed with the FERC as a supplement to the certificate application, possibly as early as February of 1981. Any designs filed should be analyzed by a consulting engineer to determine any impacts on the potential for petrochemical development.

CONCLUSION AND RECOMMENDATION

As noted previously, this immediate phase of the proceedings appears to be nearing a conclusion. Significant state interests remain involved here, although it seems clear that the available options are narrowing daily. Specifically, the potential for instate use of NGLs has not yet been foreclosed by FERC action. However, decisions with respect to pipeline pressure and diameter, coupled with environmental recommendations of the FEIS have already limited the choices the state may make in terms of developing a petrochemical industry. Similarly, whether or not the state may recover any of its impact costs from Northwest appears increasingly in doubt, especially since to date no evidence in support of the claimed costs has been submitted to FERC.

These FERC proceedings and the negotiations under the Cooperative Agreement appear destined to take a back seat in 1981 to two matters: (1) pursuit of necessary changes in the ANGTA to allow North Slope producer equity financing and a billing commencement date satisfactory to the Canadians, and (2) the effects of interest rates and the economy generally on pipeline economics.

In our judgment these are the critical items which must be resolved before Alaskan Northwest can complete its filing of financial and other data with the FERC. And without such filings, it is hard to conceive that FERC can issue a certificate of public convenience and necessity for the pipeline. We are optimistic that FERC and the other federal agencies involved will continue to make relatively positive decisions with respect to the pipeline during 1981. We are at least guardedly optimistic that favorable Congressional action on amendments to the ANGTA may be forthcoming. In terms of interest rates and the economy, we make no prediction.



Joseph M. Chomski



C. Floyd Mathews

JMC:CFM:skp

To: Joint Natural Gas Pipeline Committee

Re: Analysis of Final Certificate Application for the Alaska Segment, Cooperative Agreement and Related Matters

INTRODUCTION

In a memorandum dated July 29, 1980 our firm outlined a proposal to prepare a report regarding certain aspects of the final certificate application of Alaska Northwest Natural Gas Transportation Company (Alaskan Northwest) for the Alaska segment of the Prudhoe Bay natural gas pipeline (FERC Docket No. CP80-435) and of the Cooperative Agreement between Alaskan Northwest, the Prudhoe Bay Natural Gas Producers (Atlantic Richfield Company, Exxon Corporation and Sohio) and the State of Alaska. This report will examine the content of these documents, and where possible analyze their impact upon prospects for development of a petrochemical plant in Alaska using North Slope natural gas liquids and upon general State interests in the development of the Alaska segment of the pipeline.

The certificate application consists of eight volumes, and several sections of the application have not yet been filed with FERC. Much of the information is technical in nature and will require analysis of an engineer and lawyer-engineer dialogue to determine its full implications for the State's interest. Due to these reasons and the time available, this analysis should be considered preliminary.

The following documents are discussed below:

1. The U.S. Court of Appeals for the District of Columbia Circuit January 3, 1980 decision in Earth Resources Company of Alaska, et al. v. FERC (D.C. Cir. No. 79-2191).
2. The FERC Final Environmental Impact Statement dated July, 1980 for the Prudhoe Bay Project in Docket No. CP78-123 et al.
3. Alaskan Northwest's application for the final segment of the Alaska gas pipeline and application for export permit filed July 1, 1980 in FERC Docket Nos. CP80-434 and CP80-435.
4. The Ralph M. Parsons Company September, 1978 study for the Prudhoe Bay Sales Gas Conditioning Facilities.

5. Alaskan Northwest's Supplement filed June 30, 1980 to its application to the Department of Interior for right-of-way grant for the pipeline, and the Interior grant of right of way of December 1, 1980.
6. Comments of the State of Alaska Office of the Pipeline Coordinator filed July 24, 1980 with the Department of Interior regarding Alaskan Northwest's supplement to its right-of-way application.
7. The Cooperative Agreement dated June, 1980 between Alaskan Northwest, the Prudhoe Bay Natural Gas Producers and the State of Alaska.

The road to pipeline construction remains somewhat uncertain, but the documents filed this year evidence substantial progress toward resolution of many problems (some of them quite sticky) and lead us to a somewhat improved outlook for 1981. As has been the case since 1976, the primary problem continues to be financing for the project. Of course, the submission and approval of each successive document or filing narrows the alternatives, be they routes, pipeline pressure, throughput composition or others. In turn, the opportunities for the State of Alaska to protect its interests by restructuring the pipeline or guaranteeing an instate gas liquids supply also diminish. While the instate petrochemical project remains a live option today, it can be eliminated if firm contractual commitments for the North Slope liquids are made by the producers with out-of-state interests. While we know of no such arrangements or pending negotiations, we remain concerned that Alaska is not yet protected from such a prospect.

I. BACKGROUND

In September, 1977, in accordance with procedures established by the Alaska Natural Gas Transportation Act (15 U.S.C.A. §719, hereinafter ANGTA), the President approved a general proposal for the nature and route of the Alaska Gas Pipeline. The President's decision, subsequently ratified by Congress (Pub. L. No. 95-158), left many specifics of the pipeline design open for future final decisions by FERC and other agencies. Following the President's decision, FERC granted a conditional certificate of public convenience and necessity for the construction of the Alaska segment of the system, but this certificate did not specify the pipeline design. On March 2, 1979 Alaska Northwest applied to FERC for a final order approving certain pipeline design specifications; Alaska Northwest requested a 48 inch diameter pipeline with 1260 psig (pounds per square inch gage) maximum working pressure. The FERC gave notice of the application, invited and received comments, and on August 6, 1979 issued an order approving Alaskan Northwest's proposed pipeline diameter and pressure. After unsuccessfully petitioning FERC for rehearing, Earth Resources Company of Alaska and the State of Alaska appealed to the U.S. Court of Appeals for the District of Columbia Circuit. The D.C. Circuit issued its decision on January 3, 1980 which dismissed the appeals as premature under ANGTA. The pipeline pressure decision virtually assured that the gas conditioning plant would be

located on the North Slope, due to the apparent technical difficulties associated with transporting the heavier fractions in the 1260 psig line. As has been widely noted, locating the plant at Prudhoe Bay significantly limits state options with respect to utilization of gas liquids.

The Court's decision (Slip page 5) states as follows:

"Complainants claim that the Commission violated due process by deciding the pressure issue in isolation from decisions on such related issues as carbon dioxide content and conditioning plant design. By foreclosing options on these related issues, complainants contend, the Commission's piecemeal decision on the pressure issue has rendered any future hearing on the related issues meaningless, . . . The State of Alaska's desire to develop a petrochemical industry, which it says will be frustrated by the Commission's order, is far removed from the sort of legitimate claim to entitlement necessary to demonstrate a liberty of property interest." [footnote omitted]

The Court's dicta do not bode well for future State attempts to gain access to the natural gas liquids, if such access results in conflicts with federal authority and policy. While the dicta of the Court cannot be considered absolutely dispositive of the issue, it is a clear indication of potential problems ahead, especially given the constraints imposed on judicial review by the ANGTA. In this regard it may be the wisest policy for the State to seek a program for utilizing the natural gas liquids which to the greatest extent possible accomodates itself to the federal regulatory and policy framework rather than placing heavy reliance upon court-ordered modifications.

I. THE FERC FINAL ENVIRONMENTAL IMPACT STATEMENT (FEIS) FOR THE SALES GAS CONDITIONING FACILITY (SGCF)

The staff's FEIS analyzed a proposed SGCF design which was originally conceived by the 1978 R.M. Parsons Study discussed below. The Parsons Study was based on a number of assumptions*/ which, in hindsight, may not be correct. However, the FEIS does state that two critical issues

*/ The Parsons Study assumed that pipeline pressure would be 1,440 psig and that carbon dioxide maximum would not exceed one percent.

(pipeline pressure in the Alaska segment and the maximum allowable carbon dioxide concentration) will determine the percentage of the heavier NGL's that can be transported through the pipeline without operational problems. These two considerations will influence both the type of conditioning process chosen and the location of the SGCF. As indicated above, on August 6, 1979 the Commission decided that the pipeline's operating pressure should be set at 1260 psig. The FEIS discusses treatment of NGL's at the following pages: ii-iii, and v, 1-3, 7, 105-106, 131, 197, 205, 227-231. The FEIS concentrates primarily upon the environmental impact of construction and operation of the SGCF at various locations. The FEIS recommends however that the Prudhoe Bay site is environmentally acceptable, and is probably the best location for the SGCF. On the location issue the FEIS concludes that alternative sites for the SGCF would be technically feasible only if the decision were made to construct a pipeline capable of sustaining a higher maximum pressure than the presently authorized 1260 psig (page 205).

The FEIS also concludes that some of the NGL's should be used for fuel at the SGCF and for other fuel requirements at the Prudhoe Bay complex. These NGL's of course would not be available for any future petrochemical plant. The NGL's produced by the SGCF would include separate streams of ethane, propane, butane and pentanes plus. The FEIS states that these separate streams could be blended into fuel streams to control heating value, or blended into pipeline gas to the hydrocarbon dew point limitation (propane or butane), or blended into the crude (butane or pentanes plus) as limited by the vapor pressure specification (p. 231).

As was noted previously the location of the sales gas conditioning facility at Prudhoe Bay is largely an artifact of pipeline pressure and design specifications. And has also been previously noted, the location of the conditioning facility significantly limits the geographic scope of the State's ability to acquire natural gas liquids. Consequently, we believe it may be appropriate for the Committee to retain an consulting engineer to analyze the proposed SGCF to identify the specific technical limitations on transportation of NGLs which exist, alternative modes of transportation and utilization, and the possibility of using other fuels and the NGLs at the conditioning facility and the Prudhoe Bay complex. As pointed out above with respect to the decision by the Court of Appeals, modification of the conditioning facility or its relocation seems to be an unrealistic goal at this stage in the proceedings. Consequently, planning for utilization of the NGLs instate probably must proceed on the assumption that availability, both geographically and in terms of quantity, will be fixed within the broad perimeters outlined in the FEIS.

II. NORTHWEST ALASKA'S CERTIFICATE APPLICATION FOR THE FINAL SEGMENT OF THE ALASKA GAS PIPELINE AND APPLICATION FOR EXPORT PERMIT

I. THE STREAMLINED CERTIFICATE APPLICATION PROCEDURE AT FERC

The FERC has ordered special expedited procedures for consideration of Alaskan Northwest's application. The Commission's normal procedure is described in the paragraph below.

Under the Natural Gas Act (15 U.S.C.A. §717) it is unlawful for anyone to construct or operate any interstate natural gas pipeline in the United States without first obtaining a certificate of public convenience and necessity from the FERC. The required contents of the certificate application are usually quite voluminous, including designs for the proposed pipeline, evidence of economic feasibility of the proposed pipeline, financing plans, estimated future rates, environmental impact and other matters. The Commission normally publishes notice in the Federal Register of the filing of the application, and invites any interested persons to intervene and participate in future proceedings. If the application is for a small pipeline addition and is unopposed, the Commission in a few instances has issued the requested certificate without conducting full evidentiary proceedings. However, for a major contested application the Commission usually assigns the case to an administrative law judge to conduct evidentiary hearings. The presiding judge usually schedules prehearing conferences for the purpose of reaching stipulations of the parties, expediting discovery among the parties, and scheduling dates for filing prepared written testimony and hearings. After the close of all evidentiary hearings, the parties file briefs with the presiding judge setting forth their positions in favor of or in opposition to the proposed pipeline. The judge then issues an initial decision recommending that the Commission either issue a certificate (possibly with conditions) or deny the application, depending upon how the proposal affects the public interest. The parties then file briefs on exception to the initial decision with the Commission, and the Commission subsequently issues a decision either granting the certificate (with or without conditions) or denying the certificate.

Since the above procedure is usually time consuming, particularly when adverse parties wish to defeat or delay a project, the Congress passed the ANGTA to expedite all federal regulatory approvals for the Alaska Gas Pipeline Transportation System. Section 9(a) of ANGTA requires any certificate, right of way or other permit required by law from a federal agency, to be issued for the Alaska Natural Gas Transportation System on an expedited basis. Under Sections 9(c), (d) and (e), federal agencies may include terms and conditions for any certificates issued for the Alaska Gas Pipeline, but not if the terms and conditions would compel a change in the basic nature and general route of the approved transportation system.

On July 1, 1980 Alaska Northwest filed its application with FERC in Docket No. CP80-435 for a certificate under the Natural Gas Act and ANGTA authorizing construction and operation of the Alaska segment of the Alaska Natural Gas Transportation System. In an order of August 1, 1980 the FERC published notice of the application and established expedited procedures for its consideration of the application in keeping with section 9(a) of ANGTA. The Commission decided to utilize simple notice and comment procedures normally used in rulemaking proceedings. Instead of requiring the parties to file prepared written testimony and present witnesses at evidentiary hearings for cross examination, the Commission decided to hold a series of technical conferences to be presided over by the Commission's Alaskan Delegate, John Adger, in conjunction with the Office of the Federal Inspector. The Commission's Alaskan Delegate will issue a series of interim reports to the Commission reporting on the progress of the technical conferences. After conclusion of the technical conferences */ the Commission will issue a notice to the public requesting written comments on the Commission's proposed certification of the pipeline. The Commission, after review of any comments filed in the future, will issue its order on certification.

The Commission's August 1, 1980 order in Docket No. CP80-435 noted that the applicant requested, among other things, the following action from the Commission:

- (1) review and approval of the applicant's certification cost estimate (\$7.9 billion in 1980 dollars) and proposed center point of 1.292 ;
- (2) issuance of a final unconditional certificate of public convenience and necessity after review and approval of the applicant's financing plan for the pipeline;
- (3) approval of certain issues related to implementation of the incentive rate of return mechanism;
- (4) approval of the applicant's plan for financing of the Alaska segment;
- (5) a determination that the project costs do not "materially and unreasonably exceed" those considered as part of the President's decision.

*/ In late October, 1980, we supplied the Committee with a summary of certain of these technical conferences held in Washington, D.C.

The Commission's August 1, 1980 order noted that the application omits all materials related to financing and cost of service analysis for the Alaska segment of the pipeline. The application contemplates that, after the final design of the Alaska segment and conditioning facilities are completed, a final financing plan will be filed. As of December 22, 1980 no financing plan, cost of service data, shippers tariffs or final design of the pipeline have yet been filed by Alaskan Northwest. The Commission's August 1, 1980 order noted that certain matters could not be decided by the Commission until the applicant submits its financing plan, such as the issues of the marketability of the gas, the continuing relationship of the proposed project to the national interest, and the relationship of the project's estimated cost to those considered at the time of the President's decision. Accordingly, the August 1, 1980 order deferred consideration of these issues, and also deferred issuance of a final certificate, until after the applicant files its proposed financing plan. However, the August 1, 1980 order directed the Alaskan Delegate to proceed with technical conferences on the remaining issues of the applicant's proposed certificate cost estimate, center point value, and the incentive rate of return mechanism.

2. FERC PROCESS: 1981

The last technical conference was held November 20, 1980. The Commission Staff's comments on the incentive rate of return, center point, cost estimate and certain design issues were filed with Mr. Adger on December 15, 1980; the Staff proposed center point and cost contingency figures lower than those in the application. Alaskan Northwest's reply comments were filed with Mr. Adger on December 22, 1980, and as expected, Alaskan Northwest opposed the Staff's position. It is anticipated that Mr. Adger will issue a draft report on the pending issues about mid-January or early February, 1981. Another technical conference will be convened within about ten days for the purpose of correcting minor mathematical or technical errors in Mr. Adger's draft report. Mr. Adger would probably issue his final report on the pending issues to the Commission in February, 1981. The Commission would then probably issue a notice requesting comments on Mr. Adger's final report. A final Commission order on the issues of incentive rate of return, cost estimate, center point and design issues would probably issue, at the earliest, in late March, 1981. However it is more likely that the Commission's final order on these issues will not be rendered until the spring of 1981.

In conversations with Alaskan Northwest spokesmen and FERC staff personnel, we have learned that Alaskan Northwest intends to supplement its application in the future with final designs (prepared by the Design Board) for the SGCF and Alaska segment. At present, it is expected that the Design Board may issue a preliminary design for the SGCF in February, 1981, and this is not expected to delay the pending proceeding at FERC. Alaskan Northwest also will file a supplement describing a proposed financing by the Producers; this will require new authorizing legislation but Alaskan Northwest is confident such legislation can be easily and quickly obtained from Congress.

The Commission previously (in Order No. 45) excluded the SGCF from the jurisdictional facilities to be covered by the final certificate. However the Commission could exercise some indirect control over the final design of the SGCF by conditioning the certificate in such a way as to specify the content or quality of natural gas to be introduced and transported through the pipeline.

When Alaskan Northwest files its proposed financing plan, it is anticipated that the Commission will issue another order directing the Alaska Delegate to expeditiously commence further technical conferences and prepare another report to the Commission regarding the deferred financing and cost of service issues discussed above. It is not yet known when Alaskan Northwest will make these supplemental filings, but the filings may possibly be made in the first half of 1981.

Because of the large number of issues being considered, it is probable that the FERC will not issue final orders granting the certificate exactly as requested by Alaskan Northwest. Instead the Commission is more likely to grant a certificate with conditions slightly modifying the project. Mr. Adger's final report to the Commission in February, 1981 should be a good indicator of the contents of any Commission final order.

After the Commission issues its last order granting a certificate and resolving all issues in this proceeding, any party may file with the Commission a petition for rehearing. The Commission's order on such petitions for rehearing would be subject to judicial review under Section 10 of ANGTA in the United States Circuit Court of Appeals for the District of Columbia.

There appears to be little or no opposition to the proposed pipeline in the pending FERC proceeding. However, if FERC imposes numerous or harsh conditions in its final order, Alaskan Northwest (and possibly other parties) may appeal in the future.

3. CONTENTS OF THE APPLICATION

The present application on file at FERC does not include specific designs for the SGCF or the Alaska segment of the pipeline. The Cooperative Agreement (discussed below) establishes a Design Board which will finalize designs for the SGCF and the Alaska segment of the pipeline. The application (Volume I, page 7; Volumes IV, VI, VII and VIII) states that the Alaska segment will have a diameter of 48 inches at a pressure of 1260 psig. The application does incorporate by reference the earlier 1978 R. M. Parsons Study (discussed below) for a proposed SGCF, but contains no specific final design for the SGCF or the Alaska segment.

As discussed above, the pending application also does not contain any specific proposal for financing the pipeline (Volume I, Exhibit L). As FERC staff has repeatedly stated in comments, this lack of financing plan continues to raise the question of whether the project can be certificated at all.

A consulting engineer should analyze Volumes IV, VI, VII and VIII to determine the effect of the proposed project on the potential for petrochemical development in Alaska.

Volume I of the application requests the following action from the Commission prior to issuance of a final certificate:

- (1) Commission approval of the certification cost estimate and center point;
- (2) approval of the applicant's plan for private financing to be filed in the future;
- (3) a determination that the project costs are not unreasonably different from those considered as part of the President's decision and report.

The application states that the following matters will require Commission action prior to construction of the Alaska segment: establishment of the carbon dioxide content of the gas to be transported, and final resolution of Commission Order No. 45 which found that construction and operation of the Prudhoe Bay Gas Processing Facilities were the responsibility of the Alaska North Slope Producers. The application states the following matters will be the subject of future filings by Alaskan Northwest: shipper tariffs; downstream transportation and exchange agreements; to export and import Alaskan gas; and the remaining portions of the ANGTS eastern and western legs not previously certificated in the prebuilding proceedings (Volume I pg. 5).

The application states that the financing plan could not be submitted in July, 1980, because Alaskan Northwest has recently entered into a cooperative agreement with the principal North Slope Producers (Exxon, Arco and Sohio). The Joint Statement of Intention in this agreement defines the process for developing a financing plan for the Alaska segment, including significant producer participation. Alaskan Northwest intends to submit the financing plan in the "future" (Vol. 1, pg. 6). At present, our best guess is that the financing plan will not be finalized and submitted until May, 1981 at the earliest.

The certification cost estimate and the risk analysis which support the requested center point are submitted as exhibits K and Z-7 (discussed below).

Exhibit E of the application (Vol. I) states that Alaskan Northwest has four other filings pending before FERC in Docket No. CP78-123 et al. which are related to the application for the Alaska segment.

Exhibit F (Vol. I) contains two maps and gives a very generalized description of the proposed pipeline. The pipeline route is intended to utilize existing rights of way as much as possible.

Exhibit G (Vol. I) contains flow diagrams showing daily design capacity, both with the proposed additional nine compressor stations and with the initial Alaskan segment of only seven compressor stations.

Exhibit H (Vol. I) shows total estimated reserves and deliverability of the Prudhoe Bay Gas Field. Exhibit H states that the applicant will be a transporter of natural gas, and as such will not buy or sell natural gas. The FERC has found that, based on the best available data, the estimated reserves in place are between 40.4 Tcf to 42.8 Tcf, and recoverable reserves are approximately 25 Tcf. Nine natural gas companies have gas purchase contracts or letters of commitments from the three major producers in the Prudhoe Bay field, which represent 85 percent of the available gas. Six of the nine purchasing companies are members or affiliates of members of the Alaskan partnership. Exhibit H also states that production levels of the Prudhoe Bay field are governed by decisions of the Division of Oil and Gas Conservation of the Department of Natural Resources of the State of Alaska. This Division is presently considering amending the authorized production levels. The state may wish to monitor developments in this area, since a certificate conditioned on minimum levels of reserves and/or deliverability could significantly impair the State's ability to manage the reservoir.

Exhibit I will be filed in the future, and will describe market data for sale of the gas. The application (Vol. I, Exhibit I) states that the shippers will be submitting this market data in the future.

Exhibit J (Vol. I) states that the shippers will also file information in the future to supplement the application regarding applications for facilities for the transportation and/or sale of the Prudhoe Bay gas.

Exhibit L regards financing and, as indicated above, the application states that financing data will be filed in the future. This is the major deficiency of the application at present.

Exhibit M (Vol. I) describes the applicant's management plan for construction, operation and management of the pipeline. The project management contractor will be Fluor Engineers and Constructors, Inc. of Irvine, California. Alaska Northwest will monitor Fluor's activities, but the actual detailed management of design and construction will be performed by Fluor and subcontractors. Exhibit M-4 states that Northwest Alaska Pipeline Company (a member of Alaska Northwest) will retain direct responsibility for coordination with all government agencies, obtain all government authorizations, and monitor compliance with government regulations.

Exhibit N (Vol. I) will be filed in the future with Exhibit L. Exhibit N will describe estimated revenues, expenses and income of the pipeline.

Exhibit O (Vol. I) describes the depreciation rate which will be used in the pipeline tariff, which was previously approved by the FERC by orders of June 8 and September 6, 1979 in Docket No. RM78-12.

Exhibit P (Vol. I) will be supplemented in the future with cost of service data in conjunction with the filing of Exhibit L. Exhibit P will describe Alaska Northwest's tariff as approved by FERC orders of June 8 and September 6, 1979 in Docket No. RM78-12. The FERC previously approved the applicant's tariff provisions with respect to billing commencement date, interim rate, service interruption, billing procedures, cost allocation and availability of transportation services. In those orders the FERC required Alaska Northwest to submit for FERC approval 12 months prior to the commencement of operations a modified tariff which will conform to the requirements of the Commission's rate orders.

Exhibit K gives the certification cost estimate of \$7.9 billion and is contained in Volume II. A matter of some concern to the state is contained in Exhibit K; viz., Northwest's inclusion for some \$203.4 million in proposed "impact assistance" payments to the State of Alaska to mitigate a variety of pipeline construction impacts. In their comments of December 15, 1980 (p. 32) Staff has opposed inclusion of this amount in the certification cost estimate, stating in part, "These costs are not required by statute, have been traditionally disallowed in other cases, and may be more properly supported by tax and royalty revenues from the project. Their inclusion would open Pandora's Box."

In discussions with FERC staff on this issue, we were informed that Alaskan Northwest had obtained the impact cost estimate of \$203.4 million from the State of Alaska and had included it in their application without further supporting evidence. Staff indicated that the state had undertaken to provide the justification for this amount to FERC. However, the deadline for filing such information was December 15, 1980, and as of December 29, 1980, the Staff had received no further information from Alaska on the subject.

Two issues appear to exist now with respect to the allowance of impact costs in the rate base: first, the basic policy question of whether impact assistance costs should be included in rate base; and second, the evidentiary issue of whether the state can supply sufficient factual justification to permit a favorable decision from FERC. The latter question is paramount at this point, since it is highly unlikely that the Commission will approve such a major cost item for inclusion in the rate base without additional supporting evidence. The state's best chance for collecting these impact assistance funds from Alaskan Northwest is to persuade FERC to allow inclusion of these costs in the certificate cost estimate. Therefore, submission of supporting information

with respect to the \$203.4 million is imperative at the earliest possible date. We believe that any attempt by the state to collect such costs, without FERC approval, will be opposed by Alaskan Northwest. Any future litigation of this issue is well beyond the scope of this report, it is safe to say that the state may have difficulty demonstrating that such charges are permissible exercises of the state's police power.

Another possibility is that the state has determined not to pursue this issue at FERC. If so, such a decision has not been communicated to FERC staff with whom we have spoken.

Exhibit Z-1 is contained in Volume III and is the applicant's proposed environmental engineering manual for construction and operation of the pipeline.

Exhibit Z-2 describes the proposed gas conditioning plant at Prudhoe Bay and is contained in Volume IV. Exhibit Z-2 states that the general location and layout of the gas conditioning plant will be in agreement with the information contained in the Commission's staff Prudhoe Bay Project Final Environmental Impact Statement discussed above. Exhibit Z-2 also states that the proposed gas conditioning plant design, construction and operation plans proposed in the R. M. Parsons Study discussed above are adopted by reference for the purposes of the application. However, as indicated above, the Parsons Study describes several general design alternatives, and was not a specific final design for the gas conditioning plant. The final design for the gas conditioning plant, as well as the final design for the Alaska segment of the pipeline, should be completed by the Design Board in early 1981. Page 3 of Exhibit Z-2 describes the composition of the sales gas, and indicates that the sales gas will contain small amounts of NGL's. The proposed sales gas composition will include 4.425 percent ethane which might possibly be utilized in a petrochemical plant if extracted from the Alaska segment somewhere in Alaska. Exhibit Z-2 should be analyzed by a consulting engineer to determine its impact on the potential for development of a petrochemical plant in Alaska.

The application reserves Exhibit Nos. Z-3, Z-4 and Z-5 for descriptive information relative to other segments of the ANGTS, and states that additional descriptive information will be submitted in conjunction with the Exhibit L financing plan. It is possible that these exhibits will be used for filing the final design of the sales gas conditioning facility and Alaska segment of the pipeline.

Exhibit Z-7 (Vol. V) describes Alaska Northwest's center point justification. The Commission previously directed that an incentive rate of return mechanism be used to provide an incentive for cost control during construction of the Alaska Natural Gas Transportation System. Under the incentive rate of return (IROR) mechanism the project sponsors will earn either higher or lower rates

of return depending upon their ability to control project costs. If actual costs are greater than estimated costs, sponsors will earn a lower rate of return on equity. If actual costs are below those estimated, the sponsors will earn a higher rate of return on their equity. The certification cost estimate includes a normal contingency of 12 percent to cover normal uncertainties of estimating future costs. Uncertainties from abnormal events which might raise future costs are covered by raising the estimates to a higher cost, which is termed the "center point." The applicant requests that the center point be set at 1.292, which means that if the actual cost of the project is exactly 1.292 times the certification cost estimate, there would be no penalty or downward alteration in the proposed rate of return. The applicant argues that there is convincing evidence that the potential for cost increases beyond the certification cost estimate, due to abnormal events, is substantial and therefore the center point must be substantially greater than 1.

Exhibit Z-9 (Vol. VI) is Alaska Northwest's design summary. This is not the final design of the pipeline, but is a generalized overview of the proposed pipeline as presently planned. Exhibit Z-9 should be analyzed by a consulting engineer.

Exhibit Z-9.1 through Z-9.5 (Vols. VII and VIII) describe and summarize design proposals for parts of the pipeline. These exhibits should be analyzed by a consulting engineer. Exhibit Z-9.1 is the proposal for the Alaska segment pipeline design. Exhibit Z-9.2 describes proposals for the compressor station designs. Exhibit Z-9.3 describes proposals for the Alaska segment communications system. Exhibit Z-9.4 describes the operations and maintenance facility to be located in Fairbanks Alaska. Exhibit Z-9.5 describes the design of temporary facilities to be utilized for construction of the gas pipeline, compressor stations, metering stations, and other elements of the pipeline system.

4. RALPH M. PARSONS COMPANY 1978 STUDY

The Ralph M. Parsons Company 1978 Study describes various proposals for a SGCF. This study was completed before the FERC limited the Alaska segment pressure at 1260 psig. Therefore several basic assumptions in the Parsons Study (Volume I, page 2-1) are probably no longer valid. As indicated above, the Design Board will complete a preliminary design of the SCGF in early 1981, and the final design should render the Parsons Study largely obsolete.

The Parsons Study discusses natural gas liquids at the following pages:

1978 Study - pages 2-2 to 2-3, 3-1 to 6-5.

February, 1979 CO2 Specification Study - pages 4-4 to 4-5, 4-9 to 4-10, 4-21 to 4-23.

III. NORTHWEST ALASKA JUNE, 1980 SUPPLEMENT TO APPLICATION TO THE DEPARTMENT OF INTERIOR RIGHT-OF-WAY

Under the Mineral Leasing Act of 1920, as amended, (30 U.S.C.A. §185) the Department of Interior has authority to issue grants for rights of way for certain natural gas pipelines to traverse federal lands, subject to approval of Congress. An original application for the Alaska segment right of way was submitted July 5, 1977 to the Department of Interior. The June, 1980, five volume supplementary application sought a right-of-way grant from the Department of Interior (DOI) for the portions of the pipeline to be built on "Federal land." The supplement stated (Volume I, p. 2) that the right-of-way, if granted, would be subject to Federal laws and regulations, and that the applicant would be subject to Federal regulation under the Natural Gas Act.

The supplement (Volume I, pp. 6-7) included as "Federal lands" certain land selections by the State of Alaska pursuant to the Alaska Statehood Act for which patents have not been issued by DOI. Also included as "Federal lands" were certain Native corporation selections and Native allotment applications under the Alaska Native Claims Settlement Act for which final Federal administrative approval had not been issued. Alaskan Northwest correctly included the selected but unapproved or unconveyed Federal lands in Alaska as being subject to the Secretary's powers to issue Federal rights-of-way grants. See, §6(g) of Alaska Statehood Act, 48 U.S.C. Prec. 21; §17(b)(1) of ANCSA, 43 U.S.C. 1616(b)(1).

The basic Alaskan Northwest Federal right of way grant was approved December 1, 1980. Since the right of way application was approved before the Alaska Lands Bill was signed into law, all lands conveyed or approved in the bill will be subject to this right of way. Secondly, Section 1327 of the Alaska Lands Bill contains several provisos to the effect that no provision in that legislation was to effect or impede the Alaska Natural Gas Pipeline process.

As additional assurance that the state, as a land owner, could not interfere in the right of way grant, Section 906(1) of the Alaska Lands Bill expressly preserves all existing rights of way permits or grants over state land. All subsequently issued conveyance documents must reflect the right of way and the Secretary shall continue to administer the right of way once it is reserved to the United States. This will ensure continued federal control, although

after tentative approval the receipts are to be paid to the State. Section 906(n) provides yet another safeguard by stating that no provision regarding the conveyance of state land shall alter or affect the rights or obligations of any party under the Alaska Natural Gas Transportation Act.

North Dakota's recent lawsuit which challenged federal decisions on siting of the Eastern leg of the Northern Tier Pipeline without seeking approval from the state's Public Service Commission brought into sharper focus the need for the foregoing provisions. The drafters of the Alaska Lands Bill attempted to limit third party lawsuits challenging the right of way grant as much as feasible. However, one kind of land grant conflict may not be as easily resolved. When Congress passed ANCSA in December, 1971, more than 1000 applications for land grants under the Alaska Native Allotment Act were pending. While the allotment act is also repealed under ANCSA, allotment applicants can still elect to receive a certificate of allotment, a kind of equitable title, for land personally used. A land survey was previously required before approval could be obtained, so it is altogether possible that allotment applications overlay the pipeline right of way. There is very little caselaw governing the Secretary's authority to grant rights of way across allotment applications, but general principles of public land law lead to the tentative conclusion that allotments will be subject to the right of way grant. However, this may be a troublesome issue in the months to come as all pending allotments were approved in the lands bill, and could provide a basis for litigation.

The final December 1, 1980, grant also requires Alaskan Northwest to enter into an indemnification agreement with Alyeska to pay for any damages caused by the construction and operation of either the natural gas pipeline or the oil pipeline in and adjacent to the federal rights-of-way. Lastly, Interior anticipates negotiating a memorandum of understanding with the state to resolve certain issues raised by the state's July 24, 1980 comments discussed below, and which are intended to facilitate acquisition of rights-of-way across remaining state and native lands.

VI. THE COMMENTS OF THE STATE OF ALASKA OFFICE OF THE PIPELINE COORDINATOR ON ALASKAN NORTHWEST'S RIGHT-OF-WAY APPLICATION

These comments dated July 24, 1980 indicate that the State of Alaska intends to attempt to exercise some regulatory control over pipeline construction and right-of-way.

The State's comments raised the following significant issues the final resolution of which will affect the State's interests:

- cover letter, page 2 - The application ignores NGL's, and contemplates possibly misusing them as fuel.
- cover letter, page 3, 4-5 and enclosure pages 23-24 -
The State intends to apply State law on Federal land; the comments also note that stipulations of the Federal grants should be consistent with conditions of State right-of-way leases for the pipeline over State-owned land.
- cover letter, page 4 - The State requests a joint State/Federal cooperative agreement be included in the right-of-way grant in order to eliminate any inconsistencies between Federal and State regulatory authority.
- cover letter, pages 5-6 - The State opposes the application's position that unconveyed State and Native land selections should be included in the Federal grant.

In conversations with DOI staff we have learned that the December 1, 1980 right-of-way grant has not resolved all of these issues and DOI will seek to enter into a memorandum of understanding with the State of Alaska in the future regarding resolution of some of these issues. It is clear that such a memorandum could have significant impacts on state authority to regulate the pipeline right-of-way and related matters.

VII. COOPERATIVE AGREEMENT BETWEEN ALASKAN NORTHWEST,
THE PRUDHOE BAY NATURAL GAS PRODUCERS AND THE STATE OF ALASKA

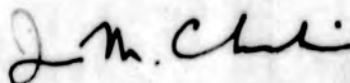
This agreement forms a Design Board to finalize designs for the SGCF and the pipeline in Alaska. As indicated above, preliminary designs will be filed with the FERC as a supplement to the certificate application, possibly as early as February of 1981. Any designs filed should be analyzed by a consulting engineer to determine any impacts on the potential for petrochemical development.

CONCLUSION AND RECOMMENDATION

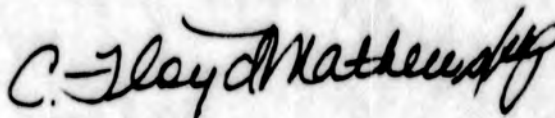
As noted previously, this immediate phase of the proceedings appears to be nearing a conclusion. Significant state interests remain involved here, although it seems clear that the available options are narrowing daily. Specifically, the potential for instate use of NGLs has not yet been foreclosed by FERC action. However, decisions with respect to pipeline pressure and diameter, coupled with environmental recommendations of the FEIS have already limited the choices the state may make in terms of developing a petrochemical industry. Similarly, whether or not the state may recover any of its impact costs from Northwest appears increasingly in doubt, especially since to date no evidence in support of the claimed costs has been submitted to FERC.

These FERC proceedings and the negotiations under the Cooperative Agreement appear destined to take a back seat in 1981 to two matters: (1) pursuit of necessary changes in the ANGTA to allow North Slope producer equity financing and a billing commencement date satisfactory to the Canadians, and (2) the effects of interest rates and the economy generally on pipeline economics.

In our judgment these are the critical items which must be resolved before Alaskan Northwest can complete its filing of financial and other data with the FERC. And without such filings, it is hard to conceive that FERC can issue a certificate of public convenience and necessity for the pipeline. We are optimistic that FERC and the other federal agencies involved will continue to make relatively positive decisions with respect to the pipeline during 1981. We are at least guardedly optimistic that favorable Congressional action on amendments to the ANGTA may be forthcoming. In terms of interest rates and the economy, we make no prediction.



Joseph M. Chomski



C. Floyd Mathews

JMC:CFM:skp

L.V. OFFICES

BIRCH, HORTON, BITTNER, MONROE,
PESTINGER AND ANDERSON

A PROFESSIONAL CORPORATION
1127 WEST SEVENTH AVENUE
ANCHORAGE, ALASKA 99501

(907) 276-1550

TELEX 25-356

1200 AIRPORT HEIGHTS DRIVE
ANCHORAGE, ALASKA 99504
(907) 273-9501

751 OLD RICHARDSON HWY., SUITE 349
FAIRBANKS, ALASKA 99701
(907) 452-1666

130 SEWARD STREET
JUNEAU, ALASKA 99801
(907) 586-2890

4400 JENIFER ST., N.W., SUITE 300
WASHINGTON, D.C. 20015
(202) 244-4250
TELEX 9-89-2591

RONALD G. BIRCH
MAL R. HORTON
WILLIAM M. BITTNER
SUZANNE CHEROT PESTINGER
LLOYD V. ANDERSON
BRUCE MONROE
GREGORY C. TAYLOR
ROD CARMAN
MICHAEL R. SPAAN
JOSEPH M. CHOMSKI
GORDON F. SCHATZ
CAROL A. JOHNSON
GERALD D. STOLTZ*
RONALD E. NOEL
JOSEPH W. EVANS
WINSTON S. BURBANK
E. BUDD SIMPSON
JAN SAMUEL OSTROVSKY
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PAUL H. GRANT
DOUGLAS J. SERDAHELY
NANCY J. SHAW
PATRICK H. OWEN
MICHAEL C. GERAGHTY
PERCY R. LUNEY*

* NOT ADMITTED IN ALASKA

July 21, 1980

The Honorable Mike Colletta
SRA Box 1458-K
Anchorage, AK 99502

Dear Senator Colletta:

This is to confirm our phone conversations of July 11 and July 16 wherein you have asked us to undertake for the JIPC an analysis of the FERC submission made by Northwest.

We will undertake such an analysis and furnish to the Committee, no later than Labor Day, the results of that analysis. The study will be conducted in our Washington, D.C. office and headed by Joe Chomski. It will be billed at our normal hourly rate.

Yours very truly,

BIRCH, HORTON, BITTNER, MONROE,
PESTINGER & ANDERSON

Ronald G. Birch/m.s.e.

Ronald G. Birch

RGB/mbr

cc: Joseph M. Chomski, Esquire