Z cy

THE ALASKA NATURAL GAS TRANSPORTATION SYSTEM

STATUS REPORT

ON

FINANCING

Prepared by the Staff for the

Subcommittee on Oversight and Investigations

of the

Committee on Interior and Insular Affairs

of the

U. S. House of Representatives

Ninety-Sixth Congress

Second Session

April 1980

CONTENTS

Page

Letter of Transmittal....................i

I. Introduction....................1

II. Background....................3

III. Issues....................9

A. Cost....................9

B. Overrun Pool....................11

C. Completion Guarantees....................11

D. Antitrust....................12

E. Gas Conditioning....................14

F. State of Alaska Participation....................15

G. Regulatory Uncertainty....................16

IV. Financing Proposals

A. Baseline: Decision, September 1977....................18

B. Producer Proposal, November 1979....................19

C. "Fedline" Proposal, January 1980....................20

D. "Double Overrun Pool" Proposal, February 1980....................22

E. ARCO Proposal, March 1980....................24

V. Time Considerations....................26

I. INTRODUCTION

The ability of the sponsors of the Alaska Natural Gas Transportation System (ANGTS) to secure private financing for the project is currently being tested. This issue will pace all progress on the project until it is definitively resolved.

Two and one half years have elapsed since the President declared the Alaskan Northwest consortium the successful applicant to construct the 4,800-mile natural gas pipeline. The President's selection was made after "an exhaustive review" by ten interagency task forces. The Recommendations of these advisors were evaluated and formed the basis of the Decision and Report to Congress on the Alaska Natural Gas Transportation System (hereinafter referred to as the Decision). This document was approved in its entirety and incorporated by reference by Congress through the enactment of Public Law 95-158.

Financial and antitrust Terms and Conditions are specifically identified in the Decision. Financial analysts and potential lenders in the private sector must judge the project's merits and risks on a stand-alone basis and also within the framework of the Decision's Terms and Conditions.

The purpose of this report is to identify the organizations involved in the financing negotiations, to separate and define the obstacles, and to present a summary of each of the major financing proposals which have been circulated to date. Because the topic is presently under intense

negotiations among the private parties concerned with the project, no staff recommendations are included. This report is prepared as a function of the Subcommittee's responsibilities with regard to the Alaska Natural Gas Transportation System and supplements and updates the more comprehensive Alaska Natural Gas Transportation System Status Report released in December 1979 and printed in full as part of the Interior and Insular Affairs Committee hearing record (Serial No. 96-22, page 109).

II. BACKGROUND

In order to understand the complexity of current financing talks it is necessary to look at the framework provided in the enabling legislation and the President's Decision. What follows are excerpts from the relevant sections of both of these documents. In addition, a list of the parties involved in the negotiations and their respective roles is provided.

The Alaska Natural Gas Transportation Act of 1976 (ANGTA), Public Law 94-586, was passed by Congress on October 1, 1976, in response to a shortage of natural gas within the contiguous United States. This Act provided guidelines for an expedited Presidential decision on a natural gas pipeline for Alaska gas and included provisions which set broad parameters for the development of a financing strategy. Three pertinent sections are listed below.

With regard to antitrust laws:

> "Sec. 14. Nothing in this Act, and no action taken hereunder, shall imply or effect an amendment to, or exemption from, any provision of the antitrust laws."

Regarding waiver of law:

> "Sec.8.(g)(1) At any time after a decision designating a transportation system is submitted to the Congress pursuant to this section, if the President finds that any provision of law applicable to actions to be taken under subsection (a) or (c) of section 9 require waiver in order to permit expeditious construction and initial operation of the approved transportation system, the President may submit such proposed waiver to both Houses of Congress."

Concerning the President's financial analysis:

> "Sec.7.(a)(6)(c) The report of the President pursuant to subsection (b) of this section shall contain a financial analysis for the transportation system designated for approval. Unless the President finds and states in his report submitted pursuant to this section that he reasonably anticipates that the system designated by him can be privately financed, constructed, and operated, his report shall also be accompanied by his recommendation concerning the use of existing Federal financing authority or the need for new Federal financing authority."

The President's Decision and Report to Congress on the Alaska Natural Gas Transportation System followed passage of ANGTA by eleven months and fulfilled the Congressionally mandated guidelines by identifying a route, the facilities to be included in the system, the entity to construct the system, and related statutory determinations. The document referred to as the Decision is composed of three sections: the Presidential decision, the Agreement on Principles between the United States and the Government of Canada, and the report which accompanied the President's decision and which explains in detail the basis for the decision.

These three sections of the Decision address the question of financing in the following manner:

1. The Agreement on Principles with Canada states:

   "It is understood that the construction of the Pipeline will be privately financed."

2. From the decision, Section V, Terms and Conditions and Enforcement:

   "The successful applicant shall provide for private financing of the project, and shall make the final arrangement for all debt and equity financing prior to the initiation of construction."

"The (applicant), or its successor, ... shall be publicly held corporations or general or limited partnerships, open to ownership participation by all persons without discrimination, except producers of Alaskan natural gas."

3. Contained in the report, Chapter II - FINANCIAL ANALYSIS:

"The equity investment in the Project would be placed at risk under all circumstances and the budgeted equity investment be considered the first funds spent. The rate of return on equity would compensate sponsors for bearing this risk."

"Producers and the State of Alaska, as direct and major beneficiaries of the project, should participate in the financing either directly or in the form of debt guarantees."

"The burden of cost overruns be shared by equity holders and consumers upon completion through the application of a variable rate of return on common equity."

"Provision of debt service in the event of service interruption would be borne by consumers through a tariff that becomes effective only after service commences."

Also found in the report under FINANCIAL ANALYSIS:

"Presidential Finding That the Alcan System Can be Privately Financed -

"The (sponsors) and financial advisors have stated the (project) can be privately financed. The financial analysis above supports this conclusion. Therefore, it is reasonable to anticipate that the (project) can be financed in the private sector.

"Novel regulatory schemes to shift this project's risks from the private sector to consumers are found to be neither necessary nor desirable. Federal financing assistance is also found to be neither necessary or desirable and any such approach is herewith explicitly rejected."

Antitrust concerns are discussed in two sections of the Decision.

1. The decision document, Section V, Terms and Conditions and Enforcement provides:

    "The successful applicant shall exclude and prohibit producers of significant amounts of Alaska gas, or their subsidiaries and affiliates, from participating in the ownership of the Alaska natural gas transportation system, except that such producers may provide guarantees for project debt. The aforesaid producers of Alaska gas may not be equity members of the sponsoring consortium, have any voting power in the project, have any role in the management or operations of the project, have any continuing financial obligation in relation to debt guarantees associated with initial project financing after the project is completed and the tariff is put into effect, or impose conditions on the guarantees of project debt permitted above which may give rise to competitive abuse, including power to veto pro-competitive policies."

2. The report provides:

    "The Department of Justice indicated that its concern about producer ownership or control of the pipeline does not preclude producer participation in financing the system. For example, consistent with antitrust objectives, producers could be involved in guaranteeing a portion of the project's initial debt or cost overrun debt. To assure antitrust insulation, any producer role in the management of the transportation system prior to its becoming operational should be the minimum necessary to protect the producers' investment interest but in any event should not permit producers to engage in anticompetitive conduct. In addition, producer debt guarantees should terminate upon completion of the project and commencement of the tariff."

The parties currently involved in assembling a financial package for the ANGTS are the sponsors of the Alaskan Leg, the producers of North Slope

natural gas, and officials of the Department of Energy. The sponsors of the Alaskan Leg are lead negotiators in financing by virtue of their responsibility to construct and operate the most expensive and risk-laden leg of the four-section pipeline system (consisting of the Alaskan, Canadian, Eastern, and Western Legs). The role of the Department of Energy was signaled by President Carter in his July 1979 energy speech in which he accused the producers of foot-dragging and instructed the Secretary of Energy to meet with them to discuss plans to help finance the project. Between November 1, 1979, and February 18, 1980, a special consultant to the Department of Energy, Martin Lipton, attempted to forge a financing agreement among the interested parties. Although his efforts did not generate final agreements, much of his work is being actively discussed.

SPONSORS -

Alaskan Northwest Natural Gas Transportation Company

John G. McMillian, Chairman, Board of Partners (seven firms):

Northwest Energy Company, managing partner
Panhandle Eastern Pipe Line Company
Northern Natural Gas Company
United Gas Pipe Line Company
Pacific Lighting Corporation
Pacific Gas and Electric Company
American Natural Resources

Financial advisors to the sponsors:

Mark J. Millard, Chairman and Senior Managing Director, Loeb Rhoades Shearson
Peter Sacerdote, Goldman, Sachs and Company
Andrew Sage, Lehman Brothers, Kuhn Loeb, Incorporated
Paul Miller, First Boston Corporation

PRODUCERS -

Exxon Company U.S.A., a division of Exxon Corporation - 36% gas ownership

Randall Meyer, President
Fred C. Ackman, Executive Vice President
E. A. Robinson, Senior Vice President
W. Allen Harrison, Treasurer

Corporate leadership:

Cliff C. Garvin, Jr., Chairman and Chief Executive Officer
Howard C. Kauffmann, President
Donald M. Cox, Senior Vice President

Atlantic Richfield Company - ARCO - 36% gas ownership

Robert O. Anderson, Chairman and Chief Executive Officer
William F. Kieschnick, Jr., Vice Chairman
Thornton F. Bradshaw, President
Claude O. Goldsmith, Vice President, Financing and Tax Division

Standard Oil Company (Ohio) - SOHIO - 27% gas ownership

Alton W. Whitehouse, Jr., Chairman and Chief Executive Officer
Paul D. Phillips, Senior Vice President, Finance and Administration
Charles W. Karcher, Manager, Alaska Natural Gas Pipeline Project

DEPARTMENT OF ENERGY -

Charles W. Duncan, Jr., Secretary
John Sawhill, Deputy Secretary
Lynn R. Coleman, General Counsel
Leslie J. Goldman, Assistant Secretary for International Affairs
James Geocaris, Director, Office of Special Projects
Martin J. Lipton, Consultant

Officials of the State of Alaska can be included in the organizations and individuals listed above in view of the state's one-eighth royalty ownership of the North Slope natural gas, and its designation by the President as one of the major beneficiaries of the project. State officials have been invited by the Department of Energy to participate in meetings concerning financing.

III. ISSUES

It is understood by all parties that conventional financing structures do not apply to this project. Rather than a 50 percent debt, 50 percent equity capital structure and "balance sheet" financing, the project is being structured on a 75 percent debt, 25 percent equity basis with non-recourse "project financing". Under this arrangement a new enterprise is created, the Alaskan Northwest consortium, which in and of itself is expected to generate the necessary revenues for operating costs, interest and principle on its debt, and a return on and of equity to its investors.

Lenders of debt must assess the risk that the project may not be successfully completed and there would be no recourse to the corporate assets of the sponsoring companies.

In order to reduce the risk to private debt lenders, the project beneficiaries (sponsors, producers, and the State of Alaska) would need to provide an overrun pool, completion guarantees, and an operating agreement that is cleared of legal obstacles and regulatory uncertainty. The following pages attempt to summarize the seven major issues which the beneficiaries must resolve.

1. COST

No definitive cost estimates exist for the project. None will be available until preconstruction testing is completed and there is agreement on final design between the sponsors and the Federal Inspector, who represents

all Federal agencies with jurisdiction over the pipeline.

Discussions of project costs, therefore, are complicated by the use of figures which lack definition and which have limited validity in current financial markets. For clarity, four technical definitions should be made available for each cost estimate: 1) the project cost in "escalated", or 1985, dollars, 2) the presence or absence of AFUDC funds in the estimate (interest charged to the sponsors on money used during the construction period), 3) the use of Canadian or U.S. dollars in estimates for the Canadian section of the pipeline, and 4) the existence and percentage of any contingency reserve in the cost estimate. A more basic definition which enables comparison of cost estimates has to do with facilities. In particular, the estimate should indicate whether or not the cost of the gas conditioning plant, gathering facilities, and field preparation is included in the total.

Below are three frequently mentioned project cost estimates:

September 1977 estimate
(1985 U.S. dollars, including AFUDC and a 5% contingency)

Alaskan Leg	$3.3 billion
Canadian Leg	4.7 "
Eastern Leg	1.4 "
Western Leg	.9 "
TOTAL	$10.3 billion

October 1979 estimate
(1979 U.S. dollars, including AFUDC, undefined contingency)

Alaskan Leg	$6.0 billion
Canadian Leg	5.7 "
Eastern Leg	1.5 "
Western Leg	.7 "
TOTAL	$13.9 billion

February 1980 estimate
(1985 U.S. dollars, including AFUDC and a 5% contingency except for the Alaskan Leg which is a 20% contingency)

Alaskan Leg	$7.5 billion
Canadian Leg	6.0 "
Lower 48 Legs	3.0 "
Conditioning Plant	3.5 "
Gathering Facilities	4.0 "
TOTAL	$24.0 billion

2. OVERRUN POOL

To enable the sale of debt to conventional lenders, analysts have proposed that a sizable overrun pool be established by the beneficiaries prior to construction. A 100% overrun pool for the Alaskan Leg, or $6 billion, is considered by some to be sufficient to satisfy rating agencies, lenders, and underwriters that the project would be completed. Such a commitment is beyond the resources of the sponsors. This concept, therefore, is designed to involve substantial producer participation.

3. COMPLETION GUARANTEES

Construction of the pipeline in Alaska is not subject to the predictability enjoyed by ordinary pipeline projects. Weather extremes, poor soil stability, and limited infrastructure take the project out of the bounds of proven engineering practices and force the risks into a category reserved

for projects such as the Trans-Alaskan oil pipeline (TAPS). Lender confidence is not enhanced by the TAPS precedent. The ultimate support for lenders would be an unrestricted completion guarantee. Existing legislative and regulatory decisions preclude a federal completion guarantee and also a consumer completion guarantee. The producers have said that they will not guarantee completion of the pipeline. The concept of an overrun pool (#2 above) attempts to provide a limited completion guarantee.

4. ANTITRUST

As expressed in the Decision, the producers are prohibited from equity ownership of the pipeline because of the potential for anticompetitive conduct. Authorship of the antitrust principles with respect to producer participation is claimed by the Department of Justice. Their objections to ownership were clarified in a November 1979 letter from Mr. Ky Ewing of the Antitrust Division of the Department of Justice, to Lynn Coleman, General Counsel for the Department of Energy:

> "In the case of the ANGTS, we believe that it may be possible to develop competitive safeguards that are consistent both with the concerns expressed in the DOJ Report and with the needs of the Prudhoe Bay producers for compensation and protection. In fashioning such safeguards, however, the Department would object to any form of participation by producers which permits producer-owners effectively to deny access to non-owners, or provides producer-owners with the ability to control capacity decisions when others are willing and able to provide the capital necessary for expansion."

The Department of Justice focuses on "access" and "expansion" decisions. The ability of an owner to deny access to the pipeline to other smaller or

future natural gas producers in the North Slope region would result in throughput below a competitive level. With limited throughput the nature of demand ensures that prices are maximized. Similarly, management decisions on system design and expansion have the same potential toward monopolization.

The Department of Justice is not ruling out equity participation by producers, but it is indicating that alternatives with safeguards against control in key management decisions must be found if the producers are to be owners.

The producers will not make the financing commitment required of them without control over design, construction, and other matters which protect their investment. Of equal interest to the producers is their desire to earn the equivalent of an equity rate of return on their funds.

The antitrust policy was drafted in 1977 and was based on the assumption that natural gas would be deregulated. With the Federal Energy Regulatory Commission continuing as regulator of the ANGTS, the threat of a natural monopoly is lessened. The discretion of the pipeline owners with respect to system design is limited by regulatory governance. The Department of Justice will evaluate any ownership agreement that is reached between the sponsors and producers. Their comments will address anticompetitive safeguards and consistency with the President's Decision. If the agreement satisfies the former, then recommendations could be expected with regard to modification of the latter.

One final area of potential antitrust concern is ownership of the gas conditioning plant. The Department of Justice's policies apply equally to design and control of that facility because of its influence on throughput. However, because the gas conditioning plant was not defined as a part of the ANGTS in the Decision, the legislative and regulatory framework is not applicable. In the current financing talks the producers are urging inclusion of the gas conditioning plant in the system. The success of that effort would be attended by the complete set of antitrust concerns which the Department of Justice applies to the pipeline.

5. GAS CONDITIONING

Alaskan natural gas is not suitable for pipeline transport until it is "conditioned". Gas conditioning involves removal of water, sulfur, hydrogen sulfide, oxygen, and carbon dioxide as well as compression and chilling of the gas stream prior to reaching the inlet of the pipeline system. The cost to construct a conditioning facility is estimated to be $3.5 billion with an additional 75¢ per million Btu to operate. Total conditioning costs would amount to $40 billion over the 20 year life of the project.

The magnitude of these costs insure their inclusion in the financial negotiations. Two questions must be settled: 1) who should be responsible for constructing and operating the conditioning plant, and 2) what operating costs, if any, should be passed along to the consumer.

Financial responsibility for construction and operation of the facility is

placed on the gas producers by the Decision and Federal Energy Regulatory Commission (FERC) Order No. 45, issued on August 24, 1979. That Order was stayed indefinitely by FERC at the request of the Department of Energy pending resolution of the financing issue. FERC's Order also held that the operating costs should not be borne by the consumer, but rather should be recovered by the producers under their wellhead ceiling price of $1.45 per mcf, a ceiling fixed by section 109(a)(4) of the Natural Gas Policy Act of 1978, Public Law 95-621.

The producers do not agree. They view the capital and operating costs of the conditioning plant as logical components of the overall system, both from a management and a technological standpoint. They maintain that the costs should become part of the tariff and receive "rolled in" pricing treatment.

The State of Alaska has indicated a strong interest in financing the conditioning plant provided the producers and the Department of Energy cooperate with State efforts to establish an in-state petrochemical industry.

6. ALASKA PARTICIPATION

In 1978 the sponsors asked the State of Alaska to support the project in the form of $1 billion in tax-exempt revenue bonds and $500 million in convertible debentures. The sponsors withdrew this proposal a year later when it became apparent that no consensus existed within the State on the best form for its financial commitment.

Currently the state is attempting to obtain options on gas liquids from the producers for use in an Alaska petrochemical industry. The state, through its lease agreements, has the ability to take a one-eighth royalty share of the gas stream in-kind. For development purposes it has been proposed that the state exchange its royalty share of methane, on a Btu basis, for gas liquids. Acquisition of options for additional quantities from the producers would be necessary to economically justify industrial investments by major petrochemical companies.

On February 4, 1980, the state solicited "letters of interest" from companies desiring to participate in development of an Alaska petrochemical complex. This is considered a first step toward demonstrating the feasibility of the state's goal. In financing negotiations for the pipeline all forms of participation by the state, including building the conditioning plant, are measured against realization of this economic goal. Some negotiators fear that the state's efforts could complicate or delay the project.

7. REGULATORY UNCERTAINTY

This broad term applies to issues awaiting final action by the Federal Energy Regulatory Commission and to the general perception that the Federal government at some future time is likely to alter "final" orders as conditions change. This possibility is disconcerting to lenders and investors. Future Commissions are not necessarily bound by current FERC orders unless the orders clearly indicate that they are meant to apply for the entire life of the project. Without locking-in FERC decisions, lenders

risk losing incentives which are now offered to attract investment.

Perfect shipper tracking of costs remains an elusive target which adds to lender uncertainty. The extent to which the shippers of gas will be able to track costs straight through to the end users in the event of service interruption is unknown. The obstacle to perfect tracking is the separation of regulatory authority between FERC and the state utility commissions. Lenders require approval by all regulatory authorities of shipper service agreements which guarantee debt service even when gas is not flowing through the system. Ultimately the issue may require clarification by the courts.

IV. FINANCING PROPOSALS

A. Baseline: Decision and Report, September 1977

Author: President Carter

Cost estimate for Alaskan Leg: $3.7 billion (excludes conditioning plant)

Capital Structure

Basic cost:	$ (in billions)	% of total cost	% of category
Equity			
Sponsors	.9	25	100
Producers	0.0	0	0
Debt			
Institutions	2.8	75	100
Producers	(provide debt guarantees)		

1. Cost estimate - This proposal is based on a total project cost of $10.3 billion.

2. Overrun pool - Provision of an overrun pool is not required, however, it is assumed to be the responsibility of the beneficiaries.

3. Completion guarantees - None are outlined for the beneficiaries, however, the consumers are specifically prohibited from providing a completion guarantee.

4. Antitrust - No producer equity participation is allowable under this proposal, eliminating antitrust conflict.

5. Gas conditioning - The producers would assume responsibility for the construction and operation of the conditioning plant.

6. Alaska participation - As a project beneficiary, the state's financial participation is encouraged.

7. Regulatory uncertainty/lender confidence - The proposal called for the reorganization of government to expedite permitting and enforcement. Such action was designed to increase confidence in the project by avoiding the governmental delays which were experienced in construction of the TAPS pipeline.

8. Requisite actions to implement -
   a. Steps must be taken to resolve the legal obstacles to perfect shipper tracking.

B. Producer Proposal, November 1979

Author: Exxon Company, U.S.A.

Cost estimate for Alaskan Leg: $10 billion (includes conditioning plant)

Capital Structure

Basic Cost:	$ (in billions)	% of total cost	% of category
Equity			
Sponsors	1.5	15	60
Producers	1.0	10	40
TOTAL	2.5	25	100
Debt			
Institutions	4.5	45	60
Producers	3.0	30	40
TOTAL	7.5	75	100

1. Cost estimate - This proposal is based on a total project cost of $19 billion, including the conditioning plant and AFUDC.

2. Overrun pool - Following reassessment of the project, the producers would have the option of purchasing a proportionate share of overrun costs. This would be on the same basis of a 40% share of equity and debt by the producers.

3. Completion guarantees - The producers would not provide a completion guarantee.

4. Antitrust - Exxon proposes 40% equity participation and a change in the partnership agreement to require a two-thirds vote on significant issues. The Department of Justice points out that the Exxon proposal confers on the producers "effective control ... despite the fact that they will contribute only 40 percent of the project's capital. It is this control to which the Department objects." (letter from Ky Ewing of the Department of Justice to Lynn Coleman, Department of Energy, November 1979).

5. Gas conditioning - The cost of constructing and operating the conditioning plant would be included in the cost of the entire system and recovered through the tariff.

6. Alaska participation - The role of the state is not specified.

7. Regulatory uncertainty/lender confidence - The producers have the credit strength to attract other lenders, but one analysis of the proposal concludes that it substitutes for conventional financing rather than supplementing it. Overrun support it lef uncertain. Lenders, therefore, would be left without any form of completion guarantee. In addition, FERC regulation would be complicated by includion of the conditioning plant in the project tariff.

8. Requisite actions to implement -
   a. The Department of Justice's objections to this proposal would have to be reconsidered.
   b. The Decision would need to be amended with respect to the project description and producer equity participation.
   c. FERC Order 45 would need to be abandoned or redrafted.
   d. The partnership agreement would need amendment and FERC approval.
   e. The question of perfect shipper tracking would have to be resolved.

C. "Fedline" Proposal, January 1980

Author: Martin Lipton, special consultant to the Department of Energy

Cost estimate for Alaskan Leg: $11 billion (includes conditioning plant and a 20% contingency reserve)

Capital Structure

Basic Cost	$ (in billions)	% of total cost	% of category
Equity			
Sponsors	(not applicable)	n/a	n/a
Producers	n/a	n/a	n/a
Debt			
Sponsors	n/a	n/a	n/a
Producers	11.0	100	100
Overrun Pool:			
Equity	n/a	n/a	n/a
Debt			
Producers	(not estimated)	n/e	20
Fedline Corporation	n/e	n/e	80
TOTAL			100

(Fedline Corporation, a government pipeline corporation composed of an 11 person board of directors, would issue bonds to the producers upon completion of the construction of the project in the amount of the total of the producers' basic and overrun investment. The bonds would not be Federally guaranteed. Title to the project would be conveyed to the Fedline Corporation. The producers could offer the bonds for sale in the public market. The Fedline Corporation could contract with the producers or pipeline companies for the operation of the project).

1. Cost estimate - The total system is estimated to cost $20 billion in this proposal, including the conditioning plant and AFUDC.

2. Overrun pool - Costs of the pool would be funded 20% by the producers and 80% by the Fedline Corporation. Fedline Corporation would fund its portion of the overrun through borrowing from the Treasury. Any overrun investment by the producers would be added to their basic $11 billion investment and receive the same debt service treatment (on the basis of a 20 year amortization rate).

3. Completion guarantees - Fedline Corporation would provide 80% of the overrun costs. The proposal does not specify a ceiling to the overrun pool.

4. Antitrust - Control of Fedline Corporation by the government-designated directors (only three would be producer-designated) would provide full assurance with respect to antitrust concerns arising from producer participation in construction of the project. Access and expansion decisions would not be controlled by the producers.

5. Gas conditioning - The capital expenses for the conditioning plant would be included in the project total. Both capital and operating costs would be recovered through the tariff.

6. Alaska participation - The Governor of the State of Alaska would designate two members of the Fedline Corporation board of directors. The state would have no role in financing.

7. Regulatory uncertainty/lender confidence - The producers would provide the $11 billion investment with completion assured by Fedline Corporation's participation in 80% of the overrun pool. The proposal also addresses perfect shipper tracking by expressly providing for it when authorizing the Fedline Corporation.

8. Requisite actions to implement -
   a. New legislation would have to be enacted which would incorporate: 1) expeditious permitting by Federal agencies, 2) the role of the Federal Inspector, 3) rolled-in pricing of Alaskan gas, and which would create: 1) the Fedline Corporation, 2) provide it with bonding authority, 3) include the conditioning plant in the project description, 4) provide for perfect tracking of

costs, and 4) extend the authority of the Federal Inspector to the state level with regard to expedited permitting.

b. The agreement on Principles with the Government of Canada would require renegotiation to reflect Federal participation.

D. "Double Overrun Pool" Proposal, February 1980

Author: Martin Lipton, special consultant to the Department of Energy

Cost estimate for Alaskan Leg: $11 billion (includes conditioning plant and a 20% contingency reserve)

Capital Structure

Basic Cost:	$ (in billions)	% of total cost	% of category
Equity			
Sponsors	1.9	18	70
Producers	.8	7	30
TOTAL	2.7	25	100
Debt			
Sponsors	0.0	0	0
Producers	8.25	75	100
TOTAL	8.25	75	100
First Overrun Pool:			
Equity			
Sponsors	.14	2.6	10
Producers	1.23	22.4	90
TOTAL	1.4	25.0	100
Debt			
Sponsors	.4	8	10
Producers	3.7	67	90
TOTAL	4.1	75	100
Second Overrun Pool:			
Equity	-	-	-
Debt			
Institutions (Federally guaranteed)	10.0	100	100

1. Cost estimate - The total system is estimated to cost $20 billion in this proposal, including the conditioning plant and AFUDC.

   In order to obtain a definitive cost estimate this proposal calls for a "Phase I" agreement: a commitment by the parties to an equal share of the engineering and design costs. Included in the Phase I agreement would be a description of the basic elements of a financing plan for Phase II, the construction phase. Phase II would be conditioned on Congress enacting the requisite legislation. Design expenditures in Phase I would become equity in the project.

2. Overrun pool - The sponsors and the producers would provide a $5.5 billion first overrun pool at a 10/90 participation ratio while maintaining the 25/75 equity to debt relationship. The Federal government would guarantee a second overrun pool of $10 billion which would not be used unless the basic cost and the first overrun pool (both basic and first overrun pool costs total $16.5 billion) had first been expended. The Federal government would assume no liability or responsibility for the first $16.5 billion. The Treasury would guarantee project bonds for the second overrun pool and these bonds would be repaid through the tariff.

3. Completion guarantees - The second overrun pool is of a magnitude to assure completion.

4. Antitrust - Equity participation in the basic cost is a 30/70 relationship between producers and sponsors, giving them that ratio of control in management. If the first overrun pool were committed entirely to the project, the ratio would become 50/50. In either case access and expansion decisions would be monitored by government-appointed directors on the Board of Partners.

5. Gas conditioning - The construction and operation of the conditioning plant would be included in the overral system and in the tariff.

6. Alaska participation - The state would be given the opportunity to participate in the financing of the project as a producer or otherwise. A deadline for a decision on participation by the state would be set.

7. Regulatory uncertainty/lender confidence - The producers would have the ultimate responsibility for securing all of the debt except the sponsors' 10% of the first overrun pool debt ($.4 billion). Therefore, if conventional debt lenders were not attracted to the project, the producers would provide funding. The question of perfect shipper tracking would be addressed and settled in the authorizing legislation.

8. Requisite actions to implement -
   a. New legislation would have to be enacted which would incorporate; 1) expeditious permitting by Federal agencies, 2) the role of the Federal Inspector, and 3) rolled-in pricing of Alaskan gas.

and which would authorize: 1) perfect shipper tracking, 2) Treasury bonds for the $10 billion second overrun pool, 3) Federal directors to monitor access and expansion decisions during construction and operation, 4) expansion of the Federal Inspector's authority to the state level with regard to expedited permitting, and 5) inclusion of the conditioning plant in the project description.

b. The Agreement on Principles with the Government of Canada would have to be renegotiated to reflect Federal participation.

E. ARCO Proposal, March 1980

Author: Atlantic Richfield Company

Cost estimate for Alaskan Leg: This proposal is limited to agreements on financing and managing the design and engineering phase of the project (Phase I) in order to provide a reliable cost estimate for the Alaskan Leg.

Capital Structure

The proposal does not recommend a financing plan for the construction phase of the project (Phase II). It does, however, convey the company's willingness to consider any financing issues during the time required to complete Phase I.

1. Cost estimate - The basis for the ARCO proposal is the need for a definitive cost estimate prior to any commitment to construction financing. Phase I costs are estimated to be as much as $500 million and would be shared by the producers and the sponsors on a 50/50 basis. Each producer would be entitled to a vote in design and engineering matters equal to its participation. Decisions of the partnership would be based on a two-thirds vote, except when decisions affecting access and expansion are considered. Such questions would be resolved by a majority vote. This arrangement requires agreement on the form of arbitration in the event of a deadlock.

2. Overrun pool - Briefly mentioned in the proposal is the company's willingness to consider financing a share of a limited overrun pool. This would apply to Phase II financing plans, and is therefore not covered in detail.

3. Completion guarantees - ARCO clearly states that it would not agree to provide a completion guarantee in Phase II. It also would not provide debt guarantees for other participants. ARCO's mention of participation in a limited overrun pool (#2 above) is the only suggestion resembling a liability for costs beyond the final estimate.

4. Antitrust - Although silent on participation in a Phase II financing plan, the extent to which the producers participate in Phase I costs does raise antitrust questions. The proposed agreement on access and expansion matters in Phase I would flag the attention of the Department of Justice. Although the question of whether the producers' Phase I costs will be turned into equity is not addressed in the proposal, that possibility will confer antitrust complications on the Phase I agreement.

   The proposal sets conditions under which parties to the agreement may withdraw from the partnership. One such condition is the failure of the agreement to overcome the antitrust restrictions detailed in the Decision. Such a failure could result from administrative, legislative, or judicial action.

5. Gas conditioning - One of the conditions which would permit withdrawal from the agreement by any party involves the gas conditioning plant. That condition allows the producers to discontinue capital contributions following governmental or judicial action which excludes the plant from the project. By definition the proposal includes both the pipeline and the conditioning facilities in the project.

6. Alaska participation - The State of Alaska is invited to participate in the Phase I agreement if it so desires.

7. Regulatory uncertainty/lender confidence - Regulation by FERC is complicated by inclusion of the conditioning facility in the project. Such a step would insure a delay as production-related costs are sorted and assigned between oil and gas, and between producers and transporters. Also, it is uncertain whether or not institutional lenders would be assured by the limited commitment to an overrun pool referred to in this proposal.

8. Requisite actions to implement -
   a. The antitrust objections of the Department of Justice would have to be addressed before Federal endorsement of a Phase I agreement would be possible.
   b. The Decision might have to be amended to allow participation of producers in the project, as well as broaden the definition of the "project" to include the conditioning facilities.
   c. Although Phase II is not detailed in this proposal, it assumes that in order to proceed FERC Order 45 would have to be modified with regard to conditioning costs.

V. TIME CONSIDERATIONS

Alarming interest rates coupled with an unprecedented inflation rate could have a severe negative effect on the economic viability of this project. Most interested parties agree that some form of financing arrangements must be made in the near future if the sponsors are going to be able to carry on with the project as provided in the 1977 Decision. If a financing arrangement appears to be beyond the capabilities of the sponsors, alternative methods of bringing about the construction of an Alaska natural gas transportation system will have to be considered in the not too distant future.