ALASKA GAS PIPELINE PERSPECTIVES: HISTORY, CURRENT PERCEPTIONS AND POTENTIAL FEDERAL INFLUENCE RELATED TO STATE FINANCIAL PARTICIPATION

- SUPPLEMENTAL MEMORANDA -

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JUNEAU, ALASKA

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MEMORANDUM

TO: Joint Interim Natural Gas Pipeline Committee

SUBJECT: TREASURY FOIA REQUEST.

Attached are additional materials provided to us by the U.S. Department of Treasury under our continuing Freedom of Information Act request for materials relating to the decision-making process on the Northwest Alaska Pipeline Project. The additional material released by the Treasury Department was provided to us in three separate groups of documents, each dealing with somewhat separate and distinct subject areas. The original Treasury groupings of this material have been maintained in the Appendix and each group of documents and its related subject area is discussed separately.

The initial group of documents released to us by Treasury (in addition to those materials contained and identified in the February 15, 1979 Preliminary Report) relate to the process by which Northwest/Alcan modified its original position on the question of private financing. Of greatest interest in this group of documents is the memorandum of August 10, 1977, from Mark J. Millard of Loeb, Rhoads to John G. McMillian of Northwest/Alcan. As indicated in this memorandum, Millard, as financial advisor to the project, was asked by the White House Task Force to consider the feasibility of private financing without a "consumer guarantee" prior to completion. As we noted in our Preliminary Report of February 15, the position of

all parties before the Federal Power Commission proceedings had been that a guarantee either in the form of federal participation or an all-events tariff (essentially a consumer guarantee) would be necessary if the project were to be financed. In the Preliminary Report we concluded that private financing was one of several major policy imperatives established by senior federal policymakers with respect to the pipeline project. The Millard memorandum, as well as other documents included in this group of Treasury releases, seems to make clear that a primary impetus for Northwest/Alcan's changed position with respect to private financing was from the federal government. As will be seen from subsequent documents released to us by Treasury, it was becoming increasingly clear by August of 1977 that the Alcan project was the preferred alternative among federal officials below the White House level -- thus, the White House Task Force request for an alternative private financing approach was, in our view, tantamount to telling Alcan that "if you can conceive of a private financing scheme, you will be selected as project sponsor."[1/] Not too surprisingly, Alcan and their financial advisors, in concert with federal officials, developed such an approach to private financing. Also of significance in this group of documents is a letter from Sterling Gallagher, former Commissioner of Revenue, to James Schlesinger, Secretary of the Department of Energy, dated August 19, 1977. In this letter Gallagher specifically states:

> It has come to my attention that the Alcan Pipeline Consortium stated in a letter dated August 10, 1977, that the State of Alaska would give the same financial support to Alcan it is presently giving to El Paso if Alcan were

1/ This quote is solely stylistic; it is not the quote of any government official.

> selected. This statement is not true because the 10th Alaska State Legislature passed a resolution authorizing the Administration to develop a plan to aid the All-Alaska Pipeline route.

The Gallagher letter goes on to state:

> I do not feel that I can discuss either with the Alcan Pipeline Company or with representatives of the Federal Energy Administration and the Department of Treasury possible State financial support for the Alcan route, without first obtaining legislative direction for that action. I am prepared to discuss financial support of the Alcan project with the Legislature, but must add that definitive action by the Legislature is not possible until sometime next year as the Alaska Legislature does not convene until the second week in January.

Gallagher's statement with respect to State policy on the question of financial support for Alcan seems clear. However, the incident did reflect a growing tendency within the federal government to assume State financial support for Alcan in the event El Paso were not selected, simply on the basis that the State had never stated that it would not provide such support. As will be pointed out subsequently, additional documents provided to us by the Treasury Department indicate that federal policymakers may have gone to some lengths to avoid having the State make such a denial, and that a reasonable inference can be drawn, that part of the federal strategy with respect to the gas line project was to essentially preempt the State into financial participation. In addition to this material, there is a copy of a letter from Sterling Gallager to Leslie J. Goldman, Federal Energy Administration (Goldman is now a senior advisor to Energy Secretary Schlesinger) on the subject of North Slope natural gas pricing and the relation of pricing decisions to the regulatory treatment of the gas conditioning plant. The remainder of the documents in the first Treasury release deal largely with

comments by the competing projects on the changes in Alcan's proposed financing approach.

The second group of documents released to us by the Treasury Department consists primarily of internal Treasury documents detailing the results of meetings with Alaska officials during the Spring and Summer of 1977. In addition, this material included staff notes made by Treasury officials during meetings with both El Paso and Alcan to discuss financial matters. The meeting with Alcan representatives is apparently the same meeting referred to in the Millard memorandum of August 10, 1977, at which time he was requested by members of the White House Task Force to posit assumptions under which the Alcan project could be privately financed. In the copy of the notes dealing with the Alcan meeting under the heading "Millard", there is a list of several items which are presumably Millard's responses to the Task Force inquiry. Item 2 of this list consists of the note: "State of Alaska same as El Paso offer". Whether this was considered a working assumption or a prerequisite for private financing is not clear from the material released.

The second Treasury release also contains records of three meetings with State officials. Two of the meetings are between Treasury representatives and former Revenue Commissioner Sterling Gallagher. The memorandum of April 13, 1977, is of particular interest because it indicates continued Treasury interest in encouraging State financial support for the Alcan project. The memorandum

of May 25, 1977, is also interesting in that it contains the following moderately bizarre statement:

> Mr. Gallagher is an elected official, akin to a "state treasurer".

The final memorandum relating to meetings with State officials is dated July 8, 1977, and is a briefing memorandum in preparation for a meeting with Senator Ted Stevens. In this memo, Treasury's interest in promoting a State offer of financial support for the Alcan project is again expressed (it should be noted that the underlining in the margin note on page 3 of the July 8, 1977 memorandum was made by Treasury personnel. In all cases where such marginal notations or supplied emphasis exists, they are part of the original documents).[2/]

The final document contained in the second Treasury release was a draft memorandum discussing the options facing the Treasury Department in preparing its confidential report to the President of July 20, 1977. There are some inferences about the contents of this report to the President which can be drawn from the Treasury releases; in our judgment there is very little prospect for obtaining a copy of the document itself, since it is our belief that such a communication to the President is clearly protected in the exemptions contained in the Freedom of Information Act.

2/ Other documents we inspected referred to a meeting at Treasury with former Lieutenant Governor Lowell Thomas, Jr., on or about February 28, 1977, Pursuant to our FOIA request, Treasury informed us that said meeting did occur but no notes were taken nor records kept.

The third group of documents released by Treasury deal generally with internal Treasury policy determinations with respect to natural gas pipeline financing. The first memorandum, chronologically, was written during July 1976, and contains little material of interest. Likewise, the memorandum of February 3, 1977, seems to be largely a recapitulation of Treasury positions already made clear in previous material. The memoranda of June 16, July 15 and July 19, 1977, all deal with the preparation of the confidential report to the President mentioned previously. It is from these memoranda that most inferences regarding the content of that report can probably be drawn. Of particular interest in our judgment are the draft memoranda to the President attached to the memorandum of July 19, 1977. On page 2 of the draft to the President, in the paragraph containing the material blanked out by Treasury, there is a reference to the role of the State of Alaska which we find quite interesting. Specifically, the paragraph states ". . . the State of Alaska (has) not yet made these maximum commitments. In this regard the Administration also should keep open the possibility of selecting either the El Paso or Alcan projects until the last minute." We believe it is not unreasonable to draw the inference that in the blanked-out material some reference is made to utilization of dangling the El Paso project in front of the State of Alaska until the last possible minute to avoid having the State make a blanket rejection of possible financing support for the Alcan project. This is an admittedly speculative comment, but again in our judgment, not unreasonable.

II.

MEMORANDUM

TO: Joint Interim Natural Gas Pipeline Committee

SUBJECT: ANALYSIS OF PROPOSED TREATMENT AND CONDITIONING REGULATIONS.

On February 2, 1979, the Federal Energy Regulatory Commission issued a notice of proposed rulemaking and a statement of policy with respect to the question of treatment and conditioning costs for Prudhoe Bay natural gas. The basic actions proposed by the Commission were:

1. Part II, Subchapter A of Chapter 1, Title 18, Code of Federal Regulations, would be amended by adding a new section, 2.101, which would read:

> Policy Respecting Consideration of Certain Certificates Applied for Pursuant to the Natural Gas Act and involving Gas to be Transported through the Alaska Natural Gas Transportation System.
>
> In any proceeding involving the approval of applications for Certificates of Public Convenience and Necessity, whether for the construction of the Alaska Natural Gas Transportation System or for the purchase or transportion of gas through that system it will be the general policy of the Commission, absent a showing that the public convenience and necessity would otherwise be served, that the purchase of natural gas from Prudhoe Bay, Alaska for transportation through the Alaska Natural Gas Transportation System would be processed gas which is capable of immediate entry into the transportation system; and therefore, the Commission will approve only those applications for certificates of public convenience and necessity which do not require the assumption by the applicant or subsequent purchaser of processing or other related costs save to the extent such costs are allowed pursuant to Commission action taken under Section 271.1106 of its Regulations.

2. Section 271.1100 of Subpart (k), Part 271 of Subchapter H of Chapter 1, Title 18, Code of Federal Regulations, would be amended in paragraph (b) to read as follows:

(b) Exclusions.

Sections 271.1104 and 271.1105 shall not apply to any natural gas produced from the Prudhoe Bay unit of Alaska and transported through the natural gas transportation system approved under the Alaska Natural Gas Transportation Act of 1976.

3. Section 271.1106 of Subpart (k), Part 271 of Subchapter H of Chapter 1, Title 18, Code of Federal Regulations, would be amended to read as follows:

Adjustments. Pursuant to Section 502(c) of the NGPA, any person may apply to the Commission for an adjustment on the grounds that the operation of Sections 271.1100(b) or 271.1105 results in special hardship, inequity or an unfair distribution of burdens to such person.

In essence the Commission's proposed policy, if adopted, would do two things: First, the Commission would adopt as a rebuttable presumption that the ceiling price for North Slope natural gas established in Section 109 of the Natural Gas Policy Act is inclusive of amounts required to process and condition such gas to pipeline quality standards; and second, the Commission would decline to consider prices higher than the Section 109 ceiling rate for Prudhoe Bay natural gas under the provisions of Section 110(a)(2). Instead, adjustments to the ceiling price for treatment and conditioning costs must be sought under the authority of Section 502(c) of the NGPA, which grants the Commission general authority to provide relief ". . . as may be necessary to prevent special hardship, inequity, or an unfair distribution of burdens."

Background To Commission Action

In its proposed rulemaking, the Commission concluded that the facilities necessary for processing and conditioning the natural gas at Prudhoe Bay should not be considered part of the Alaskan Natural Gas Transportation System as described in the Alaska Natural Gas Transportation Act. As authority for this position, the Commission cites the Decision and Report to Congress on the Alaska Natural Gas Transportation System: "the proposed Alcan pipeline will commence on the discharge side of the gas conditioning plant facilities in the Prudhoe Bay field." The Commission further cites the Decision as stating that the first compression station would be 75 miles downstream from the point of commencement of the system (i.e., after discharge from the treatment and conditioning plant), and thus it should be assumed that the gas would enter the system at such conditions of temperature and pressure as to allow it to be moved to the first compressor station without further action by the pipeline. Finally, the Commission cites a Decision reference to the revised Alcan filing at the Federal Power Commission of March 8, 1977, which specified and referenced specific processing standards for gas within the system (these standards were: 1% carbon dioxide by volume; 0.6% nitrogen by volume; 1138 BTU/cubic feet gross heating value; a hydrocarbon dewpoint of -10° Fahrenheit at 1000 PSI; a maximum water content of .02 lbs. per million cubic feet; a sulphide content of no more than 0.25 grains per one hundred cubic feet; and a total sulphur content of 10 grains per one hundred cubic feet).

Having made their case that the treatment conditioning facilities should not be considered a part of the pipeline system, the Commission addressed the question of allocating costs for conditioning between producers, the pipelines and consumers. The Commission again relied heavily on the authority of the Decision (which was, of course, issued prior to the enactment of the Natural Gas Policy Act) and cited discussion in the Decision of the discretionary nature of Commission authority to allow additional charges for treatment and conditioning costs. The Commission then pointed out that the actual establishment of Prudhoe Bay natural gas prices was contained in Section 109 of the Natural Gas Policy Act and that the question of allowing additional charges for "certain production related costs" was a discretionary matter for Commission determination as provided in Section 110 of the Act. It also indicated that the legislative history of the NGPA indicates that the exercise of this discretion should be in keeping with "prevailing industry practice". The Commission goes on to state its belief that because there is no history of production in Prudhoe Bay, and hence no contracts for natural gas sales upon which to base comparisons, the "prevailing industry practice" standard would not be appropriate for Prudhoe Bay. The broad rationale for this view by the Commission can be found at 43 F.R. 56493 in the Commission's introduction to the Interim Regulations of the Natural Gas Policy Act of 1978:

> Suffice it to say that the Commission believes that its authority under Section 110 of the NGPA is broad enough to make special provisions and exceptions as between regions if good cause can be found.

Further, the Commission concluded that it would be in the public interest for the producers to bear conditioning costs since forcing the pipeline to bear such costs might have adverse effects on the financibility of the project or marketability of gas to the consumer. Additionally, they found producer ownership and operation of the treatment facility would provide incentive for the producers to maximize deliveries to the Alaska Natural Gas Transportation System, and thus in a general sense, would constitute a partial throughput guarantee.

Response to the Commission Proposals

Not surprisingly, reaction by the producers to the proposed Commission treatment of conditioning costs has been highly negative. Basically, the producers' position has been that the Commission has no authority to prevent pipeline purchasers or transporters from assuming gas-related processing and conditioning costs. They further contend that the Commission's determination with respect to such allowances under Section 110 and its refusal to consider such allowances constituted abuse of discretion under the NGPA. In many respects, the producers' position represents the obverse of that taken by the Commission. Major contentions made by the parties to the proceeding include:

1. Conditioning costs have historically been a function of pipeline transportation.

2. The Commission did not include conditioning costs in establishing nationwide producer rates under the Natural Gas Act,

but instead permitted producers and purchasers to negotiate allocation of such costs between themselves.

3. Contrary to the Commission assumption, the Decision and Report to Congress on the Alaska Natural Gas Transportation System contemplated that the producers and pipeline companies would determine the appropriate allocation of conditioning costs on the basis of negotiation, and that the system would bear a portion of these costs.

4. The intent of the Natural Gas Policy Act was consistent with Commission practice (as asserted above) with respect to nationwide rates and that Commission authority to effect the allocation of gas-related processing and conditioning costs between producers and purchasers is limited.

Commission staff response to these contentions has been negative. The staff position is that processing and conditioning costs have historically been borne by the producer, and thus are production-related, rather than transportation-related charges. The staff also contends that the original Federal Power Commission proceedings with respect to nationwide area rates did in fact take into account the degree to which pipelines and producers bore costs related to treatment and conditioning activities. Thus, staff concludes that the formulation of just and reasonable rates under the areawide proceedings included processing and conditioning costs and that the general Commission policy has been to prevent pipeline purchasers who have borne such costs to pass them on to customers. Also, contrary to the producer view that the President's decision contemplated that conditioning costs attributable to the gas stream would

be allocated between producer and purchaser in the gas sales contracts and that the Commission would have no authority to effect such allocations, the staff asserts their belief that the decision contemplated Commission authority to determine such allocation. Thus, the staff supports the original Commission position that inclusion of additional charges for treatment and conditioning costs is a discretionary matter and that the Commission's determination to exclude such costs is proper absent a showing of hardship under Section 502(c).

The staff cites as additional authority the emphasis contained in the Decision that the capital costs for construction of the Alaska Natural Gas Transportation System should not "materially and unreasonably" exceed those cost estimates filed by Alcan in March of 1977. The staff reasons that inclusion of all treatment and conditioning costs might, in fact, result in such "materially and unreasonably" excessive costs, and therefore, as a matter of policy, they should not be allowable over and above the ceiling price, again absent 502(c) relief.

As a corollary to their contention that the NGPA allows the question of treatment and conditioning costs to be permissively negotiated between producer and pipeline interests, the producers have contended that it was the intent of Congress that the NGPA be the sole source of authority governing the regulatory treatment of production-related costs. Following the producer theory that treatment and conditioning costs are allocable between producer and purchaser on the basis of negotiation, and further, that the

Commission has no authority to control such allocations, they reason that Section 601(c) is therefore applicable. This section provides that prices determined under the Natural Gas Policy Act may not be denied Section 7 certification under the Natural Gas Act and are necessarily "just and reasonable prices". In support of this theory the producers cite the following from the Senate debate on the NGPA:

> Senator Gravel: Senator, I infer that the permissive nature of the Commission's power to provide by rule or order, an allowance in excess of the maximum lawful price for any costs of gas conditioning borne by the seller beyond the wellhead does not preclude a purchaser from acquiring natural gas at the wellhead, paying the maximum lawful price at that point.
>
> Senator Jackson: The Senator is correct.

The staff response to this contention is, that while the NGPA does not prevent a sale at the wellhead as described in the colloquy outlined above, additional Commission authority and responsibility exist under the Alaska Natural Gas Transportation Act, the President's Decision, and the Natural Gas Act. The staff theory is the conflicting authority and responsibility conferred by these acts and the Decision can only be resolved by interpretation of the legislative intent of all relevant statutes pertaining to Prudhoe Bay natural gas. Following this line of reasoning, the staff returns to the Decision and the ANGTA to conclude that the additional authority contained in these acts and actions and the intents surrounding them provides the authority to preclude such sales at the wellhead, and that the NGPA should not be considered as the sole basis for such a determination.

Both the producers and the State of Alaska contend the establishment of a different standard for allowance for production-

related costs under Section 110 of the NGPA for Prudhoe Bay gas than that existing for Lower 48 natural gas is discriminatory and not in keeping with the "prevailing industry practice" standard. As noted previously, the Commission is construing its authority to make such distinctions broadly and the staff supports, in general, this approach. The staff again relies to some extent on authority beyond the NGPA to demonstrate the case for such "special" treatment for Prudhoe Bay gas. They also argue that no disincentive to additional natural gas development in Alaska exists because the proposed policy statement and restrictions with respect to Section 110 allowances are made solely with regard to the Prudhoe Bay unit and not Alaska generally. The only major area in which staff differs from the original Commission proposals is their conclusion that while promulgation of a rule under Section 110 prior to the execution of gas sales contracts is not unlawful, the Commission should consider whether any allowances should, in fact, be made on a factual basis, rather than relying solely on their interpretation of the intent of the President's decision.

To the extent that the Commission wishes to consider any allowances for extraordinary cause, the staff cites allowance for removal of carbon dioxide from three percent to one percent, refrigeration costs and possibly inclusion of some compression costs, reflecting the 75 mile distance between the processing facility outlet and the first jurisdictional compressor station.

Submissions by the Justice Department suggested that if the producers owned the conditioning facility and it were to be treated

as a non-jurisdictional production-related facility, the possibility would exist that the producers could exercise monopoly power over North Slope gas. The producers have cited this point by the Justice Department, while denying that any anti-competitive effects would in fact occur, as a point in their favor. The staff, however, rebuts the Justice Department's comments by indicating their belief that in the event significant new gas reserves are discovered on the North Slope, additional conditioning facilities will be provided and will in fact be, to some degree, required at or near the location of any new discoveries. They further cite the Ralph M. Parson's Company study on the conditioning facilities as evidence that the proposed construction design of the plant provides no economic incentive to further concentrate treatment facilities within the Prudhoe Bay unit due to the modular design of the proposed facility. Thus, staff concludes that the department's fear of the possible monopoly power by the North Slope producers is overstated.

Impact on the Pipeline Project

The issues raised in the instant proceedings are extremely complex, and the outcome of regulatory and judicial review on any of the discrete questions raised is highly uncertain. Nonetheless, we believe the following general comments are appropriate:

1. The Commission, as a matter of policy, seems determined to pursue a theory of its responsibilities with respect to Prudhoe

Bay natural gas that most broadly define its regulatory authority. While the factual basis of the current proceeding has to do with treatment and conditioning costs, it is significant to note the general tenor of the Commission's position: that decisions under the NGPA will be made on the narrowest grounds available in terms of that Act, and where any possible question exists as to the statutory language or the intent of Congress with respect to that language, the Commission will rely on its broader authority under the Natural Gas Act or other statutes.

2. The Commission seems determined to greatly restrict, and very possibly eliminate, any extra charges above the Section 109 ceiling rate for Prudhoe Bay natural gas.

3. The producers seem equally determined to exclude such costs from the ceiling rate, and perhaps more importantly, oppose the Commission's assertion that the NGPA should be construed narrowly and that residual or uncertain questions should be determined in accordance with the Natural Gas Act or the ANGTA. Clearly, the question of treatment and conditioning in Prudhoe Bay are of major significance to the producers. It may be, however, that the general policy questions surrounding the Commission's assertions of authority and interpretation of the statute may prove to be more important to the producers and their current and prospective activities than the particular issue at hand.

4. To the extent that the producers are concerned about the policy implications of the Commission position, the result of the current proceedings will almost certainly be protracted litigation

regarding the proper interpretation of authorities granted under the NGPA and their relationship with preexisting statutes.

5. There is some sentiment at the FERC that the producers may not wish to litigate these issues extensively because such action would portray them as obstructionists in terms of the pipeline project and because such delays would result in uneconomic reinjection costs over the long term. To the extent, however, that the producers view litigation regarding these questions as important policy matters relating to activities beyond the Prudhoe Bay unit, this assumption may be faulty.

6. In the event that the question is extensively litigated, the Commission may find itself in a difficult position to the extent that it is attempting to carefully define the conditioning and treatment facility as being not a part of the Alaska Natural Gas Transportation System and, thus, a production-related facility. To the extent that the Commission is successful in so defining the facility, they will remove any litigation farther from the expedited judicial review proceeding provided for in the Alaska Natural Gas Transportation Act. On the one hand, the producers contend that Commission action is inappropriate and taken narrowly under the NGPA; on the other, the Commission purports to act both within the NGPA as well as under the ANGTA and the Natural Gas Act. It is not clear under which theory the question of jurisdiction would fall, and the question of whether judicial review should be via normal proceedings or via the expedited processes enumerated in the Alaska Natural Gas Transportation Act, in our judgment, is likely to be subject to separate litigation.

Concern over this point is reflected by statements by both Northwest Pipeline and Foothills that the Commission make a finding that the actions taken in this proceeding are made pursuant to Section 9 of the ANGTA (which section contains the expedited review procedures).

The recently concluded contract between Exxon and Pacific Gas and Electric Company seems to indicate the willingness of at least one producer to oppose the FERC position directly, by adding treatment costs on top of Section 109 ceilings. Simultaneously, we have seen no signs to date that the FERC is willing to modify its position on treatment conditioning costs to the satisfaction of the producers. While predicting the outcome of any regulatory proceeding is always hazardous, we see little prospect in the current dispute other than extended litigation. To the extent that this is the case, neither gas sales contracts nor financial commitments to the pipeline project can be finalized.

III.

MEMORANDUM

TO: Joint Interim Natural Gas Pipeline Committee

SUBJECT: ANALYSIS OF THE IMPACT THAT THE RECENT SUPREME COURT DECISION IN THE SHELL V. FERC CASE WILL HAVE ON FEDERAL LEVERAGE OVER ALASKA

On February 22, 1979, the United States Supreme Court issued a per curiam opinion in Federal Energy Regulatory Commission v. Shell Oil Company, et al, Supreme Court Docket No. 77-1652. The opinion stated that the Supreme Court split four to four, thereby affirming a lower court decision handed down by the Fifth Circuit of the United States Court of Appeals on January 20, 1978.[1/] Since the United States Supreme Court does not release the names of the judges who voted on each side of a per curiam decision (Justice Powell had disqualified himself on this opinion), it is impossible to determine the positions taken by individual justices.

Clearly, an equally divided Court breeds both hope and fear for proponents on either side of the issues presented in Shell v. FERC. The replacement of a justice or a change of heart could yield a determination in a similar case favorable or unfavorable to the interests of the State of Alaska regarding its long term control over North Slope

1/ Shell Oil Company v. Federal Energy Regulatory Commission, 566 F.2d 536 (5th Cir. 1978).

royalty gas. We will examine below the background of this case, the issues presented, and their relevance to the State of Alaska's interests. We will also discuss the impact Shell v. FERC may have vis-a-vis federal leverage over Alaska in the future.

BACKGROUND

The Natural Gas Act, 15 U.S.C. 717 et seq., contains certain provisions which limit the control of the federal government over natural gas and reserves certain powers to the states. For example, 15 U.S.C. 717b states that "the provisions of this Act . . . shall not apply . . . to the production or gathering of natural gas". Furthermore, the statutory language in Section 7b of the Natural Gas Act, 15 U.S.C. 717f(b), appears not to apply jurisdiction over abandonments to states by providing only that "no natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of services is unwarranted, or that the present or future public convenience or necessity permit such abandonment." (Emphasis added). The courts have defined states as not falling within the category of "natural-gas company".

Like many federal agencies, particularly regulatory agencies, the Federal Power Commission and its successor, the Federal Energy Regulatory Commission, have in recent years made efforts to expand their authority through liberal interpretation of their enabling statutes. FERC has focused on the problems created by excess intrastate gas and shortages of interstate gas and has attempted to claim the power to compel producers to sell natural gas interstate and to maintain the levels of existing interstate sales. It is from this policy and enforcement effort made by FERC that the Shell v. FERC case arises and, in turn, the potential problems proposed to the State of Alaska with regard to its royalty share of gas to be transported by the Alaska Natural Gas Transportation System.

The Shell v. FERC saga commenced on October 14, 1975, when the Commission issued Order 539, which was later reissued as Order 539-A, and on July 30, 1976, as Final Order 539-B. The essence of the 539 Orders can be summed up in the following principles: (1) Once a natural gas producer commences sales that are jurisdictional under the Natural Gas Act, that producer agrees to an obligation to continue delivery of certain volumes of gas to the interstate market; (2) once the producer accepts the delivery obligation, he can diminish or terminate interstate deliveries only subsequent to Commission approval; (3) delivery contracts do not circumscribe the delivery obligations, rather the obligation must be considered an implied condition to service the interstate market and that implied condition may go well beyond the

requirements of the contract; (4) finally, FERC has the authority to enforce delivery obligations. It should be noted that Final Order 539-B added that the "prudent operator standard" was to be used to determine delivery obligation compliance.

Needless to say, 539 created shock waves throughout the natural gas industry. It presented a substantial outreach of federal regulatory authority into pre-existing contractural agreements, as well as into the production and gathering arena formerly not considered to be under the Natural Gas Act.

Natural gas producers petitioned the Fifth Circuit for a review of FERC's order, requesting a ruling that the Natural Gas Act excluded FERC from jurisdiction over "the production and gathering of natural gas" and that FERC could not use its power to issue certificates to extend its jurisdiction into the excluded areas. On January 20, 1978, the Fifth Circuit vacated and remanded the FERC opinion. The Court's basic finding was that Section 1(b) of the Natural Gas Act excluded federal jurisdiction over production and gathering, so FERC Order 539-B was without legal foundation.

The Court differentiated between FERC's admitted jurisdiction over activities classified as "sales or transportation" and activities such as "production or gathering" over which FERC's jurisdiction is precluded by statute. The Court does state that "Through the years, the 'production or gathering of natural gas' exemption has been judicially narrowed."

Id. at 539. Citing the Rayne Field case,[2/] the Fifth Circuit stated that the U.S. Supreme Court has determined that "The 'production or gathering' exemption relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to the Commission's jurisdiction." Id. 381 U.S. at 403, 85 S.Ct. at 1523. By retaining the distinction between production and gathering versus sales and transportation, the Natural Gas Act is "in no way interfering with State regulatory power over the physical processes of production or gathering in furtherance of conservation or other legitimate State concerns." Id. U.S. at 403, 85 S.Ct. at 1523.

The Fifth Circuit did, however, opine that FERC can enforce "service obligations" contained in the certificates that it issues to producers, preventing producers from ceasing deliveries from fields admittedly capable of continuing production. While this authority exists, the Court stated that "no case has been found, however, that extends FERC jurisdiction directly into physical activities, processes, and facilities of production and development. The cases recognizing the broad scope of FERC's authority have nonetheless also recognized the 'production and gathering' exclusion." Shell v. FERC at 540. The Court goes on to state that production means the act of bringing gas from the earth and

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2/ United Gas Improvement Co. v. Continental Oil Co. (Rayne Field), 381 U.S. 392, 85 S.Ct. 1517 (1965).

gathering means the act of collecting gas after it has been brought forth. It states that Order No. 539-B "clearly is intended to open the door to FERC involvement into forbidden production activities". Id. at 540. FERC's order does so by applying the "prudent operator" standard which encompasses obligations to develop the properties consistent with what a reasonably prudent producer would do with respect to drilling completion, workover, recompletion or abandonment of wells. The Court concludes that to hold this power within the jurisdiction of FERC would all but eliminate the production and gathering exclusion and would allow FERC to encroach in areas reserved to the states.

ANALYSIS

The importance of Shell v. FERC to the State of Alaska revolves around the extent Order 539-B ousts the State from controlling the natural gas reserves within its borders, and particularly the Prudhoe Bay royalty gas. The most obvious problem that may occur is federal interference with the state's ability to withdraw some or all of its royalty gas from the Northwest Pipeline at some future date. Specifically, the controversy may pit the guarantees provided in Section 13(b) of the Alaska Natural Gas Transportation System Act, 15 U.S.C. 719k(b), versus federal natural gas law as interpreted and administered by FERC and the courts, the "emergency" provisions of the 1978 Natural Gas Policy Act (Sections 301 through 303 of Public Law 95-621), and any natural gas legislation to be passed in the future that may be used to mitigate the guarantees found in ANGTSA.

The revolutionary changes in natural gas law in the last few years have run roughshod over the traditional balance of state and federal control over of natural gas regulation. The pendulum has swung dramatically toward federal regulation and away from state regulation. While there have been some departures, such as Section 13(b) of ANGTSA and the Fifth Circuit decision in Shell v. FERC, the direction is quite pronounced toward near federal preemption of the field. The implications for the Northwest Pipeline and Alaska's royalty share are substantial. Because the volume of gas is so great and the service area covers so many states, any attempt to withdraw state gas from the pipeline will be noticeable and effect a large constituency. Anyone harmed by a proposed withdrawal of royalty gas may be expected to raise great opposition and cause the federal government and/or their states to make every effort to avert the diminution or termination of supply.

What is frightening about the Supreme Court decision in Shell v. FERC is that it was not a resounding affirmation of the Fifth Circuit. The 539 Opinions on their face, as well as subsequent to the Fifth Circuit's analysis, appear blatantly beyond the dictates of statutory natural gas law. Yet, the United States Supreme Court almost ruled that the Federal Energy Regulatory Commission could extend its powers well beyond its apparent authority. It seems clear from other recent natural gas decisions that the protections guaranteed states by existing law are in no way sacrosanct. The precedent of such decisions should make the State of Alaska

question its ability to securely rely on the guarantees of the Alaska Natural Gas Transportation Act. Action such as the Supreme Court's 4-4 vote indicate that 13(b) of ANGTSA is outside the mainstream of natural gas regulatory policy and is an exception that many constituencies will try to erase should it be used to their detriment.

We call your attention to a very significant decision issued on January 11, 1979 by the U.S. Court of Appeals, Fifth Circuit, dealing with state royalty interests in natural gas and the ability of states to divert their royalty gas to intrastate markets after taking their natural gas royalties in money while it was sold interstate. The case in question is Public Service Co. of North Carolina Inc., et al. v. FERC, 587 F.2d 716 (1979). In this case, the State of Alaska was one of three states who intervened. The issue of section 13(b) of the Alaska Natural Gas Transportation Act was to some extent raised. 3/

3/ The precise language of Section 13(b) of ANGTSA is as follows:

> The State of Alaska is authorized to ship its royalty gas on the approved transportation system for use within Alaska and, to the extent its contracts for the sale of royalty gas so provide, to withdraw such gas from the interstate market for use within Alaska; the Federal Power Commission shall issue all authorizations necessary to effectuate such shipment and withdrawal subject to review by the Commission only of the justness and reasonableness of the rate charged for such transportation.

The Public Service deals with the basic question of whether a state, which is not a "natural gas company" under the Natural Gas Act, may nevertheless be made subject to the abandonment provisions of Section 7b of the Act. The court concluded that where the state has consented to the interstate dedication of its gas, the state must obtain FERC approval prior to abandoning the certificated service. The court's decision is particularly significant since FERC has made quite clear in a series of decisions that abandonment authorization will rarely, if ever, be granted.

In the Public Service case, gas was extracted under lease from state owned land and the state in question retained a royalty interest that could be taken for value or in kind. For several years, the state received its royalty share in money and then elected to take in kind. Upon learning of this contemplated change, the Commission informed the parties that the royalty gas could not be diverted from the interstate market without prior abandonment authorization from FERC. Public Service petitioned FERC for an order declaring that FERC had no jurisdiction to require abandonment authorization because the state was not a natural gas company. FERC determined that the reserves were dedicated to interstate commerce, that the state did not object to this course of business, and that "once dedicated, the reserves remain dedicated and this is the result distinct from the underlying contractual arrangement."

The Petitioners main contention on appeal to the Fifth Circuit was based on their not being a natural gas company. The Court cited the 1978 U.S. Supreme Court decision in California v. Southland Royalty Company, 436 U.S. 519, 98 S.Ct. 1955, leading it to the conclusion that an entity's status as a natural gas company is largely irrevelant to the question of whether that entity must seek abandonment authorization. The Court interprets Southland to establish the principle that "any party, whether a natural gas company or not, that acquiesces in the 'dedication' of its gas to interstate commerce becomes obligated to continue the dedicated service or seek Commission approval to abandon it." Id at 719.

The Fifth Circuit goes on to further quote the Supreme Court in Southland stating that the issuance by the Commission of a certificate to sell gas interstate "created a federal obligation to serve the interstate market until abandonment has been obtained. The Commission reasonably concluded that under the statute the obligation to continue service attached to the gas, not as a matter of contract but as a matter of law." Southland, at 526, 98 S.Ct. at 1959. The Court concluded that once this gas was so dedicated, the owners could not divert it from interstate commerce without first seeking Commission authorization under 7b of the Act.

Were it not for ANGTSA, it would be quite clear that dedication of Alaska's North Slope royalty gas to the Northwest Pipeline (the interstate market) would deny the state its ability to regain control of its royalty gas without FERC

approval. In fact, the criteria the Court uses--that it is the dedication of the gas that creates the service obligation, and that convergence of three factors: (1) interstate transmission by a natural gas company, (2) commission certification, and (3) the State's acquiescence in No. 1 and No. 2, gives rise to a continued service obligation"[4/] --would all but exclude any hope Alaska would have of regaining its royalty gas were it not for 13(b). These criteria almost certainly will be used by any opponent who seeks to circumvent the 13(b) guarantees and void any efforts Alaska makes to withdraw its royalty gas from the Northwest Pipeline.

The public service case in a footnote discusses Section 13(b). It states that intervenor New Mexico contended that FERC violated the "equal footing doctrine" in light of Section 13(b) by requiring more of other states than Alaska. This argument was not raised on appeal and the Fifth Circuit did not decide it. But one of the parties did rely on 13(b) as an indication of Congressional policy favoring the right of all states to dispose freely of their royalty gas. (see footnote number 14 in Public Service). The Fifth Circuit made the following statement regarding ANGTSA: "From our reading of the Alaska Natural Gas Transportation Act and its legislative history, we do not find sufficient support for

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4/ Public Service at 720.

this interpretation that goes beyond the clear language of the statute." The Court's statement seems to indicate that it is not challenging the efficacy of 13(b), but it is limiting it to Prudhoe Bay gas only. This Court dicta is probably to Alaska's benefit although it would hard to call it authoritative.

LEVERAGE

The essence of the Shell v. FERC Supreme Court decision and the direction that natural gas regulation has taken is to isolate Section 13(b) of ANGTSA. It is the exception to the rule, a sore thumb that is sure to gain attention and much opposition should it be utilized. Should Alaska attempt to diminish the amount of royalty gas pumped into the Northwest line, thereby disadvantaging a large number of states in Northwest's service area, it will almost surely run into Congressional as well as administrative opposition. This opposition will seek to bring Alaska into line by finding a means of eliminating the guarantees provided in Section 13(b) and making Alaska adhere to the same royalty gas rules as all other states.

This may be achieved in several ways. The most obvious is to repeal 13(b) or to pass subseqent legislation that negates its impact. This may have already happened, if one interprets the "emergency" provisions in the Natural Gas Policy Act as ones that the federal government can use to force Alaskan royalty gas into a continued supply obligation to the interstate market. In all likelihood, diversion of so substantial an amount of gas as one-eighth of the daily Northwest throughput would create shortages in select areas

that could be termed "emergencies" and FERC could seek to gain control over Alaska's royalty gas pursuant to the Natural Gas Policy Act provisions. Needless to say, future legislation may also contain provisions that may be interpreted by FERC as giving them authority to override 13(b) of ANCSA. Unfortunately, courts may focus on Congress' most recent legislative actions to interpret Congressional intent regarding North Slope gas, so future legislation may well take precedence over 13(b).

A second element of leverage that Shell v. FERC creates is the uncertainty that Alaska must confront regarding receiving relief from the U.S. Supreme Court should the State have its 13(b) rights challenged at some future date. The Court's action in Shell v. FERC, as well as FERC's liberal interpretation of the Natural Gas Act in recent years and many of the court decisions in FERC's favor, make all existing statutory law that does not comport with federal policy fair game and vulnerable to challenge. Alaska's ability to control its royalty gas to a degree not available to any other state is not within the framework of national natural gas policy. It must therefore be considered a target.

What the state may want to consider is a stragegy that reduces the federal government's ability to threaten state control of its royalty gas. Most obviously, the state can continue to intervene in litigation as it did in the Public Service case to protect its ANGTSA guarantees. Secondly,

the state Congressional delegation can continue to work toward protection of 13(b). Third, the state should consider whether there is any possibility of avoiding ever dedicating any of its royalty gas to the interstate market. Unfortunately, there is no market in-state to use Alaska's 1/8 share of the North Slope natural gas in the foreseeable future. Whether the royalty could be taken in gas liquids and a market for those gas liquids be found in-state is also uncertain. By never dedicating North Slope royalty gas to the interstate market, the state will be taking its safest and surest path to forever protecting its sovereignty over the 1/8 royalty share.

MEMORANDUM

TO: Joint Interim Natural Gas Pipeline Committee

SUBJECT: STATUS OF NGPA REGULATIONS.

The following is a general description of FERC regulatory activities with respect to implementation of the Natural Gas Policy Act of 1978, specifically in those areas which were identified in the Preliminary Report of February 15, 1979, as being of particular concern in terms of possible federal leverage over the State and its financial participation in the gas pipeline project.

Wellhead Pricing

As noted in the February 15, 1979 Report, we believe Sections 110 and 208 contain the most significant language regarding leverage over the State. Section 110 deals with allowing State severance taxes and certain production-related costs over and above Section 109 ceilings; the discussion of the issues surrounding production-related costs is detailed in the section of this Report dealing with the Commission's rulemaking on these specific matters. As stated in that section, the conflict between the interests of the Commission and those of the natural gas producers are so significant that they probably outweigh the possible use of Section 110 as a source of leverage against the State. As also noted in the section of this report dealing with issues relating to the Trudeau/Carter meeting of March 3, 1979, there is strong pressure

on the Commission to expedite regulatory matters relating to the pipeline, and thus we doubt the Commission leverage would likely be exerted in ways which might result in further delay to the project. Regulations relating to treatment of State severance taxes are contained in Subpart (k) of Sections 271.1100-271.1103. These sections largely incorporate the provisions of the NGPA virtually verbatim, and in our analysis are not subject to interpretations that would be immediately injurious to State interests.

It is not impossible, however, that the FERC could follow the same line of reasoning it is currently pursuing with respect to Section 110 treatment of production-related costs in terms of some future State action on severance taxes. While the addition of State severance taxes to the applicable ceiling price is not discretionary in Section 110, there is a requirement that such application must be equally applied to gas sold intrastate as well as gas sold in interstate commerce. Since construction of Alaska statutes on severance taxation has often focused upon ways to allocate relative tax levels between high production areas (typically Prudhoe Bay) and low production areas (typically Cook Inlet), it is not inconceivable that the Commission might view such tax treatment as de facto taxation of interstate natural gas at higher levels than that imposed upon intrastate sources. While this is admittedly speculative, the material contained in the section discussing the treatment and conditioning facilities at Prudhoe Bay should make it clear that FERC is no stranger to tortured regulatory construction. Hence, the current interim regulations which are in effect with

respect to State severance taxes should not necessarily be considered the Commission's final word on the subject.

Another area of concern cited in the February 15 Report was Section 208 of the Natural Gas Policy Act dealing with incremental pricing policy for North Slope natural gas. No proposed or interim regulations for Title II of the NGPA (containing the incremental pricing provisions of the Act generally) have been issued since the Act provides that the Commission has until November 9, 1979 to promulgate such regulations. However, two alternative staff proposals dealing generally with the major issues facing incremental pricing were issued on January 31, 1979 (44 F.R. 6134-6140). Staff comments with respect to Alaska natural gas in this material were as follows:

> h. Alaska Natural Gas Transportation System.
>
> In the case of natural gas produced from the Prudhoe Bay unit of Alaska (as defined in Section II of the NGPA) and transported through the Natural Gas Transportation System approved under the Alaska Natural Gas Transportation Act of 1976, the following amounts shall be subject to incremental pricing:
>
> (1) Any portion of the first sale acquisition cost of natural gas which is not described in (2) below and which exceeds the maximum lawful price, per million btu's, computed under Section 109 of the NGPA (relating to other categories of natural gas) for the month in which delivery of such natural gas occurs without regard to Section 110 of the NGPA; and
>
> (2) Any amount paid to any person (other than the producer of such natural gas or an affiliate of such producer) for, or attributable to, any compressing, gathering, processing, treat-

> ing, liquifying, or transporting such natural gas, or any similar service provided with respect to such natural gas, before the delivery of such natural gas to such system.

This language seems to say that to the extent conditioning and treatment costs are borne by a third party or a pipeline company, such costs would be incrementally priced. In the Commission's statements with respect to treatment and conditioning costs for Prudhoe Bay natural gas under RM 79-19, reference was made to the possibility that third parties might be engaged to process and treat the natural gas at Prudhoe Bay. The Commission indicated its intent to view any such third party arrangements very closely in terms of their announced policy of not permitting the aggregate price paid for such Prudhoe Bay natural gas to exceed the Section 109 ceiling rate.

Section 505 of the Natural Gas Policy Act was also cited in the Act as a potential source of federal leverage over the State. Section 505(a)(1) empowers the Secretary of Energy to intervene as a matter of right in any proceeding relating to the proration of, or other limitations upon, natural gas production which is conducted by any state agency having regulatory jurisdiction over the production of natural gas. To our knowledge, no regulations have been promulgated with respect to this Section, and our concern over its possible effect on State policy alternatives remains.

Also noted in the February 15 Report were emergency authorities contained in Title III of the Act, especially Sections 301-303. Again, to our knowledge no regulations with respect to this portion of the Act have been issued. FERC has, however, promulgated regulations covering Section 311 regarding transportation of natural

gas by interstate pipeline companies on behalf of intrastate pipeline and local distribution companies and the transportation by intrastate pipeline companies on behalf of any interstate pipeline or local distribution companies. Regulations covering these matters are contained in the final interim regulations issued by the Commission on December 1, 1978 (43 F.R. 56623, et seq.). The final area under the NGPA which was noted as being of interest to the State were those areas where significant regulatory responsibilities were delegated to State agencies. In general these provisions are contained in Title V of the NGPA, specifically Section 501-503. In general, regulations pertaining to this portion of the Act remain as they were in the final interim regulations of December 1, 1978 (43 F.R. 56586-56608). In addition, FERC has exercised its authority under Section 501(a) to delegate certain 503 agency determination review functions to the Office of Pipeline and Producer Regulation (44 F.R. 20077). Also, FERC has issued proposed rules covering only the Commission under Section 502(c) (44 F.R. 18961-18966). This Section establishes the special relief provisions which, as noted elsewhere in this report, are the proposed avenue of relief for Prudhoe Bay producers for Commission determinations with respect to treatment conditioning costs.

V.

MEMORANDUM

TO: Joint Interim Natural Gas Pipeline Committee

SUBJECT: RESULTS OF CARTER/TRUDEAU MEETING

The March 3, 1979 meeting between Prime Minister Pierre Trudeau of Canada and President Carter resulted in a strong reaffirmation of U.S. support for the Northwest Alaska Natural Gas Pipeline System. At that meeting our research indicates that three major areas were discussed:

1. Canadian perceptions that U.S. consideration of the project were proceeding at too slow apace.

2. Discussion of joint U.S. and Canadian interests involved in selection of an east-west oil pipeline to serve U.S. northern tier markets.

3. Establishment of a sub-Cabinet working group to coordinate these and other major energy issues of joint interest to the two countries, including questions of oil supply, exchanges of oil, strategic petroleum reserves, utilization of surplus Canadian refinery capacity, electricity exchanges, and questions regarding liquified or synthetic natural gas exports to the United States.

With respect to the Alaska Natural Gas Pipeline, we have been informed that Trudeau was highly critical of U.S. handling of the project. He presented the Canadian view that U.S. inaction and regulatory delay had resulted in the two national sections of the project becoming badly out of phase with the result that costs were rising and the project as a whole was becoming endangered. He

reiterated the Canadian position that "bubble gas" from Alberta would be available to northern tier states and should be an important factor in American support for the project. Finally, he indicated that his Government's cooperation on this issue, including moving forward with authorizations for the gas necessary to support the pre-build sections of the pipeline in Lower-48 areas of the United States, involves some political risks in view of the upcoming Canadian elections. This point was reportedly placed in the context of the extent to which Canadian energy decisions are affected to some degree by nationalist sentiments in Canada, and that appearances of U.S. inaction could give the impression that the Canadians had been "suckered" with respect to negotiations on the natural gas pipeline.

As noted previously, Carter's response was the strong and public reaffirmation of his support for the pipeline which translated into fairly direct marching orders at DOE and the Federal Energy Regulatory Commission. The visible results of this reaffirmation of support for the project consisted largely of a pledge by the Federal Energy Regulatory Commission to complete the major regulatory decisions remaining on the project by early Summer, 1979. It also elicited a statement of support from FERC Commissioner Don Smith, who has been designated as the lead Commissioner on this issue. Smith restated the Commission's understanding of the importance of rapid and positive actions on regulatory matters. It is not clear to what extent the Administration initiatives have actually speeded the process over what would have

occurred naturally; the Federal Energy Regulatory Commission has issued notice of proposed rulemaking on the remainder of the issues involved in the incentive rate of return, tariff and related issues for the Alaska Natural Gas Transportation System. This will be handled on an expedited basis with written comments due by May 4, 1979, and reply comments due by May 16, 1979. Final Commission action on these questions is expected within six weeks after reply comments are received. In a similar vein, the Commission is moving toward finalizing RM 79-19 (relating to treatment and conditioning costs) by the end of May, 1979, although as was noted previously in this report, we believe significant delay may well result on this issue due to litigation arising from the numerous and complex issues surrounding it.

The discussions with respect to coordination of U.S. and Canadian policy on selection of an east-west pipeline system to move crude oil to northern tier U.S. markets was aimed at establishing a framework for consideration and consultation that would allow both U.S. and Canadian objectives to be attained without overt conflict. The U.S. has in the past repeatedly requested the Canadian Government to express a private preference for one of the five different pipeline systems (these systems are the Northern Tier Pipeline project, the Transmountain Reversal project, the Kittimat project, and the Foothills projects -- the overland route from Fairbanks via Canada and the combined tanker-overland route from Skagway, Alaska via Canada to central U.S. markets). Consideration of these alternatives routes is a primary objective of the sub-Cabinet working group identified in the joint communique of March 3,

1979. Since the communique was issued, the sub-Cabinet working group (headed on the Canadian side by Deputy Minister for Energy, Mines and Resources Ian Stewart and on the U.S. side by Assistant Secretary of State Julius Katz and by Assistant Secretary of Energy Harold Bergold) has met once in Washington, D.C. in late March. The primary result of that meeting was that the Canadians exhibited some preference for the Foothills proposals and very strong opposition to the Kittimat project. Their position with respect to Transmountain Reversal and to Northern Tier has been termed "neutral". The U.S. group was somewhat discomfited by Prime Minister Trudeau's recent statements in Calgary, Alberta, which appeared to place the Canadians firmly behind either of the two Foothills proposals. This position was, at least superficially, at odds with the objectives set forth in the Carter/Trudeau meeting which were to establish a joint U.S./Canadian choice prior to either government committing themselves fully to one or the other of the projects. However, recent statements by U.S. officials on this subject have downplayed the importance of the Trudeau endorsement of the Foothills projects, indicating that in their view the comments were politically motivated and that Canadian policy after the May 22 elections will prove to be more flexible. U.S. economic analysis of the various proposals indicates that the Foothills projects would be prohibitively expensive and thus, continued Canadian insistence on one or the other of these alternatives could result in serious problems for approving any east-west project. The preliminary economic analysis performed by the Department of Energy

indicates that the most advantageous economics for an east-west pipeline project are achieved with Transmountain Reversal, both because the pipeline system is already in existence and because it is appropriately sized relative to the ability of the northern tier U.S. market to absorb additional crude oil. While no final decision has yet been made, DOE personnel indicate their belief that the final choice will be between the Transmountain Reversal and the Northern Tier projects, with Transmountain being a slight favorite.