



THE STANDARD OIL COMPANY

MIDLAND BUILDING, CLEVELAND, OHIO, 44115

March 10, 1976

CHARLES E. SPAHR
Chairman

The Honorable John L. Rader, Chairman
Gas Pipeline Impact Committee
Alaska State Capital
State Capitol Building
Pouch V
Juneau, Alaska 99801

Dear Senator Rader:

I know that you are working hard for a gas pipeline that would be built from Prudhoe Bay south through Alaska, possibly along much of the right-of-way for the Trans Alaska Pipeline now under construction. I also understand your hope that Sohio could be able to support such a gas pipeline by committing its Prudhoe Bay gas to the proposed pipeline.

On February 19th in our response to questions you had asked on behalf of the Gas Pipeline Impact Committee we indicated that Sohio had entered into a Preliminary Gas Agreement with Columbia Gas dated August 3, 1971 covering our Alaskan gas. This agreement is still in effect and I expect that it will remain in effect. It gives Columbia Gas control of the ultimate disposition of the gas, subject to appropriate federal and state regulations and subject to Sohio and Columbia Gas reaching a final agreement on the price of the gas.

Our agreement with Columbia Gas is probably not fully understood by many in Alaska and elsewhere, and in fact, is a little bit complicated. It did serve as an important part of the early financing of the development of Sohio Prudhoe leases. I think your committee might find it useful to have a summary of what our agreement with Columbia Gas is all about and that's the purpose of this letter.

The Preliminary Gas Agreement covers all of Sohio's Alaskan gas except that which may be used for field purposes. The State of Alaska's royalty gas from our leases will be included unless the State elects to take its royalty in kind. In addition gas attributable to BP's net profits royalty interest in our leases will be included unless BP elects to take its royalty in kind. The agreement further provides that either Sohio or Columbia Gas may cause the other to enter into negotiations looking toward the signing of a regular gas purchase and sales contract of the type appended to the Preliminary Agreement as an exhibit. A regular agreement has not been signed nor have the negotiations started because there are

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still too many unknowns at this time with respect to the gas. These include how much gas Sohio will have available for sale, the rate the gas will be produced and when the production will start.

In order to get this right to negotiate for our gas, Columbia Gas was willing to pay us an advance of \$175 million as long as we used the money to develop our Prudhoe Bay leases. Sohio received the money in 1971, 1974, and 1975 and has used it for this purpose. Columbia Gas needed some assurance of getting its money back within a reasonable number of years. Since the timing of gas production was so uncertain, Sohio agreed it would repay the \$175 million advance in Prudhoe Bay oil after the field started producing. This advance and the repayment were provided for in a document called an Agreement for Sale and Purchase of Crude Oil. In effect, Columbia has bought \$175 million worth of oil for future delivery and paid for it in advance. When Columbia sells the oil it gets from us and receives an amount equal to the advance plus interest, the oil agreement will be at an end. Columbia has appointed Sohio as its agent to sell this oil on its behalf. In summary, Columbia Gas has loaned Sohio \$175 million to get the right to negotiate for the purchase of Sohio's Prudhoe Bay gas.

Both the Preliminary Gas Agreement and the Agreement for Sale and Purchase of Crude Oil are lengthy documents but if you want copies, I will be glad to send them to you.

Further background on these agreements might also be helpful. Our agreement with Columbia Gas was the first to be entered into with respect to Prudhoe Bay gas and many have asked us why we did this as early as 1971. I think the step we took was a good one, particularly in view of the financing problems we had at the time. When Sohio acquired its oil and gas interests in Alaska from BP in 1970, it recognized that the development costs of the field and the cost of building an oil pipeline across the State of Alaska, together with tankers to move the oil to the lower 48 states, would be a monumental physical and financial task. This was particularly true because Sohio was, and is, relatively small when compared to the size of this development. Consequently, as soon as the BP transaction had been agreed upon, we undertook to study every possible source of funds that was available to Sohio for this development. In making these studies, we kept in mind our need to preserve as much of our normal borrowing power as we could for the tremendous capital requirements of the oil pipeline once that project commenced.

We knew Sohio now had large oil and gas reserves in Alaska and that such reserves would have a sizable loan value as a source of development money, if they were located in the lower 48 states near transportation facilities.

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We talked to banks about loans which would, in effect, be secured by a pledge of future production from these reserves. We met with no success. The oil pipeline project had been stopped by the courts, and the banks told us, in effect, that they would not loan money on a non-recourse basis against these reserves. The banks said that until the pipe started to go into the ground, non-recourse loans supported solely by these reserves would not be made. Additional credit would have to be pledged. They could not take the risk of loaning money solely against the reserves and then find that the pipeline would never be built. Unfortunately, all during this time inflation and environmental constraints were increasing the development costs by leaps and bounds.

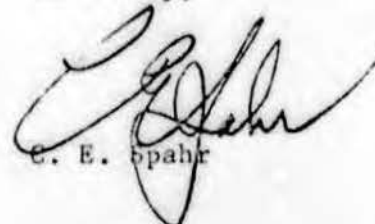
Faced with this situation, Sohio conceived and entered into the agreements with Columbia Gas. In return for agreeing to negotiate with Columbia for our gas, we were able in effect to use part of Columbia's borrowing power to supplement our own. By getting the money from Columbia we were able to carry on a continuous drilling program at Prudhoe during years when some owners stopped drilling completely.

With this perspective and the fact that Columbia Gas will probably be the company determining and arranging for the transportation of this gas, I don't think Sohio should make any statements that could be interpreted as a commitment to any particular gas pipeline project. This would be contrary to the spirit of our agreements with Columbia Gas. This is also consistent with the Statement of Position we filed with the Federal Power Commission in April, 1975.

The State of Alaska and Sohio do have a mutual interest in seeing a pipeline to transport Prudhoe Bay gas. We hope that the current process involving all the interested parties and evaluating the alternative proposals will result in the selection of the project that is best for everyone. Your committee's proceedings will add to this record. Whether or not the matter is finally resolved in the Congress remains to be seen, but we all hope for an early determination.

One other matter ought to be mentioned here. Though I am not thoroughly familiar with the arrangements other companies have made with respect to their Prudhoe gas, I believe that some made agreements which provided for advances to be made by the gas companies with the provision that if such advances did not become part of the rate base of the gas company, the agreement would not be effective. Our agreement with Columbia Gas has no such provision.

Sincerely,



E. E. Spahr