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REVISED RATES FOR NEW NATURAL GAS

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HEARING

BEFORE THE

SPECIAL SUBCOMMITTEE ON OIL AND NATURAL GAS PRODUCTION AND DISTRIBUTION

OF THE

COMMITTEE ON COMMERCE UNITED STATES SENATE

NINETY-FOURTH CONGRESS

SECOND SESSION

ON

FPC OPINION NO. 770, ESTABLISHING REVISED RATES FOR NEW NATURAL GAS

AUGUST 9, 1976

Serial No. 94–99

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REVISED RATES FOR NEW NATURAL GAS

MONDAY, AUGUST 9, 1976

U.S. SENATE,
COMMITTEE ON COMMERCE,
SPECIAL SUBCOMMITTEE ON OIL AND
NATURAL GAS PRODUCTION AND DISTRIBUTION,
Washington, D.C.

The special subcommittee met at 9:35 a.m. in room 5110 of the Dirksen Senate Office Building; Hon. Adlai E. Stevenson (chairman of the special subcommittee) presiding.

Senator STEVENSON. The subcommittee will come to order.

Natural gas supplies about one-third of the Nation's energy requirements. Natural gas produces more energy in the United States than does oil.

Recently, the Federal Power Commission (FPC) issued an order which if carried out, will increase the price of newly produced natural gas from 52 cents to $1.42 per mcf.

The means by which the Commission reached that decision and its implications for the economy are the subject of this hearing in the Subcommittee on Oil and Gas Production of the Senate Commerce Committee.

Our first witnesses this morning are the Chairman of the FPC, Richard L. Dunham, Commissioner Donald S. Smith, and Commissioner John Holloman.

Gentlemen, you are welcome to proceed.

I will give it to you, Mr. Chairman.

STATEMENT OF RICHARD L. DUNHAM, CHAIRMAN, FEDERAL POWER COMMISSION; ACCOMPANIED BY DON L. SMITH; AND JOHN H. HOLLOMAN III, COMMISSIONERS; DREXEL D. JOURNEY, GENERAL COUNSEL; DANNY J. BOGGS, ASSISTANT TO THE CHAIRMAN; RICHARD SMITH, ASSISTANT TO COMMISSIONER SMITH; JEROME E. HASS, OFFICE OF ECONOMICS; AND PATRICK J. KEELEY, OFFICE OF THE GENERAL COUNSEL

Mr. DUNHAM. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, I and my fellow commissioners of the FPC are here today in response to your request that we appear for oversight hearings on the FPC opinion No. 770.

We will be pleased to respond to questions concerning the content of the opinion and other similar factual matters.

As has been the case for me, at least, in testimony before a number of committees on subjects such as Alaskan gas transportation, electric

Staff members assigned to this hearing: Henry Lippek and Stephen McGregor.

rate policies and others, I will not be able to respond to questions which might indicate a position on matters that will come before us.

Since the national rate opinion is subject to motions for rehearing being filed until August 26, 1976, I will obviously not be able to respond to any questions that would indicate an opinion on matters that might be raised on rehearing.

Neither can we engage in an extensive defense of the existing order, as such comments could be taken as prejudgment of matters that will be before us on rehearing.

Finally, I would note that any activity which might preclude the Commission from properly considering the rehearing petitions, whether by voluntary disqualifications or by subsequent court reversal because of such actions, would simply leave opinion No. 770 in effect as it now stands.

I am confident that our dialog this morning can be informative while still leaving the Commission free to carry out its statutory duties in considering petitions for rehearing.

I am pleased to note that you will be hearing from witnesses representing groups affected by our decision later this morning.

I realize that your deliberations will also include consideration of views of those charged with general policymaking on energy such as Federal Energy Administration (FEA) and ERDA, whose opinion on the interrelation of our opinion and the legislation before you might be valuable.

Thank you.

That concludes my statement.

Senator STEVENSON. Commissioner, we are all familiar—and some of us uncomfortably so—with the parameters, of the *Pillsbury* case, which I assume is what you are referring to.

Mr. DUNHAM. Yes.

Senator STEVENSON. It is perfectly possible for us to hold an informed discussion of this subject within those parameters, and I am glad to hear you say that you agree.

Commissioner Smith, do you also have a statement?

Mr. DON SMITH. Yes, Mr. Chairman. I dissented to the order and would like to briefly set out some of the reasons why I am particularly sensitive to the Pillsbury problem as the dissenting member.

I would like to have an opportunity to participate in further deliberations on the matter, since I think they are inevitable in terms of a rehearing. I hope I will be able to make this statement which will be confined essentially to matters in the order and in my dissent without running afoul of the disqualification problem.

To summarize briefly, these are the reasons.

I felt the majority did not adequately respond to the recently developed evidence concerning the nature and potential magnitude of errors in the AGA reserve reporting process.

As a result, the majority understated the test productivity that should be derived from that data and overestimated the price.

There is a need for some explication of the way in which productivity was used in the order arriving at a just and reasonable rate.

First, I should mention a separate issue, and that is whether the just and reasonable rate should be a flat rate or whether an escalation should be used to yield a lower first year price.

I express no disagreement with the decision of the majority that a lower initial rate with periodic escalation is a better structure. Instead, I disagreed with the flat rate equivalent price, which is $1.63 per mcf.

My dissenting opinion cited page 88 of the majority order for the derivation of the base rate, and that page demonstrates how the escalation operates to modify that rate in thc initial years.

The majority states, and I quote, that, "The effect of this escalation is to move from a constant price of approximately $1.63 per mcf to an escalating rate beginning at $1.42."

Further analysis of the price determination section of the opinion demonstrates that the only way, arithmetically or otherwise, to support a price of $1.42 with an annual escalation of 4 cents, or $1.47 with an annual 3-cent escalation, or $1.53 with a 2-cent escalation, or $1.63 with no escalation at all, or $1.37 with a 5-cent escalation, is to determine that it is reasonable to use a productivity factor of 300 mcf per foot of successful wells drilled. The majority derived that productivity from the midpoint between 279, the 8-year average of AGA data, and 323, the 9-year average.

The postion taken in my dissent was that the AGA series should not be taken at face value, and that the clearly demonstrated potential for error in that data requires adjustments in the traditional productivity calculation.

Questions concerning the AGA series are set out in discussion of a staff report in the dissenting opinion. I believe that the potential for distorting the cost of finding gas are of a magnitude that simply utilizing a longer series than that used in opinion No. 699 will not be sufficient to redress that effect.

The points where the Commission's judgment can be exercised have been diminished as the costing methodology withstands administrative and judicial review. The 699–H methodology, with the exception of the productivity judgment and subject to all infirmities which are inherent in average cost ratemaking, is fast becoming rigid.

As biennial review succeeds biennial review, the basic methodology will become even more automatic. That being the case, where judgment comes into play and where the impact of that judgment on rates and consumer cost is direct and large, particular scrutiny must be given to data on which the productivity conclusion is based.

I concluded that such scrutiny required that AGA reserves added data should not be accepted without adjustment.

Thank you, Mr. Chairman.

Senator STEVENSON. Commissioner Holloman?

Mr. HOLLOMAN. I have no statement, Mr. Chairman. I concur with Mr. Dunham, that the majority opinion speaks for itseft, and I would not want to expand upon it at this time.

Senator STEVENSON. Mr. Chairman, were any factors considered in addition to cost factors in arriving at the $1.42 figure?

Mr. DUNHAM. The basis of the decision is entirely cost based.

As we state in various places and in accordance with various court decisions we did look at, we did consider noncost factors such as equivalent prices of other fuels.

Those are all clearly outlined in the poinion on pages 109–119.

Senator STEVENSON. You say that the decision was based on cost factors, but in reaching a figure of $1.42 you also considered noncost factors? Can you explain what you mean by that?

Mr. DON SMITH. Yes. Well, essentially, what we did—entirely, was to determine on the basis of the 699–H methodology which is entirely a cost-based methodology, we adjusted it for various other changes, various change factors, notably the change in tax law.

Then when that was done, we looked, as the courts have instructed us, at equivalent prices, alternative prices, other commodity values, a variety of other things, LNG prices, to judge in light of that context the just and reasonableness of our cost-based methodology.

To give you an example, if there was a basic change of, let's say, 10 cents one way or the other on an equivalent price, LNG, for instance, that would not have affected our decision.

If, however—and I am speculating here—there was wide divergencies, it probably might then have been reflected in the price as the courts have said, I think, in the *Mobil* case, but that was not the case.

In our opinion, this was—these alternative prices were within the range.

Senator STEVENSON. What cost did you assume for Federal taxes?

Mr. DUNHAM. The discussion on that is starting on page 81 of the opinion. I keep referring, Mr. Chairman, to the opinion so that I avoid deviating from that opinion.

Pages 124 and 125 are probably the best place to see the actual tax effect.

Here, you can see the net taxes were 43.72 cents.

Senator STEVENSON. How is that figure arrived at?

Mr. DUNHAM. Well, let me see if I can move this along.

Of the $1.42, 43.72 cents is attributable to taxes.

Senator STEVENSON. Are costs assumed for Federal income taxes based on an assumption that the producers pay a 48-percent rate?

Mr. DUNHAM. Yes; at the margin, and the reported figure is net of the offset for tax reductions arising from the writeoff of intangibles. That is that net figure.

Senator STEVENSON. I understand this pricing is for incremental production.

What studies, if any, were undertaken by the FPC to determine that 48 percent was, in fact, the rate paid by producers for such incremental production?

Mr. DUNHAM. Well, of course, the basic document is the Tax Reduction Act itself, which repealed depletion. Then from that——

Senator STEVENSON. Let me interrupt for a moment.

You said repeals the depletion?

Does the Tax Reduction Act repeal the depletion allowance for all producers?

Mr. DUNHAM. Well, except for the small amount that was exempted from repeal, production under 4 billion cubic feet. It was not all in that sense.

Senator STEVENSON. I want to know how you arrive at a rate of 48 percent recognizing that, among other things most independents continue to get a 22-percent depletion.

Mr. DUNHAM. Could I call on Professor Smith? Richard?

Mr. RICHARD SMITH. The depletion allowance is available 22 percent for this year, and a declining amount of subsequent years through 1980, to independent producers to the extent of roughly 4 million, roughly, thousand cubic feet production per year.

But it is available either for oil or gas, not for both. And I think it is reasonable to assume that a large portion of it will be absorbed by the oil production and not by the natural gas production.

Senator STEVENSON. On what basis is that assumption reasonable?

Mr. RICHARD SMITH. On the basis that the oil price is higher, the new oil revenue is higher than the new natural gas revenue, and I think the producer would allocate, if he had the choice, on the basis of the highest cost item, highest priced item.

Senator STEVENSON. Is this, Mr. Chairman, a theoretical assumption that 48 percent is in fact the rate paid by producers for this incremental production? Was there a tax study undertaken to determine to what extent producers received the benefit of depletion or credits from other operations and for drilling costs allocable to this incremental production?

Mr. DUNHAM. Yes. Obviously, it is based upon a set of assumptions of what will in fact occur.

As you know, as laid out in the opinion, we make allowance for the writeoff of intangible costs incurred during the pre-production period and then assume that there would be taxes paid during the production period, which begins 3 years after the first outlay.

In other words, taxes will not be paid until the pre-production period is over which is assumed to be 3 years. So it would be 1978.

Senator STEVENSON. On page 81 of the opinion, it stated that a staff recommendation issued in this proceeding suggested that there was insufficient data to estimate the income tax liability of the producers, and that it was impossible to evaluate the impact of the Tax Reduction Act of 1975 on producer costs.

Accordingly, staff recommended that the Commission use an evidentiary hearing to permit income tax estimation.

I gather, that the Commission did not examine income tax returns to estimate the income tax liability of producers?

Mr. DUNHAM. Well, obviously, we could not because it did not apply until this year. We did deal with that argument on page 82 and subsequent pages.

Taxes are one of the many estimated costs in our cost-based methodology, as are productivity rates and every other important element of performance.

Senator STEVENSON. I notice that lease acquisition costs, almost tripled 4.28 cents to 14.13 cents, from the time of the 1973 decision to this opinion; in other words, almost triple in the space of about 3 years.

What will the effect of this decision be on least acquisition cost?

Mr. DUNHAM. Well, we point out on page 58 that least acquisition costs will fluctuate with both the offshore Federal lease activity and the cost price relationship assumed by producers. As depicted in exhibit No. 10 of the opinion, lease acquisition cost increased greatly in 1973 and 1974, and it is important to the ratio of lease acquisition cost per Mcf; the other factor, which can also vary greatly, productivity of the 1973–74 period, which caused a portion of that change.

Senator STEVENSON. Well, I asked the question to raise the subject with you.

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We have observed in the case of oil, and it seems to me now in the case of natural gas, that as the cost of producing goes up, the price of oil and gas go up, and the profits and revenues of the producers rise accordingly.

The rate of inflation in this industry is far greater than in the economy at large. That is in part because the producers of fuel, by increasing the revenues, compete among themselves for a limited amount of equipment, personnel, and leases, with the result that we do not end up with more natural gas and oil, but we do end up with substantially higher prices.

Aren't we going to experience that again in this case? Isn't that increase in the lease acquisition cost a case in point? Costs skyrocket in anticipation of higher prices and now, with fulfillment of such expectations, isn't it likely to go up even more?

Mr. DUNHAM. Well, of course, you may very well be right. That is speculation. I point out in one respect, though, that—and we mention this in the opinion—that most of the leases now are likely to be in the offshore area, and the Department of Interior will recapture a portion of those costs in the bidding process for the leases.

So that whereas it is true the price will go up, in this case, the money will go to the U.S. Treasury in offshore leases.

So in that case, at least, it is not an individual profit situation.

Senator STEVENSON. Senator Stevens?

Senator STEVENS. I happen to agree with the Chairman on that, it is counterproductive to see the Federal Government forcing the price of the leases up to the point where it is disturbing the actual prices set by your Commission.

Let me ask you, are you affected at all by the various legislation that is pending here in the Congress?

Is that within your Pillsbury concept or would you like to comment?

I know our bill was $1.60. I think the House bill was a little different.

Does the fact that Congress has indicated very stongly a desire of many of us to see that the gas price rises so that it would stimulate production of gas, does that affect your Commission?

Mr. DUNHAM. Well, in the sense we do not take into account in the opinion pending legislation. We can only work within the context of the Natural Gas Act itself.

Now, the opinion does not discuss nor did we deliberate upon the effects of various alternative bills affecting natural gas pricing.

Beyond that, I, of course, can comment on the bills specifically, if you have any specific questions, Mr. Stevens.

Do you mean as to whether a bill might have achieved a greater purpose of production than perhaps this opinion? Is that it?

Senator STEVENS. I want to know whether the bill motivated your Commission toward moving in the area some of us wanted to move for a long time.

Mr. DUNHAM. I will stick to my original statement that the opinion is all inclusive.

Senator STEVENS. Are you familiar with the price of export gas from Canada to the United States?

Mr. DUNHAM. Yes.

Senator STEVENS. As I recall, last week it was $2.40.

Mr. DUNHAM. $2 I think. I think it will price less than $2 in September, but by January 1 it goes to almost $2.

Senator STEVENS. Well, following up on what Senator Stevenson said, do you have any studies which attempt to relate this pricing goal of your opinion with what the Canadian price picture is going to be in the future?

Mr. DUNHAM. Well, we have launched an inquiry into the direct effect of the Canadian export price announcement upon consumers in affected areas.

That is in process at the present time.

Again, in regard to the effect of that change on this opinion, it is I believe mentioned in this opinion. It is in the context of looking at and considering in the same way that some other prices such as oil and LNG prices were looked at.

Senator STEVENS. I am sorry. I didn't recall that.

Mr. DUNHAM. Page 116.

Senator STEVENS. Do you believe that in the Canadian price is there a terminal date for exports—reducing these exports—was that a factor in your opinion, too?

Mr. DUNHAM. Well, we looked again at the Canadian decision. We are involved in it. When that gas comes in it will require the distributing companies and the pipelines or the pipelines to file rate changes with us. And those, some of them, are in already. So the Federal Power Commission is involved in that per se.

Senator STEVENS. Let me see if I understand your time frame now. You are subject to petition for rehearing.

Mr. DUNHAM. I don't believe—yes; we are subject to petition for rehearing, they have not yet been filed. They are due by August 27.

Senator STEVENS. Do you have notice that one will be filed.

Mr. DUNHAM. No; I have no information. I would—past history would suggest it might be.

Senator STEVENS. What would be the time frame if that is filed?

Mr. DUNHAM. Well, it must be filed within 30 days so that would be August 27. We have told the court in a parallel proceeding that we would act by October 27, which is the date that the first effect of this proposed change would take effect.

In other words, the court has issued a stay, as you are well aware. So, in terms of responding to any petitions for rehearing if they in fact do occur, it will be by October 27 of this year.

Senator STEVENS. Thank you very much.

Senator STEVENSON. Senator Weicker?

Senator WEICKER. How many individuals sit on the FPC?

Mr. DUNHAM. Four members.

Senator WEICKER. I gather there were some additional comments made by Commissioner Smith—was this a unanimous decision?

Mr. DUNHAM. No; Mr. Smith dissented so three commissioners participated in the majority opinion.

Senator WEICKER. I would like to ask Commissioner Smith concerning his opinion. I am not going to the last paragraph in your statement: "The foregoing led me to conclude that while a substantial increase in the cost made mandatory a substantial increase in the rate, the costs were overstated * * *" et cetera.

But even taking into account your reservations, I gather there is no difference of opinion that in any event the status of the cost would require a substantial rate increase; is that right?

Mr. DON SMITH. Yes, sir, I would proceed from the 699–H, which was our last biennial review, and the comparison of those costs which were before us there. And those would have been reported subsequently. And, of course, in that order we were attempting to predict the costs. And we substantially understated it.

And I think on page 125, exhibit No. 30, it is probably the best and most readable comparison of the actual producer cost increases.

Senator WEICKER. I am just not in a position, very frankly, to deal with the specifics, and I can see where there might be a variation of opinion as to what the exact amount ought to be.

But in a legislative capacity, I want to get across the idea that we are not talking about no increase at all.

I gather everybody is in agreement with the fact that just by the nature of the costs there is going to have to be a substantial increase, although obviously there is some difference of opinion as to the exact amount of the increase.

Now, the base price is what, $1.42?

Mr. DUNHAM. Yes.

Senator WEICKER. And did I hear correctly in response to Senator Stevens when you said that as of the first of the year the price from Canada is going to be $2?

Mr. DUNHAM. The exact figure is $1.96, as reported on page 116 of the opinion.

I think you are referring, when you say $1.42 price, that would be the present price with the 4-cent escalator which means that on October 1 the price would be $1.43, on January 1, $1.44, and on April 1, $1.45 and so forth.

That is the way the escalator works.

In other words, a 4 cent per year escalation with a 1-cent increment placed on each quarter.

We split it on the quarterly basis in order to hopefully affected the dedication itself.

In other words there would not be a waiting if a well was available for production after, let's say, the first week in January, there would not be an inclination to wait until the next escalation occurs.

That is why we split it.

Senator WEICKER. I am trying to compare apples and apples of what we are selling gas for in this country and what gas is being sold to us by a neighbor. Which seems to me would be a good comparison.

We are not talking about importing it across the Atlantic or Pacific. Apples and apples, is it $2 versus $1.42?

That is my question.

Mr. DUNHAM. Yes. On page 116 and we relate to the Canadian National Energy Board in the recent gas pricing decision. In that decision export price was raised from the current $1.60 per thousand cubic feet to $1.80 per thousand cubic feet effective September 10. So $1.80 is directly comparable to $1.42.

Bear in mind this is all gas.

The gas we are referring to at $1.42 is new gas, new dedications.

The flat price would be $1.80 in the NEB decision; the $1.42 price relates only to new gas.

Senator WEICKER. What is the old gas?

Mr. DUNHAM. The old gas, under our opinion, the flowing gas would be $1.01.

Some gas that is under an old opinion at 29 cents when the contracts expire will go to 52, and so it leaves essentially three, we call them vintages—29 cent gas, 52 cent gas, $1.01 gas and then, with this opinion, $1.42 gas.

Those are all average.

Senator WEICKER. Why is anybody going to buy Canadian gas—why is anybody going to pay $1.80?

Mr. DUNHAM. Well, I hope that there will be plenty of $1.42 gas. But nobody is predicting that instantaneously there would be a trillion cubic feet available to replace the Canadian gas.

Quite aside from that, most or all of the pipelines are under curtailments, having to reduce deliveries on the amount of gas that they have contracted to sell or promised to sell.

So that in addition to replacing the Canadian, there is this other pent-up demand, if you will.

Senator WEICKER. Is there any other example that you can give to me aside from Canada, as to any other nation?

Mr. DUNHAM. Well, of course, I suppose in natural gas the LNG prices, the import prices are somewhat analogous and they are considerably higher.

On page 117 we mention the recent report on planned projects anywhere from 86.6 cents to $3.24. So that is a wide range. But the new LNG prices are coming in at the high end of the range and then, as you know, that is something we are contracting for with foreign governments.

So some of those contract provisions are not assured in the permanent dedication sense.

Senator WEICKER. Is it your expectation—not expectation, but speculation—that people are going to buy Canadian gas at $1.80? There are going to be plenty of takers?

Mr. DUNHAM. Oh, yes. Because there is no immediate alternative available to them. This opinion will not have much supply impact in a short period of time.

There will have to be conversion to the alternative fuels. In other words, conversion of gas furnaces to oil furnaces, for instance, of various production facilities, businesses from one to the other. So that it can be argued that even at that price that the alternative fuels plus the conversion costs would be higher than the $1.80 price.

Senator WEICKER. Do you consider that $1.80 to be an artificial price in this sense, that when 3 years ago the OPEC nations raised their price of oil, it didn't have any relationship to the market at that time? They just controlled it and they went ahead and set the price.

Now, is this what Canada is doing? Or do you think they are being fairly realistic as to what the market will bring?

Mr. DUNHAM. Well, they set their prices essentially on commodity value pegged to the world price of oil.

Just to make one thing clear here, we are talking about $1.80 but on January 1, that goes to $1.94.

Senator WEICKER. I am trying to make the most conservative use of the figures, at least in the legislative sense.

I just don't see how we can artificially create in this country a situation that doesn't apparently exist anywhere else in the world. Seems to me it is going to eventually be to the detriment of our own people.

I am trying to probe to see whether the rest of the world is out of step or the United States is out of step. Are we following pricing policies that are political in nature rather than based on sound technical analysis.

I just think that we are going to ruin our energy industry. I will pass right now, but I think this is a rather interesting comparison.

We are not dealing in speculation but in hard facts.

Here is our neighbor to the north, they are marketing their gas at $1.80 or $1.96 or whatever. We are at $1.42, and we even dispute as to whether we ought to be that high.

I think I find it hard to reconcile the realities of that situation.

Senator STEVENS. One more question.

My friend mentions his neighbor to the north; that is my neighbor to the south. Do you have any estimate as to what you think Alaska gas will come on stream 2 years from now? What the price will be?

Mr. DUNHAM. What the price will be? No; we did not cover that in this opinion. That is part of a proceeding currently before us, the transportation question.

Senator STEVENS. My latest crystal ball was that it could not be transported down to what we call the south 48 at less than $2.40. That doesn't even talk about our wellhead price as I understand it.

Mr. DUNHAM. There are figures in the record.

Senator STEVENS. I understand the Canadian exports are being decreased, have you been informed of this?

Mr. DUNHAM. I have heard some statements in the press. No official announcement.

The NEB report which is the offlcial statement, did not mention it. They said no increments, no additional amounts. But I have heard of curtailments in the press.

Senator STEVENS. One last question. The staff informs me that the amount coming from Canada is approximately the same as the new gas incrementals that you are talking about; is that correct? About 7 percent?

How much new gas do you figure is involved in the incremental pricing that you have got?

Mr. DUNHAM. It is a very low percentage at the present time. Hopefully increasing over time as we go, as the new gas comes in, but I don't know how to characterize the exact amount. But it is a small amount at the outset.

Infinitesimal.

In fact, none at the present time.

But it will increase if this decision accomplishes what we hope it will accomplish, it will become a gradually increasing portion of the supply.

But I don't know how to really characterize it—there have been various modeling techniques that try to make projections.

We used one in the back of the opinion, an appendix.

But in such general modeling there are a variety of assumptions upon which everybody does and can and will disagree.

So it is very difficult to characterize the exact amount other than the amount we mention in the appendix.

I can remember something of 5 or 6 percent in a year, initially, something in that ball park.

Senator STEVENS. Thank you.

Senator STEVENSON. Mr. Chairman, just to get the record straight with respect to Canada, it is my understanding that the Canadians are basically doing what we are doing or should be, by bringing natural gas up to a price equivalency with oil.

I don't quarrel with that proposition.

We have been discussing Canadian export prices. The United States, as far as I know, doesn't export natural gas.

Mr. DUNHAM. We have some slight exports in Mexico.

Senator STEVENSON. With minor exceptions.——

Mr. DUNHAM. LNG to Japan out of Alaska, a small amount.

Senator STEVENSON. Can you tell us what the present Canadian price is for new gas within Canada?

Mr. DUNHAM. As I recall it, it is around $1.50. In Toronto, $1.50.

Senator STEVENSON. What is the equivalent Canadian price at the wellhead?

Mr. DUNHAM. It is very difficult because they have a flat price for all their gas. Whereas ours, the gas in Rochester, N.Y., which is across the lake from Toronto, will be a blend of 29 cent gas, 52 cent gas, $1.01 gas and a minimal amount of $1.42 gas.

I don't know how to draw the exact comparison.

Again, what the Canadians did was set a flat price irrespective of location. Transportation costs are averaged in. It is $1.50 in Alberta—where the gas is produced—and $1.50 in Toronto.

In other words, the homeowner pays the same amount regardless of location.

It is just that blended in the national price policy.

So it is very difficult. We could do some studies and try to figure out an equivalent or comparable thing.

I don't know them offhand.

Senator STEVENSON. In my mind, the most questionable aspect of this decision is the definition of "new gas."

Mr. Chairman, if I understand you correctly you said a moment ago that the Commission's cost estimates assumed very little additional new gas in the first year.

The increased costs calculated by the Commission are $1½ billion in the first year; is that right?

Well, let the record show your head is nodding.

That increased cost is attributable to an increase in new gas of only 5 percent?

Mr. DUNHAM. Well, Senator, excuse me.

That increment is based on other factors involved.

The flowing gas from the 1973–74 biennium will go 52 cents to $1.01. Some of the rolled-over contracts of the old price, 29 cents, will go to 52 cents. So that we have a variety of gases which are priced in this.

It is not just the new increments of the new gas, $1.42.

Senator STEVENSON. Well, in fact, very little of the Commission's calculated increased costs can be attributable to increased production of gas in the first year.

Mr. DUNHAM. I think 5 or 8 years.

Senator STEVENSON. This increased cost of $1.5 billion to consumers is attributable to the increased price of flowing gas, of old gas, in other words.

Now, what sense does that make? How does that increase, $1.5 billion, most of which is attributable to flowing gas, stimulate the production of new gas? What need was there for a $1.5 billion increase in the price of gas already committed?

Mr. DUNHAM. Well, I think there's several answers to that.

One, we are required to base price on cost and update those costs. What I am saying is a lot of the increase could not be avoided.

The last biennial price was set just prior to the big inflationary increases that occurred particularly in 1974, but also to some extent in 1975.

So a large portion of that increase is a portion of just pure cost increases.

In addition, there is the tax element discussed earlier which, because of the change in the tax act, we have incorporated.

So a large portion of that is cost plus taxes plus change in an increase in amount to producers to account for the changes made in that cost situation.

Senator STEVENSON. The price of gas——

Mr. DUNHAM. There's another element. Excuse me, Senator. This covers gas that starts to be delivered from 1975.

Senator STEVENSON. 1973 to 1975?

Mr. DUNHAM. That is the flowing gas rate. Then there is the 1975 to 1976, which is the current biennial period.

So there is an increment of gas—very minor amount; I have forgotten the exact amount—0.8 trillion cubic feet, that was dedicated since January 1, 1975, which will start receiving the $1.42 price for gas sold after July 27, 1976.

So we have new gas and flowing gas from that particular period, which will receive the new rate for the last 6 months of the biennium.

Senator STEVENSON. Is it possible under the Commission's definition of "new gas" for a producer to drill a new well into existing reservoirs alongside an old well and produce and sell the gas at the new $1.52 rate?

Mr. DUNHAM. Yes.

Senator STEVENSON. How do you justify that?

Won't this provide an incentive to do just that, to drill into existing reservoirs for production of gas instead of going out and exploring and developing new reservoirs?

Mr. DUNHAM. Well, one thing is that drilling costs have changed so radically that producers may decide that it is not—this is speculation again—it simply is not worthwhile to drill additional holes in that reservoir even at the new price.

Senator STEVENSON. Well, there is no risk. They know by going down along an old well they are going to hit an existing reservoir. They will have the geological data.

It could very well make far more economic sense to do that than to go out and try to discover, at great risks, a new field.

Mr. DUNHAM. Yes; that is absolutely correct, and that is why we planned—I mean, that is why the decision contemplates that action.

If the price had been left at the older rate, either 29 cents or 52 cents or some other sum, then based on our estimates of their cost and the rate of return that they were dealing with, producers would most likely not drill anything additional in existing reservoirs and they would also not drill in new fields.

Senator STEVENSON. Now aren't those wells committed under contract?

Don't producers have a contractual obligation to produce from those wells?

Mr. DUNHAM. The reservoirs are dedicated to interstate commerce in those cases. But there is no way that we can force drilling.

Senator STEVENSON. Mr. Smith, did you dissent from that part of the opinion which permitted the price of gas committed to interstate commerce between 1973 and 1975 to rise?

Mr. DON SMITH. Mr. Chairman, in 699–H, I dissented as best I knew how to that aspect of the order which gave the new gas rate to renewal contracts, that being very old gas.

The Commission in that order made the assertion that it would not vintage the 1973–74 gas. The conclusion in this order was that because of the magnitude of the increase it would become necessary to vintage contrary to the intentions that had been set out in the preceding order.

I agree that is is necessary to vintage. I think the appropriate rate level for that gas has probably not been adequately explored and concluded that the parties on rehearing should address themselves to what reasonable producer expectations might have been.

Senator STEVENSON. How do you feel about the $1.42 price for gas produced from dedicated reservoirs after January 1975, proceeding at that price?

Mr. DON SMITH. Well, my dissent stated that that figure was derived from an erroneous productivity factor and was therefore too high.

Senator STEVENSON. Was the reserve—the productivity—the only basis for your dissent?

Mr. DON SMITH. Essentially; yes, sir.

Senator STEVENSON. You do accept the opinion's computations with respect to cost for taxes.

Mr. DON SMITH. Yes, sir.

Let me put it this way. I could find nothing that I believed was erroneous in the opinion's treatment of the tax issue.

If I had, I would have so stated in the dissent.

Senator STEVENSON. Gentlemen, it is the hope, the expectation, that this increased price will increase production.

Mr. Chairman, what increased production do you assume will result in the first year?

Mr. DUNHAM. We assume 0.6 trillion cubic feet. This is in the attached appendix.

Senator STEVENSON. Is that newly produced gas, newly drilled wells, wells that are all of a sudden going to be drilled and start producing in that quantity in the first year? Or, is it attributable at least in part to production which is now being withheld in anticipation of higher prices?

Mr. DUNHAM. It is essentially just the rate of dedications in 1975. In other words, we do not assume great new increments this first

year from newly developed fields—because of the time it takes for production.

Senator STEVENSON. Is this a rate of dedications that would take place regardless of price?

Mr. DUNHAM. I don't know, but it would take effect at the 52 cents price when and if there are alternatives to sell it at the intrastate prices.

Senator STEVENSON. Well, if the price had been $1.22, would you have assumed a smaller amount of additions in this first year?

Mr. DUNHAM. Well, of course, this is difficult. We are dealing with assumptions and projections, and it is logical to assume that some fewer dedications would occur at a price of $1.22 than at $1.42, namely those increments of production which cost more to drill, either because of deeper drilling or some other cost factor, and where there was an alternative of selling in the intrastate market or perhaps of tapping a well.

The assumption in terms of amounts produced and so forth was merely done; that is why we put it in the appendix as a basis for calculating an estimated impact. So we don't hold that there will be exactly six-tenths of a trillion cubic feet

Senator STEVENSON. Well, with an estimated increase of $1½ billion in consumers cost the first year you estimate net additions of 0.6 trillion cubic feet?

Mr. DUNHAM. Those are the assumptions we used to calculate the impact.

Senator STEVENSON. Weren't the net additions for the prior year at the old 52 cents price similar?

Mr. DUNHAM. That is right, 0.6—0.5, slightly changed.

Senator STEVENSON. Without the tripling in the price, 0.5 trillion cubic feet.

Now, you also——

Senator WEICKER. Would you yield so I can carry forward your question?

What do you expect then in the second?

Mr. DUNHAM. We made no assumptions beyond the first year. FEA, I saw a press release over the weekend, had done some further modeling and projections.

Senator WEICKER. Let me ask you this.

Since you don't have that figure, what is the historical pattern? In other words, is the historical pattern somewhat like what you are projecting for the first year, but then does it continue to increase beyond that?

Mr. DUNHAM. I think I can answer it this way.

Historically, it is very difficult, but let me give you one example. When the last biennial rate was adopted, the 52-cent rate, it was also with the purpose of encouraging increased dedications. They did not in fact occur in substantial amounts. There were very minor amounts of dedications, proved by the fact that we have been in a steadily increasing curtailment situation.

In other words, the amount of supplies dedicated in total in the intrastate market had decreased.

So there were no appreciable changing of trend lines as a result of the last biennial review.

It is our expectation and hope and, in fact, the design of this rate, that there will be increased dedications.

But that will remain——

Senator STEVENS. The converse of the question is without this price, did you estimate how much of this gas would not have gone into interstate commerce, but would have stayed in intrastate commerce?

Mr. DUNHAM. We didn't put a specific estimate, but at the 52-cent rate there were increasing portions of new gas finds that were going to intrastate markets.

If the existing price continued, quite likely that trend would continue.

In other words, new finds are more and more likely to go to an intrastate market if one is available. I think all you have to do is look at the price estimates we have of average intrastate prices to see how that conclusion might be logical.

Senator STEVENS. So it maintains the flow of gas in intrastate commerce?

Mr. DUNHAM. Well, maintains the flow—we have to more than maintain, because reserves that have historically been dedicated are declining as fields get used up. We have to replace the old gas from reservoirs that are being exhausted, because there are many reservoirs that are played out.

Senator WEICKER. Let me follow this line of questioning.

When somebody comes before you on a rate case, do they have to state what they intend to do if their request is granted insofar as exploration is concerned, or commitment to drilling for new gas? Is that part of their presentation or not?

Mr. DUNHAM. No. What comes before us is certificates for transportatierwof interstate gas. Then the only way that we would get into whon actually was spent is in the accounting review and auditing aftat ards to see if the pipeline did provide the producers that particular price.

Senator WEICKER. But in presentation of their costs, et cetera, there is nothing they have to commit in the way of R. & D. or exploration?

Mr. DUNHAM. Well, we assume a cost factor in the opinion for exploration and development in the rate. There are some figures in the cost table. And in this proceeding, they did come forward with facts and figures that again were averages, and so forth.

Senator STEVENS. Does your 300,000 cubic feet productivity factor include in-field drilling?

Mr. DUNHAM. Yes. It is all drilling.

Senator STEVENS. Do you have any breakdown of what is in-field as opposed to drilling new reservoirs?

Mr. DUNHAM. No data is available on that, Senator.

Senator STEVENS. The chairman made the comment about drilling into the same reservoir. In my State, the State would govern where that new well could go under a well spacing requirement.

Mr. DUNHAM. That is right.

Senator STEVENS. Is that calculated into your in-field drilling?

Mr. DUNHAM. Yes; in the onshore areas, that is true and in comparable States in the lower 48, also. It is also true in the offshore area. The Department of Interior is the supervisor of that.

In other words, conservation factors are applied in the individual States. So it is very analogous in the lower 48 and in offshore to Alaska.

Senator STEVENS. I think it is one well per 320 acres—I don't remember exactly, but it is something like that. So the chairman's question about drilling that new well in order to obtain a price involves considerable risk factor up my way.

I would hope that you would realize that.

Mr. DUNHAM. Yes.

Senator STEVENS. You don't have any breakdown, though, in terms of your productivity factor.

You took an industry average?

Mr. DUNHAM. Industry average.

We do have some offshore, onshore distinction, but that is about all.

Senator STEVENSON. I think all the States—producing States—regulate space.

Mr. DUNHAM. Yes; the so-called conservation tax.

Senator STEVENSON. And spacing requirements vary from State to State and from field to field.

Mr. DUNHAM. That is right.

Senator STEVENSON. Which gets to my point, namely, that through the definition of new gas, producers will be able to go into existing reservoirs, drill wells and produce without any or very little risk at this $1.42 price.

To go backwards, you estimated an increased consumer cost of $1.5 billion.

I assume that is a cost to initial consumers. It doesn't take into account the so-called ripple effects, the ultimate cost to consumers for fertilizer, petrochemicals?

Mr. DUNHAM. It takes everything into account.

Senator STEVENSON. It does take into account the ripple effect?

Mr. DUNHAM. It attempts to estimate the direct effects, such as increased cost of fertilizer and the other things that are made from natural gas but not indirect effects.

Senator STEVENSON. You estimate net additions of 0.6 trillion cubic feet in the first year and cannot estimate additions for the second year. Therefore, I assume you don't have any estimate of increased costs in the second and subsequent years; is that right?

Mr. DUNHAM. That is right.

Senator STEVENSON. You have no estimates of what it will cost to consumers in the second or third year?

Mr. DUNHAM. Quite obviously, you get more and more speculative the further you get away.

FEA has some models that they have used to estimate this. They show some cost savings. Those are their models.

Senator STEVENSON. In light of comments by Commissioner Smith about productivity, wouldn't it be a good thing for the Commission to get out of the business of making these kinds of calculations?

Instead of relying basically on the industry to supply figures which are self-serving, shouldn't some independent agency be created to make these productivity calculations?

You would welcome that, wouldn't you?

Mr. DUNHAM. Well, Senator, of course, more and better data would also be more helpful. But, of course, much of the information is considered protected information, business information, so it is difficult in this area.

But if you are suggesting that we ought to have better sources of data, and done by an independent group, of course.

Senator STEVENSON. Now, this committee has for 3 years—ever since I have been a member—been attempting to reform the regulation of natural gas. This decision has probably killed whatever chance remained for the reform of natural gas pricing in this Congress.

It has probably killed—I don't say this critically—any chance for natural gas reform legislation this session.

Assuming for the moment that there is no chance of passing legislation that would reform the pricing of natural gas at the wellhead, what do you need from us in terms of new legislation.

We are faced with the probability of a serious curtailment this winter? Do you need or does some agency need emergency allocation authority?

What nonpricing legislation should we attempt to enact in this session on the assumption that it is the most that can be obtained at this time.

Mr. DUNHAM. At this stage, Senator, we are now in the process of trying to ascertain the direct end use effects of the curtailments. We have various proceedings going, both formal and informal, both with the pipelines and with the State public utilities commissions, because, of course, they govern the ultimate end use situation in curtailment. We set down the general guidelines for pipelines, but the end use is set by State commissions.

We are working both with pipelines. The purpose of these meetings is to see what their exact situation is other than the general data that we have already received last spring and have reported on. We are also working with State public utility commissions to see if we can work in concert in terms of any serious and grave situations.

Senator STEVENSON. Mr. Chairman, let me interrupt, if I may, at that point.

I believe the FPC has predicted a natural gas shortfall of 30 percent last year.

Now, I grant you much will depend on the weather and other imponderables, but the FPC has predicted far more serious shortages for this winter than we experienced last year.

Very little time remains in this session of the Congress. Congress is anticipating adjournment on October 2. We can't wait. If you need any authority, whether it is to determine the end uses or priority uses, for the sake of the economy, the public health, welfare, agriculture, industry, or whatever priority, we need to know.

If you need authority to allocate among pipelines, we need to know, and we need to know quickly.

If you feel it is wise at this point to phase out wasteful uses, the burning of natural gas under boilers, for example, or to provide relief from some of the high costs by attempting to allocate the price of the old flowing gas to light commercial or residential users, we need to know.

And even so, it is going to be very difficult.

What can you tell us right now about what the Congress should do? I address this question not just to you, Mr. Chairman, but also to your colleagues from the FPC.

Mr. DUNHAM. Well, first, I believe in the very extreme situations where health and safety is involved, I think that we have sufficient authority—admittedly untested—to order allocations among pipelines.

I am talking about worst-case type situations.

I am sure the pipelines would allocate among themselves as they have in the past. In other words, they trade off and borrow from one another.

So I wouldn't be as concerned at this moment on the worst-case situations, where basic health and safety are threatened.

This is, of course, barring with all caveats some 50-year winter or 100-year winter, or something like that.

Beyond that, we believe that in the next categories, priority determination starts to become marginal. I am talking about small industry and small concerns which perhaps do not have the ability to switch to alternative fuels that larger industries have. Curtailment is unlikely to occur for most of these users at this point.

But once you get above that, it seems to me that you get clearly into policy areas which Congress should make and determine the national priorities, such as boiler fuel prohibition.

As you know, many States are prohibiting it on a phaseout basis now. The State of Texas, notably.

But when you get into those gray areas above the so-called critical, I think this is clearly an almost impossible situation for the FPC to try and decide.

We have no basis to set these priorities. A tradeoff of a particular factory that may run out of gas in one area, compared to a factory in another area—a brick factory versus a glass factory, with 50 versus 100 employees, all these types of things.

And as we go forward in the curtailments, as we have in the last few years, we get down lower and lower in the priorities, the decisions are extraordinarily difficult if not impossible to make.

So that if Congress feels, as we certainly would encourage it, that some national categories of some kind could and should be set, these would be most helpful to us in trying to allocate this scarce resource.

Senator STEVENSON. Mr. Smith or Mr. Holloman, do you have anything to add?

Mr. DON SMITH. Mr. Chairman, the Commission anticipated that this would be the last biennial review which would be initiated and decided based essentially on industry generated and collected data, both cost and productivity.

The reason we felt that way was that we anticipated that two forms, form 40 and form 64, would wend their way through the administrative and judicial processes and would become effective and that data would commence being collected by the Commission subject to Commission audit.

It now appears that we will very likely go into the next biennial review using industry generated data.

This, I believe, is a problem for industry as well as for the Commission, and, of course, the public and consumers who pay.

Part of our difficulty is our fault. I think some of the reasons the court enjoined our usage of form 40 was because we could have done a better job designing it.

Be that as it may, I think both the data base for biennial reviews, such as we have before us, and the end-use data which is currently beyond our jurisdiction to get, would be substantially helped by enactment of legislation such as you have generally been willing to include, and I think section 7 of S. 3422 would be of substantial benefit to the Commission, and that is the data collection.

Two, I would second the Chairman's comments. Over the past several years, the Commission's priorities in handling of curtailment priorities have been pretty well set out and are ripe for congressional review. If the Congress anticipates, in the light of increased curtailments this next winter, that we are misallocating in terms of failure to reflect the national priorities that you deem should be reflected, you should legislatively change those.

Third, I would urge you to review not the Natural Gas Act, but the offshore lands legislation and the manner in which we lease offshore properties with substantial mineral potential.

I think that in many instances, again, that congressional wishes that gas be allocated in particular areas or to particular uses, or that producers be required to maintain a particular performance standard, should find expression in legislative changes in the conditions under which federally owned mineral interests are sold.

Senator STEVENSON. Mr. Holloman, do you have anything to add?

Mr. HOLLOMAN. Well, Mr. Chairman, you asked a question as to what the Congress should do immediately to meet the problems we anticipate in the coming winter.

At the present time, the FPC has estimated that four or five pipelines may go into priority one curtailment this winter under average circumstances.

That takes into account that we have had a series of abnormally warm winters, and a number of other very optimistic factors.

We have about 16 other pipelines that are going to be in very serious condition, many of them curtailing into priority two, and priority two means the loss of jobs, factory shutdowns and massive unemployment.

I don't think the Congress can avoid taking, or the FPC asking for, the authority to allocate gas between pipelines under certain circumstances.

We currently have a program and we are proceeding with a plan for voluntary allocation. I think that this is a very questionable program. I think any lawyer for a pipeline will not advise a client to voluntarily take away gas supplies from its customers in order to supply to the customers of another pipeline.

To do so would subject any pipeline to massive damage suits, something we already have against some pipelines now.

I think the time has come for the FPC to ask for and for the Congress to grant the authority to allocate gas supplies between pipelines where priority one or two customers are threatened with curtailment.

Certainly, some qualifications should be imposed upon such allocations. Certainly, those supplies should be priced incrementally, perhaps a compensation plan should be built into such allocation.

But in any event, I believe the time has come to bite that bullet and proceed to enact such legislation now.

Senator STEVENSON. All of the nonpricing matters that you gentlemen raised with the exception of offshore leasing, which is not within the jurisdiction of this committee, are addressed in S. 3422.

But I don't—I just don't know if it i possible to bring up those nonpricing matters without getting into pricing.

And if they can't be separated, it means no action on any of those problems in this session of Congress.

Senator STEVENS. I think it is highly unfortunate at this late date—I'm not critical of the chairman because I know he's worked very hard, many of us have, to get a bill out this year—it's very difficult to think about dealing with shortages.

We should have had the bill out a long time ago to try and remedy this situation and increase the supply.

I would doubt, as the chairman does, that we would be able to get legislation through that dealt solely with the qustion of allocation of shortages at this late date.

Mr. HOLLOMAN. Well, Senator, what you are going to have is this. Assuming for the sake of argument that we do have priority curtailments this winter, that means shutting down residential neighborhoods and smaller commercials, as well as vital industrial employment.

It is going to mean that we will be depending on the FPC's questionable authority to take any action in those cases.

And we will then have to defend the Commission. The Commission can proceed to order these allocations under what I would regard as highly questionable authority.

Pipelines which are directed to take gas from their customers and deliver to others will be placed in a position of having to defend that order.

So we will be tied up in litigation for some time to come, and it will be, in my opinion, virtually useless.

Senator STEVENS. Well, I appreciate what you say, and I am sure we would do anything we could to move such legislation. But the people who have been vociferous to try and get legislation in to increase supply, I don't think are going to be happy about moving legislation through that does nothing but allocate existing supplies, and you are going to get into the intrastate problem there if you get into anything at all.

I just had an interesting conversation with people from California, and I think there are some deep feelings about this allocation problem.

And I am constrained to say that had our pipeline not been delayed for years, we wouldn't be having this problem today. Sometime, someone is going to wake up about the delay involved in the supply picture.

The British discovered their North Sea resources long after we did and theirs has been to market already. Ours is still languishing in the ground in Alaska and is going to continue, apparently because there is some problem about waiving a stipulation with regard to 11 welds when our pipeline is the only pipeline in history that has had every weld X-rayed and examined. Normally, it is 1 out of 10. Here we agreed to do 100 percent and 11 out of 30,000 of them can't be gotten into in time this year. It might come home to the East, it might come home to some of these people, if what you said happens. It just might come home if we had a bad winter and people had curtailments and they suddenly understood what we said was true, that would happen unless we got in the business of producing this oil and gas.

So I think there is going to be rather strong feelings around here about taking the pressure off the people who have delayed the stimulus necessary to increase supply.

Thank you very much, Mr. Chairman.

Senator STEVENSON. Senator Weicker?

Senator WEICKER. Well, I have to take exception with Senator Stevens' comments about the East, since I very frankly have spoken out loud and long both for his pipeline and also for necessary things to be done relative to getting exploration going.

But enough of that

My concern deals with the fact that I think too much politics has gotten into the regulatory area. I think our job is to legislate. I think your job is to go ahead and set prices.

We are confusing the two and impeding each other's efforts. I am not just saying your Commission and the Federal level. At the State level and the Federal level, the pressure for regulatory agencies to make political decisions has been ever increasing, and ought to stop.

And the reason why it's been increasing is we have not been doing our legislative job. If that job were done, I think the pressure would be removed. I don't wonder that it's been 3 to 4 years we have had this legislation in the Committee on Commerce and we haven't come up with the right prices.

We are not equipped to do that job. It is as simple as that. Even somebody as knowledgeable as the Senator from Alaska, the Senator from Kansas, associated with natural gas—we are not equipped, staffwise or any other wise, to do your job in the price sense.

All the suggestions made here today have been good suggestions from each one of the commissioners, and there is no reason why we can't handle those suggestions in a legislative way, this committee and the Senate as a whole.

I think it is too bad, Mr. Chairman, that we have linked together our ability to set prices, which is not our job, with our legislative duties.

I think the time has come to separate the two. And the failure of the politicians at Federal and State level to realistically grapple with the problem has put the pressure on the regulatory agencies, and that is not where the matter can be resolved.

So, if indeed there is a holdup here, I think it is a holdup of our creation, and I know that it would be nice to expect that these matters of substance can all be resolved by someone other than ourselves.

But I think the time has come to make the rather tough decisions necessary to make for this country a sound decision from an energy point of view, and that is not their job or their headache.

It's ours in the sense of policies, and theirs in the sense of price.

Senator STEVENSON. Gentlemen, I do not have any further questions.

Since the subject has come up, I will observe that we will try to do better in the case of Alaskan natural gas than we did in the case of Alaskan oil.

The Senate has already passed legislation to expedite the procedure, and hopefully, this expedited procedure will lead to a sound decision.

I can't be confident that the decision made with respect to the Alaskan oil pipeline was sound. Apparently, the oil pipeline is leaking.

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And when it begins to transport oil to the west coast, it may accumulate a surplus of up to 500,000 barrels a day. We will end up producing Alaskan oil for the benefit of Japan, unless some probably very expensive methods are provided to transport it to the East and the West.

Senator STEVENS. We could go on all day on that subject.

Senator STEVENSON. I am going to go up to Alaska and find out for myself about those leaks while you are in Kansas City.

Thank you, gentlemen.

If we have additional questions, we will follow up.

Mr. DUNHAM. Thank you.

Senator STEVENSON. The next witnesses will likewise comprise a panel.

They are Lee C. White, Chairman of the Energy Policy Task Force of the Consumer Federation of America; James F. Flug, Director and Counsel, Energy Action Committee; and Charles Wheatly, General Counsel, American Public Gas Association.

For purposes of compliance with the requirements of the Pillsbury case, the record will show that the Commissioners of the FPC have left the hearing room.

Gentlemen, you are welcome to proceed in whatever order you choose.

Rather than get started and just interrupt your testimony, we will recess for about 5 minutes to allow us time to vote.

[Recess.]

Senator STEVENSON. Mr. White, do you want to go first?

STATEMENT OF LEE C. WHITE, CHAIRMAN, ENERGY POLICY TASK FORCE, CONSUMER FEDERATION OF AMERICA

Mr. WHITE. Yes, Mr. Chairman.

Might I say at the outset that I come here as the Chairman of the Energy Policy Task Force of the Consumer Federation of America.

That is a very large umbrella group with as many as 30 national organizations, large labor unions, such as the Steelworkers, the United Automobile Workers, Machinists, the National Farmers Union and U.S. Conference of Mayors, the American Public Power Association and Mr. Wheatley's organization, American Public Gas Association, and many consumer oriented organizations around the country.

Nobody kids themselves into thinking that there is any such thing as a single consumer position on energy, and yet we do our very best to espouse the consumer view. Sometimes I have my positions disavowed or my legs cut off, but on this particular issue it is not too difficult to understand the consumers' attitude about natural gas prices and especially those that are the subject of this hearing.

As one who in an earlier incarnation had something to do with the wretched business of fixing prices, I have an enormous sympathy for the gentlemen who were here before the committee just a few moments ago. Setting prices is a tough job, at best, and I don't think you can get a great deal of consolation over the fact that you are cirticized by groups such as ours, who say the price is too high, or by groups from the industry, who say the price is too low.

There is no assurance that you have got the right price, because you are criticized from both directions.

It is a tricky business to talk about an order while it is still in the process of review—judicial review. Consumer Federation of America is one of the organizations that joined with others, such as the American Public Gas Association and Mr. Flug's organization, the Energy Action Committee, to seek a stay in court.

We believe that the order itself is illegal and, as such, the effect of it ought to be stayed until such time as there can be a review of all of the elements that went into it.

But I know Mr. Wheatley will speak more about that.

I would like to ask that my relatively brief formal statement be incorporated in the record, and I will try to make my comments briefer than the brief statement, though I haven't been very successful about that in the past.

Senator STEVENSON. Without objection, your full statement will be entered in the record.

Mr. WHITE. The most heartbreaking thing about the poor old FPC is, that I don't think they are going to achieve their goal.

Their goal is to get the price of gas high enough so that people will go out and make investments in the interstate market that will put us back into a better supply situation than we have had in the past 5, 6, or 7 years.

When the industry asks for prices over $2 mcf, when the intrastate market has prices now at the $1.60—$1.70, $1.80, $1.90, it is very hard to believe that the same considerations that took place in the board rooms in Houston and Tulsa, when the decision was made not to drill for domestic natural gas, are going to be made now.

We think, by the way, that $1.42 is an extraordinarily high price, in fact, astronomic, outrageous, and any other adjuective that applies to it, if you accept, as we believe the Commission is obligated to accept, the notion of cost-based rates.

But even with that $1.42, as a member of the committee asked the FPC, why should anyone commit their gas, when, if they wait, there may be deregulation or, indeed, there may be an ever higher price that can be obtained in the intrastate market. So that at last the poor FPC, having hunched itself together and come up with $1.42, which is enough to boggle the mind, has right now in this order, for example, Mr. Chairman——

Senator STEVENSON. Could I interrupt and inject a question at this point?

Do you think that with this recent FPC decision setting a price at $1.42 there will be an incentive within the industry to withhold production in anticipation of still higher prices down the road? Is that what you are saying?

Mr. WHITE. That is what I am saying.

Senator STEVENSON. Well, then, I suppose the best thing Congress can do is to make it crystal clear that there will be no deregulation of natural gas.

Mr. WHITE. I think, as I have said before this Commerce Committee and any other forum that would listen to me, that for at least 5 years the important thing is for Congress to act and lay down the ground rules.

It is very easy to criticize the FPC. But I think the problem has been the inability of Congress to act.

I don't mean to suggest it is easy.

We have followed it very carefully. We know about your role and the Commerce Committee's role in drafting legislation, and the difference between the Senate and the House versions of natural gas bills.

But really it is important, I think, to continue on that legislative route.

There has to be some way to resolve the impasse between the two bodies.

It is not a happy note to be voting on gas legislation just before November in an even-numbered year and yet having invested this much in it, we must try to do so.

If it can't be done, then—that is your line of work, as much as any one else's—perhaps we can look forward to January 1977, when perhaps a Democratic President and Congress can get together, accept the burden and make some decisions. If it turns out they made the wrong decision, then this would be one of the factors considered by the electorate in the subsequent election.

But it is most frustrating not to be able to see progress in something as tough as this.

Senator Weicker said it was up to the FPC to fix rates. Although they are trying, as best they can, it is up to the Congress to fix the policy. Frankly there is no reason why a prudent industry man shouldn't hang back while Congress does so.

This does not reflect any extraordinary greed or evil motives. It is prudent business judgment to avoid uncertainty.

Unfortunately, the $1.42 order, which will be challenged in our courts, will not remove this uncertainty.

Senator STEVENSON. Well, assuming the order is upheld in the court, what uncertainty remains?

How much uncertainty would exist if the Congress were to act? This committee reported natural gas legislation.

By coincidence or not, the initial price of that legislation is very close to the price the FPC has now come up with.

This legislation cannot pass the Congress today. If it were to pass the Congress today, I, offhand, don't see what more uncertainty it would give the industry than the FPC has now given the industry. And at the levels that may, at least on the basis of our calculations, be sufficient to provide all the necessary resources with which to increase the production of natural gas.

Mr. WHITE. As I said before, $1.42 is below the intrastate rates. Naturally, the tendency of a seller in a seller's market is to sell it at the highest price that he can.

I am not suggesting that, the increase would not stimulate more exploration and development. It probably would. The price is so high that it is almost inconceivable that some people wouldn't be willing to sell it for the enormous profit promised by the new rate. The older rates, which allowed 15 percent return on investment were extraordinarily generous. But this is something else!

Senator STEVENSON. Are you suggesting that, for Congress to eliminate uncertainty, it must move to regulate the price at both the wellhead and in intrastate commerce? Anything short of that isn't enough?

Mr. WHITE. It is, but the House of Representatives marched right up that hill and did it. So we would hope that it could be done.

Senator STEVENSON. Well, they didn't really do it.

Anyway, excuse me for interrupting.

Mr. WHITE. It came close enough that, if my back were against the wall, and a knife to my throat, I would say, "Let's go with the House-passed bill." It isn't as good as the one, that you introduced Mr. Chairman; but I have to be realistic about the real world of congressional action.

At this point I would like to mention a couple of aspects of the Commission order which I consider especially difficult.

The first is the problem of the Federal income tax allowance. The Commission has included in the $1.42 around 43 cents geared to the new taxes that the natural gas producing segment of the industry is supposedly going to have to pay.

For a very long time now, the question of Federal income tax has been hotly-disputed. Among the people who argue before the FPC—even among members of the Commission themselves and their staff. The Commission seems to understand a different set of precedents; it has made it clear that the amount of taxes paid is certainly a legitimate cost of producing gas and ought to be borne by the ultimate user of it.

The industry has been asked repeatedly: "Please tell us what you made in taxes on the basis of the gas that you produced, because we want to include that as an element in the cost"; and, unless somebody smuggled in a piece of information recently, its answer has been, "We are not about to do that."

As a result, the Commission's decision last week to make an allowance for the full 48 percent is mind-boggling. No matter how the price is manipulated upwards, no one will believe that the gas industry pays a full 48 percent in taxes.

The same producers of intrastate gas also lost their depletion allowance when the Congress took it away. And nobody has demonstrated that the price of gas in the intrastate market went up 43 cents, because people who produce gas in the intrastate market are now paying such a large tax bill that it has to jack the price up in the intrastate market.

A far wiser course would be for the Commission to offer adjustments for taxes actually paid. I assume, on the basis of what Mr. Wheatley has argued to the United States Court of Appeals in the petition for a stay, that this is one of the grounds upon which the legality of the Commission's act will be challenged.

There are others.

Mr. Wheatley will discuss them in detail, but I did want to stress personally the percentage of the $1.42 which would be attributable to Federal income taxes.

I also wanted to focus on two other points with which you are already familiar. The first is the key element in the cost of gas production; namely, the question of reserves. The ratio obtained when $5 is spent for 1,000 cubic feet is obviously different from that when $5 is spent for 5,000 cubic feet of gas.

Thus no one denies that the amount of gas that has actually been discovered as a result of those costs is crucial.

The difficulty is that they are all estimates. Nobody does know for sure what is in the ground until the stuff comes out. By this late date, the Commission should have developed truly independent techniques for verifying potential resources. Otherwise, all the rest of their efforts remain only an exercise.

Senator STEVENSON. Does the Commission have the necessary authority to acquire reliable data?

Mr. WHITE. I didn't used to think so, because, when I was in the Commission, we would annually request authority from the Congress to collect new data and information. On the electric side, power side of its responsibilities, the Commission had such authority, very clearly and explicitly, in the Federal Power Act; but the Commission interpreted the Natural Gas Act—and I had no different view—as to preclude their doing so.

If there have been any legislative enactments on other matters—the Natural Gas Act and Federal Power Act have not been amended during these last 4 or 5 years—if any other act has given them the authority to do it, I am not aware of it.

One additional matter is one that I think you spoke about with the Commission; that is, their definition of new gas. Of course, as Senator Stevens pointed out, there are State regulatory agencies authorized to define it. Unfortunately, past experience has not given me confidence in them. But personal prejudices aside, I can objectively say that I know of nothing that precludes a company from shutting down a well, then drilling another well in the same reservoir and selling the gas as new gas. It's just like straws in a soda; you can plug up one and drink out of the other.

And so long as the definition is so loose it is a losing proposition. The Congress itself has worked very hard to come up with a tighter definition of new gas. It is unfortunate the Commission did not adopt some of those tighter definitions, if it is sincere about really wanting this to be an incentive and not a mechanism for simply increasing the dollars that the companies have to devote to exploration and development.

Senator STEVENS. They can't abandon wells without permission of our regulatory agency; and I don't think they can, in any other area in the West. They have abandonment procedure; and, if there is still gas in the reservoir and still producing and no sanding or loss of pressure, I don't think you can poke another hole.

In my State—I can't speak for others, but I think they are the same—abandonment is a very tough proposition for a well that is still got pressure on it.

Mr. WHITE. I hope, obviously, with our goals and objectives, that the States of Texas, Louisiana, Oklahoma, and New Mexico have some of those same considerations. Those regulatory agencies which are set up to serve a resource have, again, from our view of it, not a very good track record.

For example, on a monthly basis, they fix the allowables on the grounds that you will have to protect the resource and the subsidence and the other factors that are related to too fast a withdrawal of the resource.

But curiously, there has never been a deviation between the percentages allowed and the economic considerations which leads some

of us who are skeptical and suspicious to believe that nothing other than an economic price regulating mechanism is at work.

When the track record is unbroken, one can rasise the question; but one can also say, if that is the case, why would not the Commission have defined new gas in that way so there wouldn't be any doubt about it.

The Senate, when it was acting on deregulation or partial deregulation, adopted on the floor an amendment by Senator Tunney, which did exactly that. It tightened the definition of new gas; and that is what I was lamenting in the Commission's order: they didn't take that option which was open to them.

One of the worst features is that period between January 1973, and January 1975, where the price of natural gas goes from 52 cents to $1, more than doubling. Nobody has yet been able to figure out how you can go back in the year 1978 and discover gas in 1973.

Obvoiusly the notion of retroactive incentive doesn't explain it. The only possible explanation is that industry needs more money, and this is one way to repay them. The Commission's order on the increased cost is less than persuasive as I read it; and, again, I think this is a matter that ought t9 be explored and challenged.

One of the greatest difficulties—and, indeed, it may be curable only by legislation—is how to protect the consumer who may be about to pay billions of dollars a year on top of what they are already paying. And, by the way, there are some people who are under the impression that these gas prices have been held very low. The fact, is, in the past 5 years, the price of natural gas has increased 150 percent, which isn't exactly peanuts, if you will forgive the political reference.

If there could be some assurance—and the companies have steadfastly refused to make any commitment—that they will use the increased revenue for exploration and development, then, at least, there would be some reason to be comfortable that all of the money going into the producing companies' hands would be used for the purpose that the Commission hopes it would be used for, and that everybody else does.

I don't know when the Congress will come to an excess profits tax, if it does; I don't know when the Congress will come to a requirement of reinvestment; but these are concomitants, it seems to me, of a steeply increased price.

We have heard an awful lot about the market price being the test; and, if I may suggest, Mr. Chairman, even your proposal says, "Let's take the Btu equivalency and let's have gas and coal and oil at the Btu equivalent."

If that is the trick, it seems to me we ought to bring the equivalency price down to one that is built on the basis of cost plus a 15 to 18 percent return on investment, and then have a parity. Right now the oil price that would be used as the standard for natural gas prices is not fixed in some wonderful marketplace. It is fixed by 15 oil ministers who sit in Vienna at OPEC and had concluded how much more the international marketplace can stand.

That is hardly the type of standard that I think this government ought to be imposing on the natural gas industry from the point of view of the consumers.

I think I probably hit all of the points that are mentioned in my formal statement. I don't minimize the difficulty that the FPC has. I am sensitive to their burdens. I urge the Congress to make an effort.

I know that, as you said a few moments ago, this order probably has a chilling effect on the prosects for what has been a very tough legislative battle up to now. But I hope that you won't be deterred. I think it is very important that every effort be made to come up with legislation so that the industry, the consumers, the Commission, and everybody else, will know what the guidelines are for the next period of time.

That concludes my statement.

Senator STEVENSON. Thank you, Mr. White. I assure you that as far as this committee is concerned, the effort will continue. The obstacles, however, are formidable.

The most recent effort of this committee to reform regulations on natural gas was opposed by both consumers and producers.

And now, as a result of the FPC decision, there is less pressure felt within the institution, and of course, there is less time.

The effort will, of course, continue, but I can't be very optimistic, about the chances of reforming the price of natural gas, because allocation and price are difficult to separate in the legislative process. I assure you, however, that the effort will continue.

Mr. WHITE. I certainly can't speak for all consumers or consumer groups, but it may well be that this jolt of last week will help loosen some of the opposition all the way around.

I don't know, it's at least worth a try. It does seem to me that one of the keys is for Congress to grapple with this very difficult question, even though there are reasonable people on all sides of the issue, and it's neither simple nor free from controversy, that doesn't mean that legislation shouldn't be enacted. Maybe what some of us regard as a thunderbolt from North Capitol Street may prove to be a blessing in disguise if it does move things forward.

I am basically optimistic, Mr. Chairman.

Senator STEVENSON. Senator Stevens?

Senator STEVENS. I don't see how this Congress is going to act on S. 3422; if that is what you are optimistic about, I think you are reading the wrong papers.

It's pretty clear to all of us that are involved in S. 3422 that it hasn't got a chance.

Mr. WHITE. Well, if you were to ask me what I thought would be a fine legislative scenario, I would like to see the House and Senate sit down in conference.

There is sufficient disparity between the two bills for me to believe that it is at least possible to work out something.

I don't know whether it would be acceptable to the administration, but it's at least worth a try. There has been difficulty in getting to conference; I know a little about some of the legislative in-fighting and suspicion and doubts.

Nobody wants to yield his little tactical position. But it seems to me that at this late date, with so few legislative days left in this Congress, it is the best option to pursue.

I do not suggest I support S. 3422 in its current form.

Senator STEVENS. Well, that is the trouble. S. 3422 is the best version of the current form. We wouldn't have done that if we thought we would get to conference.

The House of Representatives turned our bill around. I am sure you realize that. But I appreciate your suggestion. I hope that there has been a little bit of shock treatment to the people who have been opposing us on both sides.

It's not a comfortable position we find ourselves in. I am sure my friend here doesn't appreciate your opposition any more than I appreciate the opposition of those who normally would support reasonable concepts for resource development.

But we are in the middle on this one, and I don't see how we can move it.

Mr. WHITE. Well, the role of the compromiser is always tough. If you do your job, you are hated by both extremes. The ability to pull it together seems to me to be the assignment of great legislative skill, and, forgive the expression, a lubricant is necessary to pull this out at the last hour.

There are people who believe that time is on their side and they would simply rather have nothing than not get their own bill.

If that's of any assistance in the effort, I would be glad to say it in some different forms if you would like.

Senator STEVENS. Strange to say that the longevity of those in leadership in consumer organizations is probably much longer than that of the Senator who makes the compromises. Thank you.

Senator STEVENSON. I don't want to endanger your longevity Mr. White, but do I hear you hinting that the attitudes of consumer organizations toward the pricing formula in S. 3422 is changing or is capable of changing?

Mr. WHITE. Well, I wouldn't want to mislead anyone. We have never supported S. 3422 because its pricing formula is geared to the Btu equivalency of oil, but I think there should be a conference with S. 3422 and H.R. 9464, which we do support, to see what can be worked out.

Senator STEVENSON. Let the record show Mr. Flug's head is shaking.

Mr. WHITE. Negatively. I would think that it's impossible for a price of $1.42 coming out of the Commission—as I say, I don't know whether it will withstand judicial review or not, but it certainly has to be a factor.

We are accustomed to this type of an increase. I remember that when the price went to 52 cents I couldn't quite believe that either.

Right now in this order No. 770, the increase in 1 year, just automatically 1 cent a quarter, is 4 cents. In those halcyon days when I was involved in setting prices, that would have been 25 percent of the whole darn price.

So we have to adjust our head upward, but the difficulty is in ensuring that the FPC which has steadily favored deregulation, enforces the law, which is cost-based regulation.

The new rate is not cost based by any reasonable interpretation and that is what Mr. Wheatley has argued to the court of appeals and will do so again, I am sure.

Senator STEVENSON. Thank you, Mr. White.

[The statement follows:]

STATEMENT OF LEE C. WHITE, ENERGY POLICY TASK FORCE, CONSUMER FEDERATION OF AMERICA

My name is Lee C. White, and I am here today in my capacity as Chairman of the Energy Policy Task Force of the Consumer Federation of America. Our Task Force has 30 member organizations (Attachment A), and our expressed purpose is to ensure that the consumers' views are included and considered in the energy policy debates currently taking place, and, in particular, within the Congress. We recognize that there is no necessary single "consumer interest" in any of the numerous issues that comprise the energy policy debates; nevertheless, we have undertaken to do the best job possible in assessing and stating the views of the consuming public and, as the broad base of our membership suggests, we do indirectly represent millions of Americans.

Nobody who has ever had the responsibility for setting natural gas rates is comfortable in commenting upon the product of others who presently have that burden. Numerous factors must be taken into account, and the mere fact that many parties believe that the price set is too high and many believe that the price is too low is of scant consolation. Furthermore, there is a problem of delicacy in criticizing decisions reached by a regulatory body while the process for consideration by the body itself, together with all of the opportunities for judicial review, are yet incomplete. Since, however, the Federal Power Commission, itself in its Order 770 dated July 27, 1976, solicits public comment, and inasmuch as this hearing has been scheduled to throw some light upon the decision, there are some areas that can appropriately be discussed. Moreover, the order does have a bearing on legislation pending in the Congress.

Without in any way questioning the motivation or the sincerity of the Commission majority, it is possible to wonder out loud whether the objectives stated by the Commission in support of its $1.42 rate will be achieved by the rate, which most observers regard as a significant if not "astronomical" increase from the 52 cent rate prevailing on July 26, 1976. If the basic goal is to encourage greater investment in exploration and the discovery of new gas reserves and the dedication of those reserves to the interstate market, why should the producers who find gas make permanent dedications at that rate if there is reasonable expectation that the rate will increase again? The Commission, a little bit late, is setting by Order 770 rates for the biennium ending December 31, 1976, and might well set new rates at an even higher level effective January 1, 1977. Since the intrastate rate is heavily influenced by the FPC-fixed interstate rates, we must assume that the $1.42 rate will become a floor for the intrastate market.

The Commission, conceding the difficulty of its assignment one more time, has created yet another fascinating situation by permitting the rate for the period January 1, 1973, through December 31, 1974, to rise from 52 cents per mcf to $1.01 per mcf. Quite obviously, there is no way that people today can go out and discover gas in 1973 or 1974—the concept of "retroactive incentive", as colorful as it may seem, is a concept that does not fly. The notion that customers who are supplied wholly or in part by interstate gas produced from wells discovered during that period should pay virtually double rates to provide the necessary capital to fund exploration and development is equally unpersuasive.

Commissioner Smith's dissent emphasizes one of the weak links in the majority's rationale; namely, the volume of reserves that have been produced. This essential ingredient in the formula makes a difficult job very nearly impossible. It is unfortunate, from the consumer's point of view, that the majority has not accepted the recommendations of its own professional staff whose calculations produced rate recommendations in the order of 56 to 62 cents per mcf.

Perhaps most remarkable is the treatment of Federal income tax. Admittedly, the action by Congress in eliminating the depletion allowance could have an impact on the tax consequences of natural gas producers. But it requires a remarkable leap to jump from a zero Federal tax (until this very day, gas producers have been unable or unwilling or both to submit their tax record to the FPC) to a full 48% tax, as found by the Commission majority, when the depletion allowance was less than 23% during all the time that the depletion allowance was in effect. Furthermore, there is a bit of a mystery in the fact that the price for intrastate gas did not jump 42 cents per mcf when the depletion allowance was eliminated for gas produced intrastate as well as interstate. If indeed the tax consequences on the producers of natural gas is significant, a record ought to be made if the Commission is dedicated to cost-based regulation. If it intends to reach a particular level without regard to demonstrated cost items, let it say so and let the Courts determine whether this is regulation as contemplated by the Natural Gas Act of 1938 as interpreted by the Commission through the years and by Court decisions.

In discussions of natural gas pricing, there is a tendency to pit consuming state citizens against producers, but in fact there are millions of people who live in producing states whose rates are not fixed by the FPC and who are themselves victimized by exorbitant prices for natural gas. Indeed, the sound of outrage and revolt in some of those states whose citizens are paying considerably more for natural gas than are their counterparts in distant states are increasing in intensity and may result in some state action. One of the probable consequences of Order 770 is to create a $1.42 floor in the intrastate market. A result that not only will adversely affect millions of families, but will also take its toll on the nation's economic recovery. So far as the FPC opinion is concerned, we have not been able to find where this economic impact has been recognized, let alone evaluated.

One who is bold enough to criticize the work of others ought to bear the burden of responding to the fair question, "what do you propose?". Our organization has supported extension of natural gas price regulation to the intrastate market and a faithful adherence to the concept of cost-based regulation. The very same factors that led Congress in 1938 to pass the Natural Gas Act exist today, except that circumstances are even more significant. The physical characteristics of natural gas are such that head-to-head competition by distributors is simply out of the question. Gas can only reasonably be transported and distributed through fixed and very expensive pipelines and distribution systems. There is no opportunity for the over 30 million families connected to the interstate pipeline network to bargain with a different company to secure natural gas on more favorable terms. In 1954 the U.S. Supreme Court held that protection of the consumer would be an empty gesture unless prices paid to producers at the wellhead were also regulated. Today the situation is even more demanding of protection against exploitation. Although there is some legislative dispute about the degree of concentration in the producing segment of the natural gas industry, there can be little doubt that the greater bulk of the gas produced in each major gas producing area of this country is done by a handful of major petroleum companies. More than ever before, protection against exorbitant prices for an essential commodity is required.

To those who say that this theory may be sound, but that under it no gas will be produced, my response is that the great natural gas deposits on Federal public lands can and should be developed—at least in part—by the Federal Government. No nation should be frustrated because an industry concludes that there are greater economic opportunities elsewhere or that time and pressures of shortage will erode determination to prevent the exploitation of a national resource.

The "market price" advocated by supporters of deregulation and presumably by the FPC as the appropriate determiner of price is a strange recommendation in today's situation, where 14 or 15 ministers of oil from producing countries around the world sit in OPEC and arbitrarily set the rate in what has become one of the more effective international cartels of all time. I cannot believe that the United States must not only succumb to these pressures for international producers, but must use the rate established as a standard against which domestic production must be gauged.

ENERGY POLICY TASK FORCE MEMBER ORGANIZATIONS

Adams Electric Cooperative, Inc.
AFL–CIO.
Allegheny Electric Cooperative, Inc.
American Federation of State, County and Municipal Employees, AFL–CIO.
American Federation of Teachers, AFL–CIO.
American Public Gas Association.
American Public Power Association.
Consumers Union.
Cooperative League of the USA.
Industrial Union Department, AFL–CIO.
International Association of Machinists and Aerospace Workers, AFL–CIO.
International Brotherhood of Electrical Workers, AFL–CIO.
Kansas Municipal Utilities.
Lincoln (Nebraska) Electric System.
Maritime Trades Department, AFL–CIO.
Minnesota Farmers Union.
National Farmers Organization.
National Farmers Union.
National Rural Electric Cooperation Association.
North Dakota Farmers Union.

Northeast Missouri Electric Power Cooperative.
Northeast Public Power Association.
Northwest Public Power Association.
Oil, Chemical and Atomic Workers International Union, AFL–CIO.
Pennsylvania Rural Electric Association.
Service Employees International Union, AFL–CIO.
South Dakota Farmers Union.
Tennessee Valley Public Power Association.
Textile Workers Union of America, AFL–CIO.
Tillamook Peoples Utility District.
United Auto Workers.
United States Conference of Mayors.
United Steelworkers of America, AFL–CIO.
Washington Public Utility Districts' Association.
Wisconsin State AFL–CIO.

Senator STEVENSON. Mr. Wheatley, do you want to go next?

STATEMENT OF CHARLES F. WHEATLEY, JR., GENERAL COUNSEL, AMERICAN PUBLIC GAS ASSOCIATION; ACCOMPANIED BY ARIE VERRITS, EXECUTIVE DIRECTOR

Mr. WHEATLEY. Thank you, Mr. Chairman. I am accompanied today by Mr. Arie Verrits, who is the executive director of the American Public Gas Association.

I have been requested to present my views with respect to the Federal Power Commission opinion No. 770, which established the new national rates for interstate sales of new natural gas at $1.42 per thousand cubic feet for new dedications of gas produced from new wells after January 1, 1975, and the $1.01 price for previously flowing gas that was dedicated between January 1, 1973 and January 1, 1975.

I am presently general counsel of the American Public Gas Association which has been participating jointly with a number of other national organizations which filed a petition for a stay with the U.S. Court of Appeals for the District of Columbia Circuit of opinion No. 770.

Our motion for a stay was filed on July 28, 1976, which was the day after opinion No. 770 came down.

The court on that day issued a temporary stay of effectiveness of the order 770 until further order of the court. Oral argument was heard last Thursday.

In view of my participation in those judicial proceedings relating to the order No. 770, but, on the other hand, recognizing the desire of this committee to have information as to the status of the legal proceedings, I would at this time limit my remarks to stating the positions in opposition to opinion No. 770 which we have put forth in the formal pleadings to the court or in the oral argument.

And I have copies of those if the committee would so desire to have them.

As the petitioners in support of the stay stated in their motion, which was not denied by the FPC, the increase ordered by opinion No. 770 represents the largest rate increase ever granted in the history of the United States. The petitioners sought a stay of the effectiveness of opinion No. 770, pending rehearing by the Commission, in order to preserve the status quo, in order to avoid irreparable injury to consumers of natural gas in the form of hundreds of millions of dollars

in excessive rates paid to producers before the rates could be reviewed by a court of appeals.

Now, in order to obtain a stay, there are four criteria: (1) irreparable injury; (2) the likelihood of success on the merits; (3) no adverse effect on other parties; and (4) that it will be in the public interest.

Turning to the question of irreparable injury, the amount of the impact of opinion No. 770 on consumers is clearly substantial. The petitioners submitted detailed data as to the impact showing a $367 million impact for a 60-day period.

The FPC in its response questioned the magnitude of that, but they concede in their pleadings with the court that even under the FPC's method of computation, there would be an annual impact of at least $1.5 billion, which would come out to about $250 million for a 60-day period prior to the time that the Commission could deny rehearing.

The Commission has taken the position that there will be no impact on consumers until October 27, 1976, when the pipelines can pass on the increases through the purchase gas adjustment clauses. However, the FPC does concede that the opinion, in its view, would be effective as of the data it was issued, absent the stay.

Therefore, the producers could charge the pipelines immediately, as soon as they can make the filings. The pipelines would have to pay the producers that money, so this accumulated fund of money would be like a large balloon note that would accumulate in the pipeline adjustment clauses up until the date those clauses can legally be triggered, which the Commission advises us is October 27.

So, in effect, what you have is a liability of the consumers of this country accruing daily from the effective date of order No. 770.

And the FPC in the past has never required the interstate pipelines to stand any accumulated purshase gas payments out of their equity earnings of the stockholders. And we believe, in reality, it wouldn't be fair to ask the pipelines to have to bear that, and the real question is whether the producers should obtain these increased funds prior to the time there has been a decision on the merits that the increases are consistent with the Natural Gas Act.

The Commission has contended that there should not be any stay because there is no irreparable harm because there is a "possibility" that the Commission some day might order refunds.

But the Commission has not provided in order No. 770, or in its order of subsequently denying the stay of August 2, that the producers should make any refund if opinion No. 770 is subsequently set aside or modified.

Thus, the present status of the matter is that the Commission has refused to order refunds now, and has never said that it will ever grant them.

That the Commission has no intention of ever granting any refunds to consumers from illegal overcharges by producers is now quite clear. In the 180-day deregulation case, the Court of Appeals for the District of Columbia Circuit set aside the Commission's order as being ultra vires and beyond tis statutory authority in the Natural Gas Act, and it remanded the case to the Commission for the question of considering refunds.

Not $1 of refunds has been ordered by the FPC.

In the small producer case, after remand by the Supreme Court in its Texaco decision in 1974, the Commission issued opinion No. 742–A on the very same day as opinion No. 770—July 27, 1976—in which it expressly refused to order any refunds from prior excessive unjustified rates.

Now, having refused to grant any refunds in the 180-day case, and the small producer cases, even though the Commission conceded that the rates charged were unlawful under the Natural Gas Act, and having denied any stay in the opinion No. 770 cases, there has been little likelihood of any relief from the Commission in this area in the future, and that is one of the reasons—a major reason—why we are before the court seeking a stay and seeking relief now to protect consumers from having to pay a charge which is beyond the legal authority under the Natural Gas Act.

Now, a second major criteria for obtaining a stay is the question of whether there is a likelihood of success on the merits. We have submitted that there is a great likelihood that the petitioners will prevail on the merits of the appeal. The FPC's decision in our view is patently unlawful and in violation of the Natural Gas Act on a number of different points. I will discuss some of these.

First, a major part of the increase, the 43.72 cents, relates to the purported Federal income tax cost to the producers. This is the first producer rate case ever to conclude that producers pay any Federal income tax on their production operations.

All of the prior area rate cases, from southern Louisiana, Rocky Mountain, et cetera, and all of the appeals thereon, were based on substantial evidentiary records.

It was conceded that the producers pay zero taxes, and there was no cost allocated to the cost of service in any of the prior rate cases.

We submit that the tax calculation in opinion 770 is fatally defective because it's not supported by any evidence. There's been a consistent unbroken line of cases that hold that if the Commission wants to allow a tax cost, it must be proved by evidence in the form of actual tax payments.

And in the prior nationwide area rate case for new gas, the 52 cent case, opinion 699–H, the producers made the argument that there should be a tax cost included in the rate relating to the temination of the depletion allowance by Congress. The FPC then opposed that contention, and its decision was affirmed by the Fifth Circuit Court of Appeals recently in the *Shell Oil* case.

And the reason for this is that it is very difficult to calculate the effect of the termination of the depletion allowance in relationship to the allowance which is still on the books permitting deductions for intangible well drilling expenses.

A number of very complicated factors come into play. In reality, we submit that the Commission, in its model which it has based its opinion 770 on, is engaged in a guessing game as to what these taxes will be.

The Commission's own staff had advised it that, on the record, there is not sufficient evidence to reach any conclusion relating to the income tax. This came from two independent branches of the Commission's staff, the Office of Economics, and the Bureau of Natural Gas.

Yet the FPC has refused to listen to its own staff, and has taken the company's hypothetical numbers as a basis for its tremendous rate hikes.

But even if there were evidence to support the FPC's tax treatment, it's legally defective. At page 84, opinion No. 770, the Commission concedes that the taxes would be zero if the industry continues to spend for exploration and development in the future. But it is at that point the Commission simply arbitrarily refused to consider these facts.

In so doing, it is acting inconsistent with the entire premise of the opinion that the new rates will promote growth.

In excluding the offset of future tax deductions, the Commission, we believe, has acted contrary to a very well established long line of cases which hold that, in the absence of express direction by Congress to the contrary, a public utility subject to the Natural Gas Act is required to pass on to consumers the tax savings from the use of various tax deductions.

The Commission, in opinion 770, also holds that tax deductions from other activities cannot be considered relating to its hypothetical tax calculations for jurisdictional business.

And here again, we submit that runs flat against the holding of the U. S. Supreme Court in the *United* case, which was affirmed by the D.C. Circuit and the fifth circuit in the *City of Chicago* and *El Paso* cases.

Another major legal defect in opinion 770 is the calculation of productivity. The determination of productivity is, of course, an important factor in the technique of constructing a rate that the Commission has employed.

In the prior 52 cent case, the Commission had found a 485 thousand cubic feet per foot of successful gas well drilled productivity number. And a month after that decision was affirmed, we now see, in opinion 770, the Commission has dropped the productivity number to 300 mcf per foot.

We seriously question the productivity figure in opinion 770 on two separate bases. First, the reliability of the actual data. The Commission again has gone to the AGA Reserve Committee estimates, which we believe have been thoroughly discredited.

A recent U.S. Geological Survey report showed a 37.4 percent disparity between the AGA figures and the USGS figures. But, even further, the Commission's own staff, in 770, reported to it on June 21, 1976 and concluded that the AGA reserve reports for certain years could not be verified and the Commission's staff concluded that it had no evidence and no way of identifying whether the discrepancies in the reserves as found by it and those reported by the AGA could be reconciled.

The problem was that the Commission, even though it had its own staff report that the AGA reserves could not be verified, has utilized them as a basis for these new very low productivity numbers, and has used them as a basis for increasing the 52 cent rate up to $1.42 level.

A third objection to opinion 770 is that the new rates are illegal because in reality they are based on an attempt to match the interstate rate to the intrastate market prices.

And we believe that the net effect of the opinion was an attempt to equate those prices and to inflate the so-called cost factors in order to reach it.

This was directly contrary to what the FPC's own staff had recommended. The Office of Economics had made two studies. The first of these recommended that the rates set in 770 be the same as that set in 699–H.

But, second, they revised that and recommended an increase with a range from 56 cents to a high of 69 cents.

The Bureau of Natural Gas concluded that the proper cost should fall into a range between 61 cents and 69 cents.

Now, when the Commission departs from those ranges of numbers to go to $1.42, and abandons its own staff estimates of the proper cost of services, we submit that, in essence, what we are witnessing is an effort to abandon cost-based regulations and set the price in relationship to the intrastate market prices charged by the producers.

The law is quite clear that under the present Natural Gas Act, the FPC may not set a just and reasonable rate based upon market prices. We have had a long string of cases from a Supreme Court decision in the *Texaco* decision, to the 180 day case, the *McDonald* decision, both in D.C. circuit, and the recent *Shell Oil* case in the fifth circuit, where the courts have clearly held that any attempt to set a just and reasonable rate by utilizing a market price from an unregulated market was unlawful.

A fourth legal area that we have raised is one that pervades the entire proceeding, and that is that there hasn't been any semblance of an evidentiary hearing granted by the FPC prior to the time it issued 770. Had it granted an evidentiary hearing, many of the problem areas we find in the opinion could have been explored by evidence and cross examination, and the Commission perhaps would have avoided the error that we believe has come out.

The failure to grant an evidentiary hearing, while setting what is the largest rate hike in the United States, I think is a fundamental due process question that the courts are going to have to face.

The Commission simply solicited comments from various parties. In essence, we submit that the consumers has less due process for the annual increase ordered by the Commission, which will take billions of dollars in the future from their pockets if it is not set aside, that a citizen would receive to contest a $10 traffic ticket.

In my statement that I have submitted to the committee, I do have come comments to the effect that the Commission's stay—the Commission's presentation will have very little adverse effect, we believe, on the availability of gas. The bulk of the increases that will go into effect involve flowing gas that has been already committed to the interstate market under the previous rates.

The $1.01 involved the flowing gas for the 2 year period from 1973 to 1975. The $1.42 rate will make an immediate increase to gas that is flowing and committed from January 1, 1975 up to the present time.

Those producers who committed their gas under the previous area rates obviously felt that the rates were enough incentive to commit that gas. To now double or triple the return that they receive on an action they have already taken under the prior ceiling is in the nature of an excess windfall to those producers that certainly is not related in any way to any incentive to bring new gas on the market.

Now, with respect to gas that has been previously discovered but is being withheld from the interstate market, we submit there is no

reason for opinion 770 rates to obtain this gas for the coming winter season.

The Commission presently has available to it the limited term certificate procedure with pregranted abandonment, which it can utilize to make any such gas available to consumers this winter while the validity of the opinion 770 is being tested on the merits.

In conclusion, we submit that the effort of the FPC in opinion 770 in one fell swoop to abandon any attempt to keep regulated rates set by the standard of a just and reasonable rate required by the Natural Gas Act, to equate the interstate price to that paid in the unregulated intrastate market which in turn is set by the OPEC nations, is a patent attempt to avoid the law.

The Commission's efforts amount to the de facto deregulation of natural gas without the consent of Congress.

That completes my statement, Mr. Chairman.

Senator STEVENSON. Thank you, Mr. Wheatly. Your full statement will be entered in the record.

When do you expect a final decision to be issued on the merits in the court of appeals?

Mr. WHEATLY. I would not want to predict that. The stay remains into effect until the court considers it. It is obvious to me that the court wanted to consider it very carefully, and I don't know how long it will take them. I would expect it to be soon.

Senator STEVENSON. I asked about the merits.

Mr. WHEATLY. On, on the merits, the nearest time that the case could get to the courts on the merits would be 60 days from July 27, if the Commission denies rehearing within the statutory 30-day period.

There is an initial 30-day period for filing petition for rehearing. There is a subsequent 30-day period for the consideration of petition for rehearing.

The problem is that in most of the other cases involving producer rates, the Commission has never denied rehearing on the second 30-day period, but has granted rehearing for the purpose of further consideration.

And in the small producer case, it took them 11 months before they finally entered their order denying rehearing, and in the case involving so-called old gas prior to 1973, it took them 6½ months from the date of the initial decision before they issued an order denying rehearing.

So, during that period of time, what we would be witnessing is a rate which is in effect and is being charged to the consumers, but which is not reviewable until they decide to issue the final order denying rehearing.

[The statement follows:]

STATEMENT OF CHARLES F. WHEATLEY, JR.

At the request of Chairman Warren G. Magnuson, I've been asked to present my views with respect to Federal Power Commission Opinion No. 770, establishing national rates for interstate sales of new natural gas at $1.42 per mcf for new dedications of gas produced from new wells after January 1, 1975. I am presently General Counsel of the American Public Gas Association which has been participating jointly with a number of other national organizations which filed a petition for a stay with the United States Court of Appeals for the District of Columbia Circuit of Opinion No. 770. Our motion for a stay was filed on July 28, 1976, the day after Opinion No. 770 was issued. The Court on that day issued a stay of the effectiveness of Order 770 "until further order of the Court" and set dates

for filing of briefs and oral argument. Oral argument was heard before the Court on August 5, 1976.

In view of my participation in the judicial proceedings relating to Order No. 770, but recognizing the desire of the Committee to have information as to the status of the legal proceedings, I would at this time limit my remarks to stating the positions in opposition to Opinion No. 770 which have been previously made in formal pleadings or oral arguments before the Court of Appeals. I will provide for the Committee a complete set of the motion and pleadings which we have filed with the Court, for its information.

Order No. 770 was issued by the Federal Power Commission on July 27, 1976 and permitted producers of natural gas to (1) charge $1.42 per mcf at the well head, almost triple the present "just and reasonable" national rate for gas committed after January 1, 1975 and (2) to charge $1.01 for flowing gas previously committed between January 1, 1973 and January 1, 1975, almost double the prior ceiling rate.

A large group of national organizations representing millions of consumers located throughout the United States petitioned in the United States Court of Appeals for the District of Columbia Circuit on July 28 for an emergency stay of the Commission's order. The group filing the petition consisted of the following entities: The American Public Gas Association, Consumer Federation of America, New Jersey Board of Public Utility Commissioners, State of Minnesota, Minnesota Public Service Commission, United Steel Workers of America, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW), International Association of Machinists and Aerospace Workers, National Rural Electric Cooperative Association (NRECA), American Public Power Association, United States Conference of Mayors, National Farmers Union, National Farmers Organization, Energy Action Committee, Toward Utility Rate Normalization (TURN), and the Industrial Union Department, AFL–CIO. In addition, Senator Hubert H. Humphrey joined in the petition on July 28. Subsequently, Senators Abourezk, Durkin and Proxmire, and Representatives Bedell, Brodhead, Harrington, Harris, Hughs, McGuire, Moffett, Moss, Ottinger, Seiberling, Oberstar and Studds petitioned for leave to intervene in support of the motion of an emergency stay. In addition, the Commonwealth of Pennsylvania and the Pennsylvania Public Utility Commission, the Public Service Commission of the State of New York, the Ohio Public Utility Commission and the Public Utility Commission of South Dakota petitioned to intervene in support of the emergency stay. Also the Rhode Island Consumers' Council and the Division of Public Utilities and Carriers of the State of Rhode Island has intervened in support of the emergency stay. On the industry side, a large number of major producers, various associations representing pipelines and distributors have petitioned to intervene in opposition.

As the petitioners in support of the stay stated in their motion, which was not denied by the Federal Power Commission, the increase ordered by Opinion 770 represents the largest rate increase ever granted in the history of the United States. The Petitioners sought a stay of the effectiveness of Opinion No. 770 pending rehearing by the Commission to preserve the status quo in order to avoid irreparable injury to consumers of natural gas in the form of hundreds of millions of dollars in excessive rates paid to producers before the rates could be reviewed by a Court of Appeals.

The criteria for granting this stay require meeting four points: (1) irreparable injury; (2) likelihood of success on the merits; (3) no adverse affect on other parties and (4) that it will be in the public interest.

1. *Irreparable Injury.*

The amount of the impact on consumers of the Federal Power Commission's Opinion No. 770 is clearly substantial. The Petitioners submitted detailed data in their petition and accompanying affidavit to indicate that the impact would be $367 million for a 60 day period, at a minimum. While the Federal Power Commission in its response questions whether the figure would be that high, the Commission does concede that even under its method of computation the annual impact would be $1.5 billion or $250 million for a 60 day period.

The Federal Power Commission contends that there will be no impact on consumers until October 27, 1976 when the interstate pipelines can pass on the increases through the purchase gas adjustment clauses. The FPC admits, however, that the rate is effective as of the date of its opinion, absent a stay. Therefore the producers would charge the pipelines immediately at the increased rates as soon as they can make the filings. The payments by the pipelines to the producers would simply accumulate in the pipeline purchased gas adjustment

accounts like a large balloon note which would be levied on consumers as soon as possible under gas adjustment clauses. Therefore, the liability of the consumers is accruing daily from the effective date of Order No. 770. The Federal Power Commission has never required the pipelines to stand any such accumulated purchased gas payments out of their equity earnings of the stockholders, and in reality would not be fair for them to do so.

The Commission contends that there is no irreparable harm because there is a "possibility" that the Commission "might" order refunds at some future day. But the Commission has not provided in Opinion No. 770 or its order of August 2, 1976 denying a stay thereof, that the producers should make a refund if Opinion 770 is subsequently set aside. Thus, the Commission has refused to order refunds now and has never said that it will ever grant them.

That the Commission has no intention of ever granting any refunds to consumers from illegal overcharges by producers is now quite clear. In the 180 day deregulation order case, the Court of Appeals of the District of Columbia, after setting aside the Commission's order allowing producer rates in excess of established just and reasonable ceilings as unlawful, remanded the case for consideration of refunds. Not one dollar of refunds has been ordered by the Federal Power Commission. In the small producer case, after remand by the Supreme Court in its *Texaco* decision in 1974, the FPC issued Opinion No. 742–A on July 27, 1976 in which it expressly refused to order any refunds from prior excessive unjustified rates. Having refused to grant any refunds in the 180-day and small producer cases and having denied any stay in the Opinion 770 case, there is likelihood of any such relief in the future.

2. *Likelihood of Success.*

There is a great likelihood that the Petitioners will prevail on the merits of the appeal. The FPC's decsion is patently unlawful and in violation of the Natural Gas Act on a number of different points. I will discuss some of these.

First, a major part of the increase, 43.72¢, relates to the purported federal income tax cost to producers. This is the first producer rate case to ever conclude that producers pay any federal income tax on new gas producing operations. All of the prior area rate cases, *Permian*, *Southern Louisiana*, *Rocky Mountain*, etc., were based on evidentiary hearings and all found zero taxes were paid by the producing industry.

The tax calculation in Opinion 770 is fatally defective because it is not supported by any evidence. A consistent unbroken line of cases holds that if the Commission wants to allow a tax cost it must be proved by evidence in the form of actual tax payments. In the prior nationwide area rate case for new gas, Opinion 699–H, the producers made the argument that there should be a tax cost included in the rate relating to the termination of the depletion allowance by Congress. The Federal Power Commission then opposed that contention as not proved, and the FPC's decision was affirmed by the Fifth Circuit Court of Appeals in the *Shell Oil* case, 520 F.2d 1061, 1080–1081 (5th Cir. 1975). The reason for this is that it is very difficult to calculate the effect of the termination of the depletion allowance in relationship to the allowance which is still in effect for intangible well drilling expenses. A number of complicated factors come into play. In reality the Commission in its model has engaged in a guessing game in Opinion No. 770. The Commission's own staff has advised it that the record is inadequate to reach any conclusion relating to the income tax. Two independent branches of the Staff, the Office of Economics and the Bureau of Natural Gas, so concluded. Yet the FPC has refused to listen to its own Staff and has taken the Company's hypothetical numbers as a basis for its tremendous rate hikes.

Even if there were evidence to support the FPC's tax treatment, it is legally defective. At page 84 of Order No. 770, the Commission concedes that taxes could be zero if the industry continues to spend for exploration and development in the future. But the Commission simply arbitrarily refuses to consider such facts. In so doing,i t is acting inconsistent with the entire premise of its opinion that the new rates will promote growth. In excluding the offset of future tax deductions, the Commission has acted contrary, to a long established line of cases which hold that in the absence of expressed direction by Congress to the contrary a public utility subject to the Natural Gas Act is required to pass on to consumers the tax savings from the use of various tax deductions. *See Alabama, Tennessee* Gas Co., 359 F.2d 318 (5th Cir.), *cert denied*, 385 U.S. 847 (1946), which was recognized by the Court of Appeals in *California* v. *FPC*, 506 F.2d 228, 229 (D.C. Cir. 1974).

The FPC in Opinion 770 also holds that tax deductions from other activities cannot be considered relating to its hypothetical tax computations for jurisdictional business. This runs flat against the holding by the United States Supreme Court in the *United* case, 386 U.S. 237, 244–45, 246–47 as well as the D.C. Court of Appeals decision in the *City of Chicago* and the Fifth Circuit decision in the *El Paso* cases.

Another major legal defect in the Opinion 770 is the calculation of productivity. The determination of "productivity" is an important factor in determining the level of the rate. In Opinion 699–H, the Commission found a 485 mcf per foot of successful gas well drilled productivity number. A month after that decision was judicially affirmed by the certiorari of the Supreme Court in June of 1976, the Commission in Opinion No. 770 has now found that the productivity has dropped to 300 mcf per foot. This appears to be clear error for several reasons.

At the outset of all of productivity figures used by the Commission are based on the AGA Committee estimates. These estimates have been thoroughly discredited. The recent U.S. Geological Survey report shows a disparity of 37.4% between the AGA figures and the USGS figures on a 153 field are; for this area the AGA figures are understated by 8.5 trillion cubic feet.

Next, the Federal Power Commission's Staff reported to the Commission on this subject on June 21, 1976. It concluded that the total non-associated gas discovered in 1971 and 1972 was not accurately reflected in the AGA reserve reports for those years. The FPC Staff clearly concluded at page 11 of its report that it had no evidence and no way of identifying the discrepancies in the reserves as found by it and those reported by the AGA. The FPC, however, while paying lip service to the unreliability of the AGA reserves as reported by the Staff for the recent four or five year period, turned around and used the AGA data as the basis for its new determination of productivity. This was clearly falacious and erroneous.

For example, in Opinion No. 699–H establishing the 52¢ nationwide rate, the FPC used a ten year productivity figure of 559 mcf per foot in reaching its ultimate conclusion of 485 mcf per foot. If the Commission in Opinion No. 770 had simply added the three years of 1973 to 1975 to the data it had used in the previous case it would come out with a productivity figure of 470 mcf, far higher than the 300 mcf used in Opinion 770. The drastic drop in the productivity figures utilized by the Commission in Opinion 699–H, based on the use of the AGA data which the Commission Staff has clearly found to be unreliable, as a basis for a substantial hike in the applicable rate to be paid by consumers, was improper.

Third, Opinion 770 new rates are illegal because based in reality on the intrastate market prices so that the net effect of the opinion was an attempt to equate to those prices and inflate the so-called cost factors in order to reach it. The Commission in Opinion 770 at page 116 concedes the prices that it is setting are equal to the level of number 2 and number 6 oil prices. Commissioner Smith in dissent concluded that the new rates were above the prevailing intrastate prices (page 11). Further, the $1.42 price for new gas is substantially in excess of that which the Commission's own Staff felt justifiable on a cost basis. The Office of Economics of the FPC made two studies, first, they recommended that the rate set in 699–H would be adequate but secondly, they recommended an increase with a range from a low of 56¢ to a high of 69¢. The Bureau of Natural Gas concluded that the proper costs would fall into a range between 61¢ and 69¢. Clearly, the Commission's departure from these ranges of cost estimates of its own Staff demonstrates its effort to abandon cost base regulation and set the price in relationship to the intrastate market prices charged by the producers.

The law is crystal clear that under the Natural Gas Act, the Federal Power Commission may not set a "just and reasonable" rate based upon market prices. The United States Supreme Court in the small producer case, *Texaco, Inc.* v. *FPC*, clearly stated that under the existing act, in the absence of amendment by Congress, attempt to use market price as the basis of regulation was forbidden. Also in the 180-day deregulation case (*Consumer Federation of America v. FPC*) and in *McDonald v. FPC* as in the D.C. Circuit, as well as the decision of the Fifth Circuit in the recent *Shell Oil v. FPC* case affimring order 699–H, the Courts clearly held that any attempt to set the just and reasonable rate by utilizing the market prices from an unregulated market was unlawful.

A fourth legal area, prevading the entire proceeding, is the lack of any semblance of an evidentiary hearing granted by the Federal Power Commission prior to the time that it had issued its rates in Opinion No. 770. Under Section 4 of the Natural Gas Act the Commission is required to have "full hearings" prior to the issuance

of a new rate. Section 19(b) of the Act requires the Commission to base its findings upon "substantial evidence". In the *Mobile Oil* case by the D.C. Circuit, 483 F.2d 1838 (1973) the Court ruled that where factual issues were involved an evidentiary hearing should be held, regardless of whether the proceeding was for rule making or adjudication.

The Commission has held no evidentiary hearings of any sort, but has simply solicited comments from various parties. The testing of the facts and conclusions in such areas as the FPC's income tax calculations as well as its computation of the discounted cash flow technique, would be vitally assisted by an evidentiary hearing and cross-examination. The consumers have had less due process for the annual increase ordered by the Commission, taking billions of dollars in the future from their pockets, than a citizen would receive to contest a $10 traffic ticket.

3. *No Adverse Affect of Stay on Available Gas.*

Opinion 770 permits massive rate increases to be put into effect immediately, in the absence of a stay, but the bulk of the increases would come from gas already committed to the interstate market. The portions of the order which double the Opinion 699–H price to $1.01 for gas committed from January 1, 1973 to January 1, 1975, and triple the prior price to $1.42 since per mcf for gas committed from January 1, 1975 to the effective date of Opinion 770 represents gas that was previously committeed under the incentive of the lower 52¢ rate. The Commission's order simply doubles or triples the take to these producers beyond that which they relied upon in committing their gas. No new gas would therefore result from these increased rates to the consumers; instead the consumers would be paying more for the same gas already previously committed. With respect to any new gas not previously committed, the Commission has previously estimated that it takes from 1.6 to 5 years lag for new production to be brought in. Accordingly, no new gas production could be expected from Opinion No. 770 to be available for the coming winter. With respect to gas that has been previously discovered but is being withheld from the interstate market, there is no need for the Opinion 770 rates to obtain this gas for the coming winter season. The Commission presently has available its limited term certificate procedure, with pregranted abandonment, which could be utilized to make any such gas available while the validity of Opinion 770 is being tested on its merits.

4. *Public Interest.*

Under the circumstances, it is clearly not in the public interest for the Commission to have issued the new high rates as set in Opinion No. 770. Chief Judge Bazlon of the Court of Appeals for the District of Columbia Circuit recently stated:

"Under the shadow of the nationwide shortage of natural gas, the incentive device has been ceased upon by the FPC and paraded before the Courts in a number of guises, perhaps on the assumption that the Courts would not be inclined to reject them all." (*Cities of Fulton, et al* v. *FPC*, 512 F.2d 947, 950–951 (D.C. Cir. 1975))

The effort of the FPC in Opinion No. 770, in one fell swoop to abandon any attempt to keep regulated rates set by the standards of a "just and reasonable" rate required by the Natural Gas Act, to equate the interstate price to that paid in the unregulated intrastate market, which is in turn is set by the OPEC nations, is a patent attempt to avoid the law. The Commission's effort amounts to the *de facto* deregulation of natural gas without the consent of Congress.

Senator STEVENS. Mr. Flug?

STATEMENT OF JAMES F. FLUG, DIRECTOR AND COUNSEL, ENERGY ACTION COMMITTEE, WASHINGTON, D.C.

Mr. FLUG. I, too, have a prepared statement which I will ask to be put in the record in full, and I will try to summarize.

Senator STEVENSON. The full statement will be entered in the record.

Mr. FLUG. I will try to excerpt from it.

Mr. White has given you a statesmanlike view, I think, with a historical context of the difficulties that you face and that the FPC faces, and I think Mr. Wheatley has given you the detailed factual and legal presentation and description of the situation we all find ourselves in.

I am going to try to give some of my own personal conclusions and urgings to this committee, because I think that we are at a turning point right now on the natural gas issue.

I am particularly pleased to see these hearings going on because I think it can be the beginning of a full reconsideration by the Senate of this whole issue.

Especially to me, as an alumnus of the staff of this body, it was not easy to see the Senate succumb to what I thought was a snow job by the natural gas industry last year. And only because the industry, with its appetite whetted by what the Senate did last fall, tried to do even better for itself in the House, did we get a chance to get another look.

And basically, what the House did was take some time to look at the claims that the industry was making, to test them out, to see if the facts matched the claims.

I think that is the first big change since last year at this time, when the Senate looked at this issue.

The House Committee and the GAO, the Office of Technology Assessment and the Library of Congress developed a massive body of information, which shows that last year's crisis atmosphere—so-called—was unjustified by the facts, that any potential tightness in supplies was due to actions and omissions by the industry itself, and that the only real barrier to development of new supplies was the industry's own expectation that deregulation was imminent.

In other words, what the House findings suggested was that the 1975 natural gas crisis, the basis for the Senate action, was in fact a fraud.

Now, basically, the task that the Senate had and the task that the House had and the task that the FPC has is which side in this controversy to believe. So it is relevant to look at the credibility, to look at the record in terms of claims and in terms of facts of each side, and we did have this massive body of facts on the one side.

And when we look also over the past year at the record of the industry, we see some very disturbing indications that—to the extent that policymaking in this field is based on the word and the good faith and trust in the statements of the oil and gas industry, their facts and their projections, their desires for new benefits, their warnings—that it was faulty.

And in the past year, we have had growing evidence that the industry has time and time again shown that it is really unworthy of trust or belief.

And finally, we have another fact to put into the equation this year, and that is how much weight this body should give to the various agencies involved in energy policymaking and implementation, and here, too, unfortunately, the last 10 months, beginning with FEA's so-called pack of lies radio spots, and I believe ending with this FPC opinion, have really shown that these agencies have swallowed the industry position hook, line, and sinker, and can only be treated now as advocates for the industry's point of view.

And when we look at the House findings, we see evidence of extensive underreporting of natural gas reserves, failure or refusal to produce substantial amounts of gas, enough to meet the wildest possible shortage predictions, massive diversion of interstate gas into intrastate markets, again, more than ample to meet the curtailments, and real failure by the pipelines themselves, and by FPC and Interior, to take available steps under current law to assure adequate interstate supplies.

And I suggest that the Senate follow up on the House work and take the time to look at these materials.

We had summarized them in a sheet titled, "Recent Disclosures Regarding Gas Supplies," and we have updated and footnoted these and they are attached to the statement, and I urge the committee really to look at these and to go back and make its own judgment as to how credible these findings are, and what they mean in terms of the Senate's action.

Now, what the Senate did have last year, if it didn't have these facts, was a great deal of pressure, direct and indirect, from the oil and gas lobby, the people who stand to benefit most from higher gas prices.

And given the context of this issue—after all, this is natural gas deregulation—the last time natural gas deregulation was considered and passed by the Congress, the tactics used by the industry were so gross that President Eisenhower had to veto the bill.

So you would have thought that the industry would be on its best behavior this time, and yet I believe greed has again taken its toll.

You can look at small signs of continued arrogance and insensitivity, and large ones, too. I guess probably nobody was surprised when it came out over on the House side that a substantial part of the campaign debt, amounting to tens of thousands of dollars, of the person leading the House deregulation fight was paid off precisely during the time of the deregulation battle and paid off principally from oil and gas industry sources.

And now when we look at the records over there, we find that the very day after the House gas vote and the day after the story about those other contributions came out, the Chevron Political Action Committee made a campaign contribution to the ranking minority member who led the fight on the Republican side in committee and on the floor.

Fortunately, that congressman had the sense to return that gift to Standard Oil of California as soon as he could, and that was a small gift by today's standards, and by CREEP's standards but still the aura was there.

I think we can get another feeling for how much we should listen to industry and whether basically we should believe industry because a lot of conclusions have to be based on our belief in what industry says.

When we look at the one company that prides itself on having what it calls the best image in the industry, it says it is the "most honest and direct in talking to consumers"—that is a direct quote from its own magazine in June—and that is Mobil.

They are the ones that published all those ads last fall about natural gas, and one of them started, "The natural gas shortage which could

leave a lot of schools and homes cold this winter and throw additional hundreds of thousands of Americans out of work * * *"

That was in the third week of December last year, on December 18.

When, on December 7—and really for a month before that, the press had been carrying reports that these drastic predictions were unwarranted. In fact, the Washington Post on the seventh headlined the story "Gas Shortage Evaporates," detailing how the supposedly hard-hit States were suddenly getting newly found gas supplies once they were authorized to pay above-contract prices for it.

So, Mobil had to know that the job loss forecasts were no longer credible, and even FEA in its most partisan moments never claimed that a lot of homes would go cold.

So the people were just not getting straight facts from the industry.

But it wasn't just what they were saying, it was the contrast between what they were saying and what they were doing.

At the very time Mobil's ads were talking all about the fine distinction between interstate and intrastate gas, regulated and unregulated, and the alleged shortages in interstate, the House subcommittee was receiving evidence that Mobil itself was a major exploiter of an FPC loophole, allowing over 1 trillion cubic feet of offshore gas a year—that is, interstate gas—to be diverted into intrastate markets and be sold for many times what it should have been sold for.

And at the same time, Mobil was refusing to accept a FPC permit and begin deliveries on a field that is had in hand.

And, of course, all the time it was talking about the need for incentives and more capital to invest, it was pouring nearly $1 billion of ready capital not into oil and gas, but into Montgomery Ward.

The reason I raise this is this is supposed to be the industry's model and leader, and we have a right to expect them to get their story straight before we give them billions and billions of dollars out of the pocket of consumers for natural gas.

Are they going to provide gas or aren't they?

Are they the ones who cause the shortages they complain about so loudly? And do they come with clean hands or don't they?

And I am as disappointed as many people, because I was one of those people who used to read those Mobil ads and they looked very credible and believable, and it seemed they were a reliable force in that industry.

But it turns out that they have the same credibility problems as everyone else.

You had another example this week. Mobil is still stonewalling on the accusations that its South African subsidiary has been evading restrictions on trade with Rhodesia.

These same Mobil executives who keep assuring us that they have rechecked every Mobil transaction to make sure no cash slush funds are hidden in their subsidiaries suddenly don't know anything about huge transactions of a major subsidiary.

Once again, they can't have it both ways.

Either Mobil doesn't really know what goes on in the nooks and crannies of its vast structures so that hanky panky disclosures are still possible, or it does, and it must take the responsibility for its apparently improper African arrangements.

So I urge this committee, when it considers the presentations from industry, to think about and carefully cross-examine when it hears Mobil asking for more incentives and when it asks Mobil about diversion and withholding of natural gas and when it decides whether to give Mobil new profit windfalls.

I hope that those questions will be framed carefully, and that you will listen very carefully to the wording of their answers and count the glasses before they leave.

The third development over the past year is really a function of the other two and that is who you are going to believe, given a choice, between people like John Moss and John Dingell, and people like Rawleigh Warner and Bill Tavoulareas.

The House of Representatives opted for Moss and Dingell despite the best efforts of the industry.

Now, where were the Government agencies on this? They are supposed to be representing the public. They should be a source of neutral principles, an independent force in this, and certainly able to follow through on these investigations because the House, like the Senate, doesn't have the kind of staff in terms of quantity and expertise to follow through.

The agencies should be doing that. They should be coming up with their own program of remedial steps, and I was very pleased to hear some suggestions this morning along those lines.

One I didn't hear from the FPC, at least while I was here, was a suggestion about that trillion cubic feet of gas that is being diverted from the interstate market to people like Mobil with the FPC's approval.

But in any event, FEA just came out of the closet, showed that it was an industry advocate. It prepared those radio spots that were really unlike anything I have ever seen, just viciously partisan. They didn't stop until we and some Members of Congress reminded them that there would be fairness problems apart from possible legal liabilities of the FEA officers themselves.

Then they had a gas pamphlet which Mr. White's organization sued to prevent distribution of. They were all over the Hill and the country, pushing the industry case.

It is really unfortunate, because they could have been a tremendous help in this area.

I think, then, what we are left with is the FPC.

Now I, too, am glad that this opinion came down when it did. I think it does have shock value. For one thing, it puts into very clear terms the pricing in fact of some of the legislative proposals that have been either passed or suggested over the past year and more, and we get a chance to look at what the basis for a $1.42 price is.

Just how can you justify a $1.42 price? When you look at it, as Mr. Wheatley and Mr. White have said, you see there is no basis for it. And that should make us go back and rethink the basis for our willingness on the part of some of us, and certainly on the part of the Senate to go along with prices in that range.

This just can't be justified.

Secondly, it forces us to take a look at what the results of such a price are. And once again, the Commissioners are standing here, not able to tell us that they will really elicit any more gas or that

they will be able to attract gas from the intrastate market with the new prices.

So the presence of the opinion gives us a base again to rethink the whole issue.

I am an optimist, like Mr. White. I think the Commission will take very seriously the rehearing process. It has invited submissions on rehearing. I assume that it will grant a rehearing.

I can't understand why it didn't suspend the effectiveness of the order while it awaited that rehearing since it put a focus on the rehearing, but I think we will all have a chance, including this committee within the limits of its relationship with the Commission, to ventilate some of these issues to get some of these facts on the line.

I must say, it is incredible to me that the Commission did not, as far as I can tell—and I am going to search again—look at all at the House disclosures—and I can't see how they could come to a decision in July 1976 without taking account of some of those disclosures.

I am encouraged by today's hearing, and I am encouraged by the imminence of further consideration by the Commission, because it is going to draw out, in very dramatic form, some of the issues that have been in controversy.

We had an example last week, in the presentation to the court by one of the gas associations, which talked about the impact on this winter's gas supply of this stay that we have been talking about. And it says, in no uncertain terms, exactly what we have been saying in a broader context, that, if there is a stay, that would "provide economic incentive for producers to withhold any new commitments of gas reserves until the litigation . . . is completed. Simply stated, a producer would not be inclined to develop and sell gas at 52 cents knowing that, 2 years hence—when the litigation is over—the same gas reserves could be priced at $1.42, or some other rate well above 52 cents. Obviously, the 90-cent differential in the new gas ceiling rate is a strong incentive to defer any commitment that can be deferred."

Now, that is exactly what a lot of experts think has been happening ever since 1969. In other words, the imminence, the possibility, and, in some minds, the political probability of deregulation is what has caused the withholding of natural gas supplies.

We got a letter recently from Mobil that said it was "the height of Chutzpah" when we, energy action, asked for space in their employee and stockholder publications to tell the other side of the divesture story.

I am sure you all know that the traditional definition of Chutzpah is the boy who kills his parents and then pleads for mercy from the court because he is an orphan. I think the facts here suggest the oil and gas lobby has given us a new definition, an industry which purposely keeps gas off the market and then pleads for mercy in the form of higher prices, because there is a gas shortage.

I don't think the American people are going to stand for that. I think the Congress has a duty to protect them from it, and I am glad to see this committee beginning to reconsider the context of the decision the Senate made last year.

Senator STEVENSON. Thank you, Mr. Flug.

Do I take it from your lengthy statement that you suggest the Congress should do nothing about natural gas except rethink its past actions?

Mr. FLUG. No; if it were possible, Mr. Chairman, I think that, as Mr. White suggests, and as many other people, both in industry and in the consumer world have suggested, that one of the chief problems is the incongruity between interstate and intrastate prices.

Now, there are two ways to remove that incongruity.

You can either raise interstate prices, or bring intrastate prices under control.

The House, as you and Mr. White discussed, at least indicated that it had hoped to bring intrastate prices under control; and I would say that, probably, that would have a lot more support out in the countryside, even in the producing State, right now, than it might have had a while ago. There is nearly a rebellion forming in Texas, because the price of electricity, which there is generated from intrastate gas, has gone so high that people are paying more than their mortgage payments for their electricity.

And I think that, if a sensible regulatory system for intrastate gas were proposed, that it might have more support than you would think.

So that is one thing I think can be done this year.

I think another is, some of the proposals that were suggested here by the Commission, in terms of clarifying some of what is believed to be their existing authority. For example, in the field of assuring enforcement of existing contracts, or the diversion to "own use," if they don't think they have adequate administrative power to change that and change it quickly, then maybe that would require some legislation; but I think that, as far as price goes, what this opinion does is, really, confirm to us that any such price in this realm—talking about a price that is double what the Commission's own staff was thinking about—is just way out of line.

Senator STEVENSON. Well, Mr. Flug—and certainly Lee White realizes this—it is obvious, for all the years that I have held hearings on natural gas, that something has to be done about the disparity between intrastate and interstate prices. I personally favor Federal regulation of intrastate natural gas.

You have suggested, in a lengthy statement, that we have not considered all of the possibilities, and that we have been gullible. You used the work "snow job" at one point.

Let me assure you that I don't believe anybody, and that goes for consumer representatives as well as oil company representatives.

[Indicating.] This is the hearing record, my hearing record in this committee on the price of natural gas. I want you to take this home and start thinking yourself. If you do your homework, you will read the testimony of over 200 witnesses in over 25 days of hearings.

You mentioned the House proposal——

Mr. FLUG. I agree wholeheartedly——

Senator STEVENSON. The House proposal was considered by this committee more than 2 years ago. That proposal, adopted by a very slim majority on the House floor, does not have the support of the majority within the House.

Now, it, too, is recognized in the House as an irresponsible and irrational solution. It was a hasty response to a very, very complex question.

Now, when you have done your own rethinking, I wish you would come back and tell us what to do. Make us some suggestions. I have sat here for 10 minutes, and I haven't heard one suggestion——

Mr. FLUG. Well, I sent you a list of suggestions some time ago.

Senator STEVENSON. I am suggesting to you that the time has come to act.

Mr. FLUG. And I gave you a list of suggestions, proposed revisions to S. 3422 sometime ago that had to do with what you do to make sure that these drastic price increases don't have unintended impacts on consumers, don't provide windfalls to the producers, don't deprive the American people as owners of the Outer Continental Shelf of the additional benefits that would accrue from these drastic price rises.

So, if we are going the route of drastic price rises, then there are things that can be done to mitigate the impact.

The Senate did do a good job in some of the amendments that it put on in the floor; and we are, really, talking about the floor here, and you were one of the major proponents on the floor of a different point of view from the point of view that the Senate came out with.

So that I think that you were one that had rejected some of the ideas that industry was trying to sell the Senate at that time. It turned out that, with winter approaching and with the claims that were made about the imminence of a crisis that the claims that were made about hundreds of thousands of people being unemployed last year and factories closing down, claims that were ultimately proved to be unsupportable, that a majority of the Senate adopted something which you then opposed and which, as I understand it, you now oppose.

Senator STEVENSON. Well, I'm not going to unduly prolong this discussion. We need suggestions. Your testimony on the whole, has been very helpful.

I would like to raise with you, before we leave, a question to which—through all the years I have been holding these hearings—I have never gotten an answer.

What is the effect of energy price increases, of the magnitude that we are considering, on GNP, on consumer price indexes, and on both inflation and recession?

We do not have, so far as I can tell, any analytical techniques that are capable of running out energy price increases through every stage in the distribution and the production of every product, every commodity, and every service in our economy.

I haven't even been able to get representatives of this administration to admit that they haven't done such analyses and that in fact they don't know how.

The Minister of Interior of Iran admitted to me once that there is no means by which to ascertain the effects of energy prices, of the magnitude that we have been experiencing, on levels of economic activity, such as inflation, recession, and unemployment. This morning the FPC couldn't even estimate the net additions or the price consequences to consumers beyond the first year, let alone the implications for GNP, inflation or recession, or unemployment.

In the past economists have come before these hearings, committed to free market models and governed by habit, and conventional thinking, many were willing to admit that there is no such thing as deregulation. Many of them admit this now.

Natural gas prices are somewhat different from oil prices. Unregulated, natural gas prices will probably rise to levels that are far in excess of those for oil because of the premium nature of this clean burning fuel and its pent up demand in the United States.

The Minister of Interior for Iran admitted that they didn't know what they were doing, and that the consequences of high energy prices were not just economic, but political as well. He suggested that perhaps the job of assessing energy price impacts could be done in a conference of consumers and producers of Europe.

As far as I can tell, such an assessment still hasn't been done, there or anywhere.

In the meantime, we are making decisions in the dark. The FPC is making decisions within its authority, perhaps, without being able to predict the consequences in even the narrowest sense.

Well, my final suggestion to you——

Mr. FLUG. I would like to make one comment on inflation, if I might——

Senator STEVENSON. [Continuing.] Is that prices have to go up, for reasons of conservation, as well as increased production. What we need to do with the kind of analysis that I am suggesting, is to find the middle ground, the balance that you strike between the requirements of the producers, all the resources and incentives that they need with which to increase production on the one hand, and the requirements of a stable, prosperous economy on the other. For the past 3 years, this subcommittee, and with precious little help, I might add, has been trying to do just that and I suspect that every time we get a little bit close to the truth, we fall between the stools. We lose the consumer and the producers, and that is exactly what has happened in the past, and it has happened again.

Maybe we'll be lucky again. We were lucky last year because of a very mild winter. We may not be so lucky this winter.

Mr. FLUG. If I could just make one suggestion in terms of the inflationary impact and the conservation impact.

We do have the retrospective analysis of the amount by which inflation is increased from past energy prices, and those are instructive.

I think the last Federal figures that were issued, should a major component of the inflationary impact for that month, was based on energy prices.

But, it's very hard to project in advance.

One of the founders of OPEC told me a few months ago, that in 1973, when they tried to set the OPEC price, they built in an inflation factor and because of their miscalculations on this, it's off by $2 a barrel now.

Senator STEVENSON. I don't mean to suggest that there weren't estimates. But, we have as many estimates as there are estimators.

Mr. FLUG. Now, on the conservation, when the FPC says on the one hand that there will not be that substantial a consumer impact in the short term because of the dilution effect and because of the slow rolling in of new gas, and yet talks about the conservation impact as being very strong, I think there is an inconsistancy there that we do have to be careful about.

If there is a conservation impact, it will only be at very high cost to the consumer. And if those costs are what we need to have a conservation impact that is not equivalent to saying that those costs should be transferred to the producers.

Senator STEVENSON. We must keept going.

Thank you.

Mr. WHITE. If I may add a footnote, Mr. Chairman, I don't think any consumer spokesman, self-appointed or otherwise, that I know of, has suggested that we really ought to go back to those good old days.

I think we recognize and appreciate that the people who produce energy are not immune from all other inflation, prices having gone up, and we have no belief that there is going to be some magic breakthrough in new technology right away that is going to change things.

What we are struggling with, I think, is that level that is appropriate. There is nothing easy about it, and unfortunately, sometimes those who undertake to do the compromising, the adjustment, get terribly discouraged, because as you say, on the extremes of either side, they have to be wrong.

All I can say, if I may, without being presumptuous, is, don't lose heart, keep at it, it's got to break.

Senator STEVENSON. Well, as you can see, I'm not overflowing with optimism and enthusiasm.

Mr. WHITE. There is enough pessimism around, it seems to me, Mr. Chairman.

Senator STEVENSON. It's been a frustrating experience to me. And as you know, as a past member of the FPC, this is not a new controversy. This has been going on for some 24 or 25 years. Well, we'll move on and continue the effort.

Thank you, gentlemen.

[The statement follows:]

STATEMENT OF JAMES F. FLUG, DIRECTOR AND COUNSEL, ENERGY ACTION COMMITTEE

Mr. Chairman, I am James Flug, Director and Counsel of the Energy Action Committee. Energy Action is pleased to participate in the Commerce Committee's oversight hearings on Federal Power Commission Opinion No. 770. As a citizens' energy information and advocacy group, we have been greatly concerned with, and heavily involved in the debate on natural gas pricing.

It is especially encouraging to see this Committee reopening the natural gas issue on the Senate side. This hearing can and should be just the beginning of a full reconsideration of this issue by the Senate.

Especially for an alumnus of the Senate staff, it was not easy to watch the Senate succumb to a "snow-job" by the natural gas industry last year. We can all be thankful that the gas lobby, its appetite whetted by the Senate action, tried to do even better for itself in the House, and thereby gave the House a chance to take a closer look, and to come up with a new approach that was not a "head we lose, tails they win" proposition for American consumers.

There have been radical changes since the Senate last debated the gas issue nearly 10 months ago, and found itself stampeding towards deregulation.

First, the House Committees, along with the General Accounting Office, the Office of Technology Assessment and the Library of Congress, developed a massive body of information which showed that last year's "crisis" atmosphere was unjustified by the facts, that any potential tightness in supplies was due to actions and omissions by the industry itself, and that the only real barrier to development of new supplies was the industry's expectation that deregulation was imminent. In stronger terms, the House evidence suggested that the 1975 "natural gas crisis", which had been the basis of the Senate action, was a fraud.

Second, the past year has provided ever growing evidence that to the extent that the case for deregulation was based on the word and good faith of the leaders of the oil and gas industry—their facts, their projections, their desires, their warnings—it was faulty. For during the past year the industry has shown time after time that it is unworthy of trust or belief.

Third, to the extent that the case for deregulation depended on purportedly expert and detached findings of federal agencies, the last ten months, beginning with FEA's "Pack of Lies" radio spots and ending with FPC's Opinion No. 770, have shown that the agencies have swallowed the industry position hook, line, and sinker, and deserve to be seen only as advocates for the industry's point of view.

These are strong conclusions, and you cannot be expected to accept them on faith. In the short time we have today I will attempt only to describe the evidence to you and tell you where it can be found, so that you yourselves can gather and weigh it.

The easiest to get, and the most telling, is the evidence amassed by and for the House last winter. I am submitting to the Committee an updated version of a brief summary we put out early this year, entitled, "Recent Disclosures Regarding Gas Supplies," and I urge you to read it in full and look at the underlying reports listed in the footnotes. For in just a period of months, House investigators were able to find:

—extensive underreporting of natural gas reserves amounting perhaps to trillions of cubic feet;

—failure or refusal to produce substantial amounts of available gas—enough to meet the wildest possible shortage predictions;

—massive diversions of interstate gas into intrastate markets—again more than ample to meet all the curtailments;

—complete failure by pipelines, FPC, and Interior to take available steps to assure adequate interstate supplies.

These findings, supplemented by reports from GAO and OTA that cast serious doubt on the FPC and FEA predictions about the impact of these supply barriers, are not the last word on the subject. There is more than enough for both the House and the Senate to inquire into before committing the nation to natural gas prices regulated by the oil cartel instead of a U.S. agency. For example, was it really inherently high risks or just purposeful recklessness—or rank stupidity—that caused the world's largest oil company to spend millions to drill off Florida, based on exploratory tests that apparently couldn't distinguish between oil and water under the ocean floor. And if finding gas is so risky, why did a responsible official of a major oil company tell me that his firm has *its* exploratory techniques developed to the point that they never drill for gas offshore without finding it. That is, according to this person, they know *every time they drill for gas they will find it.*

I suggest that the Senate has a major fact-finding job to do before it can fully meet its responsibilities. The House inquiries have established at very least probably cause to believe that the Senate did not have all the facts when it acted last fall.

What the Senate did have was a great deal of pressure—direct and indirect—from the oil and gas lobby, the people who stand to benefit most from higher gas prices. To put this effort in context we have to remember that the last time gas deregulation passed the Congress, the tactics used by the industry, in that case outright passing of cash, were deemed so gross that even President Eisenhower, not a particular skeptic about the oil lobby, felt compelled to veto the bill. One would have thought that the industry would have leaned over backwards, after two decades of penance, to be and appear pure as the driven snow. But once again, greed has taken its toll.

The small signs of continued arrogance and insensitivity are almost as telling as the large ones. Perhaps no one was surprised that a substantial part of the campaign debt—tens of thousands of dollars—of the House deregulation leader was paid off precisely during the time of the deregulation battle from oil and gas industry sources. But Energy Action has discovered that the very day after the House gas vote, which was also the day after the press accounts of those contributions, the Chevron Political Action Committee made a campaign contribution to the ranking minority committee member who had led the deregulation fight on the Republican side. It is encouraging that this midwestern Congressman was sensitive enough to return that gift to Standard Oil of California as soon as he could. The amount was small—by CREEP standards at least—but the thought was there just the same.

We get a much better feel for the "clean hands" issue when we look at the company which has really put itself out front in every possible way on gas and other industry v. consumer issues. Mobil Oil blanketed the national newspapers last winter with a four-part series of "op-ed ads" on natural gas plus a fable about squirrels and nuts and a "Furry Persons' Committee" (FPC) that makes you wonder what they spend their time doing over there. Mobil is a company which prides itself on having, in its own words the "best image" in the industry, and being "the most honest and direct in talking to consumers," as it boasted to its employees in its June magazine.

On December 18, 1975, Mobil published an ad that began "The natural gas shortage, which could leave a lot of schools and homes cold this winter and throw additional hundreds of thousands of Americans out of work. . . ." Now for over a month the press had been carrying reports that these drastic crisis predictions were unwarranted. And on December 7, 1975, the Washington Post had carried a story headlined "Gas 'Shortage' Evaporates", detailing how the supposedly hard-hit states were suddenly getting newly-"found" gas supplies, once they were authorized to pay above-contract prices for it, so that the job loss forecasts were no longer credible. And even FEA in its most partisan moments never claimed that "a lot of homes" would go cold. But none of that bothered Mobil.

(In the light of the recent FTC "Egg" decision, and spurred by a recent seriously misleading Mobil ad on divestiture, Energy Action is reconsidering its decision not to complain to the FTC about Mobil's advertising.)

It is not just what Mobil said that raises questions about its credibility on the gas issue, but the contrast between what it was saying and what it was doing. At the very time its ads were talking about the distinction between interstate and intrastate gas, and the alleged shortages in the interstate market, the House Energy Subcommittee was receiving evidence that Mobil was a major exploiter of an FPC loophole allowing over 1 trillion cubic feet of offshore gas a year to be diverted into intrastate markets. And while Mobil's ads were complaining about inadequate incentives for exploration, another House Subcommittee was hearing that Mobil refused to accept an FPC permit and begin deliveries from a proved field with hundreds of billions of cubic feet of gas. And, of course, while talking the language of incentives for exploration, Mobil was pouring nearly a billion dollars of its ready capital *not* into oil and gas but into Montgomery Ward.

Now if Mobil is the industry's model and leader, it should be asked to get its story straight before it and its sisters get more billions out of gas consumers. Are they going to provide gas or aren't they? Are their gas profits going to pe plowed back or not? Are they the ones who caused the shortages they complain so loudly about? Do they come with clean hands or don't they?

Frankly, I, too, was one of those who a year ago would have pointed to Mobil as an example of the responsible element in the industry, the believable and reliable force in a group which does not have an excess of those qualities. But as it turns out you can't even believe Mobil. And if you can't believe Mobil whom can you believe among Big Oil?

We had another troubling example this week. Mobil is still stonewalling in the accusations that its South African subsidiary has been evading restrictions on trade with Rhodesia by using a chain of paper transactions to sell oil to Rhodesia. Strangely enough the same Mobil executives who keep assuring us that they've rechecked every Mobil transaction to make sure that no cash slush funds are hidden in their subsidiaries, *a la* Gulf, suddenly don't know anything about huge tranactions of a major subsidiary. Again they can't have it both ways—either Mobil doesn't really know what goes on in the nooks and crannies of its vast integrated structure so the hanky-panky disclosures are still possible, or it does know and must take responsibility for its apparently improper African arrangements.

And so when this committee gets around to asking Mobil about its diversions and withholding of natural gas, and when it hears Mobil asking for more incentives, and when it decides whether to include Mobil in new gas windfalls, it had better frame its questions precisely, listen carefully, and count its silverware before Mobil leaves.

The third development over the past year is really a function of the other two. That is, each governmental agency declaring or implementing federal energy policy has had, in essence, to decide whom to believe, John Moss and John Dingell, and their sources of information and expertise, or Rawleigh Warner and Bill Tavoulareas, and their friends. The House of Representatives, by a close margin, and despite the most pervasive lobbying by those fronting for Big Oil,

went with Moss and Dingell. But FEA rejected the House findings out of hand, and, instead of using them as a jumping off point for the kind of thorough, professional inquiry we'd expect from the nation's key energy agency, or as a basis for a program of remedial steps, or at least as a yellow caution light on the road to deregulation, beat industry's drum louder than ever. Its P.R. folk put together a vicious set of radio spots whipping up the "gas crisis" spirit, and was prepared to distribute them nationwide until we and key members of the House reminded them that stations using the spots would incur fairness obligations, and FEA itself might be violating its lobbying constraints. Next came a blatantly pro-industry gas pamphlet. And all the time FEA executives were up on the Hill and out around the country pushing the industry's case in person.

Just last week we were treated to an interesting coincidence with an FEA press conference timed to coincide with the court hearing on the natural gas case, and an FPC lawyer prepared with an advance copy of FEA's statement to read in court in support of FPC's de facto deregulation effort.

Now perhaps there's nothing wrong with an executive agency forcefully carrying out a political decision made by the Commander-in-Chief. But if that's the route it chooses, then it dilutes its standing as a source of neutral principles, unbiased analysis, or investigative capacity.

In short, FEA, believing that the end of the fight was near last winter, came out of the closet and showed its colors, and now its efforts can clearly be seen as cumulative to those of the industry, adding nothing in the way of strength or credibility, but only another voice in a well-orchestrated chorus.

And that's too bad. Because despite its past problems, and especially its incestuous relationship with Big Oil and Gas, FEA does have some good people, and has shown flashes of independence on occasion. It would have been helpful having FEA pursue the leads suggested by the House inquiries, putting some expert personpower into tracking the withholding and diversions and misreporting, and devising ways for FEA and Interior and FPC and other agencies to use their leaverage to make the industry put up or shut up, especially on the federal domain. Perhaps next year when, whatever else happens, we are likely to have an ex-Senator sleeping in Rockefeller's new bed, he can help change that, but in the meanwhile the Senate is entitled, if not obligated, to discount FEA on the natural gas issue. And the same goes *a fortiori* for Interior. I think most of you gave up on Interior a long time ago, and that is why we have FEA. With aggressive and enlightened implementation of its responsibilities as trustee for most federally owned oil and gas, Interior could have done much to pop the balloon of rhetoric surrounding the gas issue, but it has not even had the guts to enforce existing due diligence requirements effectively and has worked hand in glove with industry to defang the Outer Continental Shelf leasing reforms.

And so we are left with the major focus of this hearing, the Federal Power Commission. Other witnesses today will be pointing out the substantive and technical flaws of Opinion No. 770. I'd like to point to some of the contextual flaws. I ask the Committee to re-read some of the FPC releases on last year's impending "crisis," especially in the light of the later events and disclosures. I ask you to look at the testimony of the FPC before the House Committees. I ask you to look at the House materials detailing the failures of the FPC to assure gas supply contract enforcement and describing the inadequacies in the information utilized by the FPC. And most of all I ask you to search the FPC opinion for any indication that it has read, let alone carefully considered, the many House hearings and reports raising serious doubts about the whole conceptual basis on which Opinion 770 is built. I haven't finished looking, but I have yet to find even a single footnote dealing with any of the House Subcommittee, GAO, OTA, or Library of Congress findings. They may have flaws, they may even be dead wrong. But I don't think they can be totally ignored. The Commission had no compunctions about taking "judicial notice" of *Oil and Gas Journal* materials on LNG prices or of statements from the Canadian Oil Minister. It should at least have noticed the U.S. House of Representatives.

The fate of Opinion No. 770 now lies in the hands of the Commission itself, on rehearing, and in the Courts. I may be naive, but I take seriously the Commission's invitation for additional information. I think this hearing will provide some of that information, and that one or more of the Commissioners will give it real weight in their ultimate decision.

Especially since the House has gone in one direction and the Senate in the other, I see no reason for further legislative action at this point—other than continued factual inquiries—until the FPC itself has acted finally, unless the Senate

is prepared to cure the one immediate problem, the inter-intra incongruity, by bringing intrastate gas under controls while we all decide what the general price levels will ultimately be.

In the meanwhile, we can all contemplate some of the curious elements of the FPC decision and the industry arguments in support of it. For example, if there really is going to be a minor impact on consumer gas costs, as FPC and industry argue, where is the substantial conservation impact which FPC promises going to come from?

And more importantly, why does the industry think that a stay of the Commission's decision is going to have an impact on *this winter's supplies* when it's supposed to take years to find and develop new gas? Look, for example, at the Opposition of the Associated Gas Distributors to our petition for an emergency stay. It says:

". . . the certain effect of a stay would be to provide economic incentive for producers to withhold any commitments of gas reserves until the litigation of Opinion No. 770 is completed. Simply stated, a producer would not be inclined to develop and sell gas at 52 cents knowing that, two years hence (when the litigation is over), the same gas reserves could be priced at $1.42 or some other rate well above 52 cents. Obviously, the 90-cent differential in the new gas ceiling rate is a strong incentive to defer any commitments that can be deferred."

Now when the Library of Congress economists, and the House Committee, and groups like ours made a similar suggestion about "withholding" and "deferring" based on the industry's expectation of deregulation over the past 6 years, there were cries of outrage from the Oil and Gas Lobby. Notice that AGD—whose members have vociferously supported deregulation—does not suggest here that 52¢ gives inadequate profits or incentives. It just says that *even as to gas already found*, given a choice between 52¢ now or $1.42 later, any sensible producer will withhold gas from the market as long as possible. This is what many experts believe has happened since 1969, with industry holding back in anticipation of deregulation and thus at the same time fueling the fires of deregulation.

In a recent letter to Energy Action, Mobil Oil said it was the "height of chutzpah" when we asked *inter alia*, for space in their employee and stockholder publications to tell the other side of the divestiture story. The traditional definition of "chutzpah" is the boy who kills his parents and then pleads for mercy from the court because he's an orphan. Well, the facts suggest that the Oil and Gas lobby has given us a new definition of "chutzpah"—an industry wich purposefully keeps gas off the market and then pleasd for mercy in the form of higher prices because there is a gas shortage. I don't think the American people will stand for that, and Congress has a duty to protect us from it.

Recent Disclosures Regarding Gas Supplies

I. There has been extensive underreporting by the oil and gas industry of natural gas reserves and supplies and thus substantial exaggeration of the alleged shortage:

A recent study by the House Commerce Committee Subcommittee on Oversight and Investigations revealed that, for one group of major Louisiana Gulf fields, industry *underreported gas reserves by 37%*.[1] If there is similar underreporting for the rest of U.S. reserves, then there is 100 trillion cubic feet of additional gas available beyond industry estimates, or about 5 years more supply than industry has projected.

The Investigations Subcommittee discovered that industry had *underreported* by 2.7 trillion cubic feet of gas (about 13% of a year's U.S. production) the reserves on another group of offshore leases.[2] At this rate of underreporting, we would have over twice as much in gas reserves as industry has reported.

II. Natural gas producers have failed or refused to produce substantial amounts of available gas.

The FPC has told the Energy and Power Subcommittee that 8.5 trillion cubic feet of proven and available Outer Continental Shelf gas reserves under contract to interstate pipelines remains out of production despite current need for this gas.

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[1] Natural Gas Supplies: Declining Deliverability at Garden City, La., October, 1975. Report by the Subcommittee on Oversight and Investigations, House Committee on Interstate and Foreign Commerce.

[2] Underproduction from Federal Leases in the Gulf of Mexico. January 21–22, 1976. Report by the Subcommittee on Oversight and Investigations, House Committee on Interstate and Foreign Commerce.

Union Oil Company, for example, testified before FPC that they could produce gas from these reserves immediately and profitably, but were refusing to do so in hopes of getting even more profit in the future. [3]

A study prepared for the Energy Subcommittee determined that on only one part of the Federal Outer Continental Shelf acreage leased to production companies there are currently 3.3 trillion cubic feet of probable reserves where wells have been drilled and capped, keeping enough gas from the market to meet the highest projected shortages for many years to come.[4]

The Investigations Subcommittee found that 55% of the gas wells on U.S. territory in the Gulf of Mexico are producing at far below the well operators' own estimates of capacity.[5] If these wells were producing at appropriate levels there wouldn't even be a possibility of supply problems this winter.

The Investigations Subcommittee reported that in three major fields, Garden City, Louisiana, Bastian Bay, Louisiana, and the South Brazos offshore field, major producers have failed to do the necessary routine maintenance, repair, and drilling work on producing wells to assure continuation of production.[6] The failure to keep gas flowing from these fields, in violation of the producers contracts, account for much of the predicted "shortages" this winter.

III. Major natural gas producers are diverting massive amounts of Federal domain gas from the regulated interstate market to the uncontrolled intrastate market, causing cut-offs of interstate supplies and generating huge windfall profits to the producers.

The House Energy and Power Subcommittee disclosed that Tenneco, a major producer, had illegally diverted large quantities of offshore gas into an intrastate pipeline, and sneaked additional gas out of an interstate pipeline for intrastate use. At the time Tenneco was actually cutting off their own interstate customers, claiming unavailability of supplies. Despite the appearance of blatant criminality, which still continues, no action has been taken by FPC or the Department of Justice. Moreover the FPC is unable to tell the Committee how much illegal diversion has occurred or how many other companies are involved in similar schemes.[7]

The Energy Subcommittee has found that a 1970 FPC "experiment" to encourage production has mushroomed into a diversion of over 1 trillion cubic feet a year of gas production from regulated interstate to unregulated intrastate markets, despite FPC staff warnings in 1972 that this loophole would seriously disrupt national gas supplies. This type of diversion alone amounts to 5% of total U.S. gas production, and would cover all of the projected curtailments even under the industry's most exaggerated figures for this winter.[8]

Among those exploiting this loophole to the highest degree and removing interstate gas supplies for uncontrolled sales is Mobil, whose complaints of interstate shortages have been the loudest. According to evidence before the Energy Subcommittee, Mobil recently took 26¢ offshore gas which could have been used to meet its interstate supply obligations and sold it for $1.90.[9]

The Investigations Subcommittee further found that Mobil refused to accept a permit from the FPC and deliver gas to consumers from the Grand Isle 95 Field—a field containing *at least 350 billion cubic feet of gas.* This field could have been producing by November 1, 1975, and could have supplied some 120 to 220 million cubic feet per day to substantially alleviate curtailment problems of pipelines and customers.[10]

IV. The Pipeline, the FPC and the Interior Department have failed to take available steps to assure adequate gas supplies this winter.

The Energy Subcommittee discovered that despite industry and Administration claims last summer of an impending gas crisis, which would allegedly

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[3] Hearings before the Subcommittee on Energy and Power, House Committee on Interstate and Foreign Commerce on Long Term Natural Gas Issues, October 24, 1975.

[4] *Ibid.*

[5] *Op. cit.* Underproduction from Federal Leases. January 21–22, 1976.

[6] Preliminary Staff Report Concerning Delays in Natural Gas Production by Cities Service Oil Company, July, 1975. Natural Gas Supplies: Declining Deliverability at Garden City, La., October, 1975. Natural Gas Supplies: Declining Deliverability at Bastian Bay Field, November, 1975. Reports by the Subcommittee on Oversight and Investigations, House Committee on Interstate and Foreign Commerce.

[7] Hearings before the Subcommittee on Energy and Power, House Committee on Interstate and Foreign Commerce, on Long Term Natural Gas Issues, January 14–15, 1976.

[8] *Ibid.*

[9] *Ibid.*

[10] Mobile Oil Corporation: Failure to Deliver Natural Gas to the Interstate Market. February, 1976. Report by the Subcommittee on Oversight and Investigations, House Committee on Interstate and Foreign Commerce.

produce massive unemployment, major pipelines supplying key gas consuming areas refused to purchase large amounts of gas offered to them for winter delivery.[11]

The President of the UAW, Leonard Woodcock, testified, to the Energy Subcommittee that he was told by a pipeline executive last August that other pipelines, which would normally come to his pipeline to arrange for extra standby supplies, had not made any efforts to get additional gas, leading him to the conclusion that "there is no shortage." On this basis, Woodcock, who had been pressed to support the "crisis" advocates, has concluded that "they are playing games with us." [12]

The Energy Subcommittee revealed that even after the FPC and the pipelines knew that producers were refusing to deliver the gas they had contracted to supply, neither the pipelines, nor the FPC used their legal powers to enforce those contracts. Such enforcement would have assured more than ample supplies for this winter.[13]

The Interior Department has admitted in House hearings that it has never enforced the "due diligence" provisions of federal oil and gas leases, and has always renewed such leases despite the failure of the oil and gas companies to develop those properties expeditiously.[14]

Senator STEVENSON. The next and final witnesses are John L. Williford, chairman, Legal Subcommittee, Natural Gas Supply Committee; George H. Lawrence, American Gas Association; and, Bill Brier, Director of Energy Resources, National Council of Farmer Cooperatives.

Gentlemen, you are welcome to read your statements or if you would prefer in the interest of saving time, I would be happy to enter them in the record if you want to summarize them.

Please proceed however you choose.

STATEMENT OF GEORGE H. LAWRENCE, AMERICAN GAS ASSOCIATION

Mr. LAWRENCE. I am George H. Lawrence, of the American Gas Association.

They have asked me to proceed first and then Mr. Williford and Mr. Brier.

I will summarize my statement.

Senator STEVENSON. Your full statement will be entered in the record.

Mr. LAWRENCE. As a matter of fact, as I saw you stack the record of proceedings on the desks before you, I too am reminded of the days we have labored through. I feel quite sure there is nothing in my prepared statement, there is nothing I can say now in the way of numbers, controversial or noncontroversial, that will surprise you, Mr. Chairman or most of the members of your committee.

I think maybe it's almost a time to do a little recalling from the past, because as I have listened here this morning to the Chairman and other members of the FPC, and a former Chairman of that Commission, and others who have been so intimately involved in all the controversial proceedings before that FPC over the past 24 years, I do hear some very stale echoes of the past.

I am not a student of the cost components of this particular case. I don't profess to be. That is, how they arrived at the $1.42 for 1975 and for past years—the $1.01 for 1973–74 gas. But I was involved in the Permian Basin rate case, and I hear many of the same

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[11] *Op. cit.* Hearings on Long Term Natural Gas Issues, Jan. 14–15, 1976.
[12] *Op. cit.* Hearings on Long Term Natural Gas Issues, Jan. 20, 1976.
[13] *Op. cit.* Hearings on Long Term Natural Gas Issues, Oct. 24, 1975.
[14] Staff Memorandum. Subcommittee on Energy and Power, House Committee on Interstate and Foreign Commerce.

controversies—the arguments over the tax components, allocation of costs between liquids and gas, between that analyses of productivity based on reserves estimates.

I have heard one witness here a moment ago refer to them as discredited AGA reserves and he referred to a statement before a congressional committee by the USGS.

Now, we at AGA have not really seen the basis of that particular study, although we have tried to obtain it. But as to the corroboration of the AGA reserves estimates over the years—and those estimates have been performed consistently since 1947—and they have been corroborated by the FPC's National Gas Survey in a 2 year very comprehensive program. They have been corroborated by the FEA.

And it seems very fashionable to say that any time an objective Government agency actually does perform that corroboration, it becomes a "tool of the industry," too.

So that is the same old criticism again. The FPC, itself, in one particular aspect of those reserve estimates, recently came around and I think again corroborated AGA in the so-called 31 lease estimates in the OCS area.

But my point is, Mr. Chairman, all of these cost components will continue to be controversial but there is one thing that is not and that is the number of gas and oil wells that are drilled in the United States over the past years.

In 1956 we were drilling something like 58,000 wells. That went steadily downward through the years over a 16-year period to a low in 1971 of a little over 26,000 wells. Now, it's begun to come up ever so slightly but not nearly enough and we know the shortage is real that is causing curtailments.

Senator STEVENSON. If I may interrupt. The number of wells is declining but many of them are deeper, large producers.

Aren't the more relevant figures the production curves? Production is also declining.

Mr. LAWRENCE. Yes; production is declining indeed. So we are in clearly a shortage situation and we began to incur curtailments.

The members of the American Gas Association and distributors began to curtail in 1971 and it's increased now to where they are at a level of about 25 percent of the interstate contract deliveries.

That situation must be somehow overcome. The decision by the FPC in opinion 770 is, we think, like others have said, a step in the right direction. It's not the final answer.

We think there must be legislation to remove Federal field price controls on new natural gas. Much akin to what the Senate passed in S. 2310. Perhaps similar to many of the aspects of your compromise proposal S. 3422.

We say we are going to have to do that to get back to the S. 2310 type of legislation because we are going to have a lengthy period of court review where we will have uncertainty.

This has already manifested itself in the stay proceeding where, we submit, a stay will cause chaos for a period of 2 years plus.

A refund order, even on the new gas, would cause serious uncertainty in the future and deprive producers of the incentive the $1.42 purports to be.

But the court opinion is going to be argued very eloquently on all sides for a lengthy period. Legislation is the only thing that can remove

that threat. The other is that everyone who has studied this subject in the Senate, and I might add in the House of Representatives too, I think very quickly come to the conclusion that the intolerable disparity between interstate and intrastate prices must be resolved, and this decision, though it may be a step in the right direction, does not remove that disparity.

There will continue to be uneven competition in the intrastate market.

Senator STEVENSON. Could I interrupt at this point? I have seen some figures which indicate that the gap between interstate and intrastate prices has been narrowed tremendously by this decision.

We are estimating that the value of the $1.42 decision is really $1.63 when you included anticipated increases and the average intrastate price now is about $1.55.

Are those calculations off?

Mr. LAWRENCE. No, sir. We think they are very much in the ballpark and we think, indeed, that gap is closing that intolerable disparity between 52 cents and $1.50 and upwards—and that is why we say it's a step in the right direction.

But we submit that so long as there is a free market choice in the intrastate market to exceed some predetermined level, so long as there is a market for gas in the producing States, it's going to go in that direction.

Senator STEVENSON. The demand in the consuming States is far greater than that in the producing States. Why wouldn't that demand establish the intrastate price?

Why wouldn't the intrastate price rise to meet the new interstate price?

Why wouldn't the intrastate price be established by the FPC price for interstate gas? That is where your market is.

If producers get, in effect, $1.63 in the interstate market, they will take it, won't they?

The $1.63 works out at a higher price than the present intrastate average.

Mr. LAWRENCE. I think, if I understand the thrust of your question, Mr. Chairman, my answer would be that if we get to the point where the demand, or the reasonably future prospective demand, in the intrastate market is satisfied and this FTC decision has been a sufficient stimulus to new exploration and drilling to the point where there are new supplies coming forward, then, indeed, there will be more new gas available for the interstate market. It will improve the situation, but not nearly to the extent needed, not nearly to the extent necessary to meet the potential demand for natural gas.

Senator STEVENSON. As long as there is a shortage, consumers will go to the intrastate market, maybe on a spot basis, and pay prices in excess of the regulated price in the interstate market.

Mr. LAWRENCE. Well, I think, certainly, as long as the regulatory and legal provisions will permit. We have seen that in the past two winters, where the interstate pipeline companies through the emergency provisions and industrial users through their direct purchases, have somewhat alleviated their own curtailments, and they have done it on the basis that apparently they consider to be economic.

Senator STEVENSON. If I understand what you are saying, you are concluding that as long as there is a shortage there is no way of evening out or eliminating that disparity, except by total deregulation or by a regulation which extends to the intrastate market.

Mr. LAWRENCE. Yes, sir.

Senator STEVENSON. All right.

Mr. LAWRENCE. The price for natural gas at the consumer level right now, at the residential level, is about $1.75 for a million Btu.

The comparable price for fuel oil is in the range of $2.88.

The comparable price for electricity for space heating is in the range of $9.50 per million Btu.

So we submit, Senator, that there is an economic sphere where natural gas incentive prices could go up considerably higher than any of the numbers contemplated in any of the legislation or in any of the FPC decisions and still be in the consumers' interest.

Our supplemental supplies of natural gas are in the range of $2.50 to $4 per thousand cubic feet.

And these also can be competitive with the fuel oil and electric space heating to our Nation's consumers.

So by far the most economic source of new gas supplies is the conventional natural gas supplies and there should be a maximum incentive for developing those in the United States.

Mr. White, I think, very appropriately said earlier that the OPEC nations should not determine and control all of our energy prices.

I can't help but think at every one of their OPEC meetings they must have a very gleeful preface at what we are doing on some of our own incentives in the United States to develop our own indigenous natural supplies and especially as it appalies to natural gas supplies.

We want this incentive to be prospective. We want it to apply to new gas. We can accept certain modifications that the Senate put forward in S. 2310 to make that applicable to the future. But the future price incentive for new natural gas should be allowed to seek its own level in the free market. We have a $50 billion investment and about a million miles of pipeline.

Senator, it is our most efficient energy delivery system. And, certainly, it is our most economically compatible. You said yourself, it is our cleanest most efficient fuel.

This is a point that tends to be overlooked, that it is the most efficient fuel.

By that I mean it doesn't have to be transformed. It doesn't have to have a refiinery or electric powerplant, and the environmental site selection, and economic projection problems that go with that.

It is a natural fuel that comes out of a well underground to the burner tip.

We need the most massive incentive we can to correct this supply problem.

If I might focus on one other point to get this in perspective and then I will stop.

Mr. White referred to the price increases, presumably from $0.50 to $1.42. Frequently, there's been reference back to the 1968 price level of 18½ cents, how outlandish this was to escalate from 18½ to 52 cents to $1.42.

So frequently overlooked is the fact that way back in September 1960, the first FPC natural gas field price guideline was 23.25 cents and over this 8-year period, when this drilling trend was going downward, the FPC restrictive policies at that time cut that price stepwise on about six occasions, biting away from 23¼ to 18½.

I might say, Senator, it was that dramatic low point that I think really prompted the distribution and transmission members of the AGA to better see what was happening, because until that time, we had very vigorously opposed field prices increases before the FPC and, I might say, very successfully in the Commission and in the courts.

But at that time our members became convinced that there was a shortage. It was real. It was continuing, and there must be maximum field price incentives in the future to offset it.

Senator STEVENSON. Thank you, Mr. Lawrence.

[The statement follows:]

STATEMENT OF GEORGE H. LAWRENCE, EXECUTIVE VICE PRESIDENT, AMERICAN GAS ASSOCIATION

My name is George H. Lawrence. I am executive vice-president of the American Gas Association, a national industry association representing some 300 natural gas transmission and distribution companies. Most of our membership is almost totally dependent upon the gas sold in interstate commerce at rates established by the Federal Power Commission. Our interest in FPC Opinion No. 770 and in the proceedings before the U.S. Court of Appeals for the District of Columbia is, therefore, vital.

Opinion No. 770 is a step in the right direction, but only a step. The ultimate solution to the natural gas supply problem is the removal of federal price controls on new gas. Federal price regulations, no matter how enlightened, always will entail the potential for lengthy court challenges such as we are now seeing in the U.S. Court of Appeals. As long as natural gas producers are exposed to the uncertainties implicit in federal regulation of prices for a major segment of users, we can expect interstate gas supplies to suffer. Further, it should be recognized that as long as controls remain there will be a disparity between federally regulated interstate prices, regardless of the level, and unregulated intrastate prices.

Opinion No. 770 does indeed demonstrate how unrealistic the prior 52¢/Mcf was compared with prevailing intrastate prices ranging from $1.50 to over $2.00/Mcf. Opinion No. 770 is, thus, a temporary expedient, not a final answer to the gas supply problem. Legislation to deregulate all new gas prices still is the needed, lasting remedy.

The Federal Power Commission in conducting its biennial review of national rates for jurisdictional sales of natural gas dedicated to interstate commerce on or after January 1, 1973, for the period January 1, 1975, to December 31, 1976 concluded that, and I quote:

"Since 1968, the annual consumption of natural gas has exceeded the annual addition of new reserves. Opinion No. 699 H (which established the 52¢/Mcf rate) was issued by the Commission to establish a uniform national rate with an underlying purpose of reversing the trend of diminishing dedications of new gas supplies to the interstate market. After review of the actual dedications since the issuance of Opinion No. 699–H, *we find that this purpose was not achieved* (emphasis added). Total new qualifying gas flowing in interstate commerce is only slightly more than one and one-half trillion cubic feet per year at this time. This low level of new dedication is largely due to substantial cost increases in 1974, increases that could not have been predicted, and thus were not taken into account, in establishment of the rate prescribed in Opinion No. 699–H. Active intrastate markets with higher prices captured most new onshore gas.

"The recognition of these cost increases in this proceeding will encourage the dedication of new reserves to the interstate market. The rates established herein will permit increased drilling activity and will place interstate pipelines in a more competitive position in the onshore markets."

Our member companies can corroborate the Commission's finding. The steady decline of available supplies of natural gas in the interstate market is severely restricting the capacity of our member companies to fulfill their public utility

responsibilities, and in most areas of the country it is forcing our members to deny service to new customers and to curtail supplies to historic customers. Critics of the new rates deplore the purported higher cost burden to consumers. But they ignore the very substantial cost burdens which the lack of natural gas supplies is imposing upon the public as a consequence on the under-utilization of our natural gas transmission and distribution facilities, and the forced reliance upon higher priced natural gas supplementals and even more costly alternate fuel supplies.

These new field prices remain well below the price for new, projected, supplemental supplies such as gas from coal, LNG (Liquefied Natural Gas) and SNG (Synthetic Natural Gas) from liquid hydrocarbons, and yet these higher priced supplemental supplies are economically competitive with heating oil, which must rely on increasing foreign imports, and are much lower than electricity for space heating. So to the extent that the new higher incentive prices do increase exploration in the U.S. and bring forth new supplies, the consumer clearly is the beneficiary.

H. Zinder & Associates, Inc., of Washington, D.C. has calculated that if natural gas supply is restored to 1972 levels, assuming a deregulated wellhead price for new gas, consumers would save about $2 billion in 1980 over the cost of alternative fuels.[1] If unrealistically low rates are maintained, Zinder projects that curtailments will grow to 25% of demand and consumers will necessarily encounter higher prices because of the higher costs associated with alternative fuels.

The efficiency of transporting gaseous fuels through pipelines is seriously compromised when transmission companies are forced to operate their lines at less than full capacity because of curtailments. The fact helps explain why implementation of the new rates would actually act to keep consumer costs down. by stimulating new supplies of natural gas and keeping pipelines full.

The case of the Algonquin Gas Transmission Company, Boston, is illustrative of the relationship between pipeline load factors and cost. When operating its pipeline at full capacity, Algonquin incurs transmission costs of 70¢ per Mcf. At 80 per cent capacity, transmission costs rise to 87¢ per Mcf; at 70 per cent capacity, transmission costs escalate to $1.00 per Mcf and at 50 per cent capacity transmission costs are up to $1.40 per Mcf. When curtailed, Algonquin must supplement its supplies with propane, which costs $3.60 per Mcf. Viewed in this light, a pipeline full of $1.42 per Mcf gas is clearly the cheapest way to go.

We estimate that the new national rate will increase the average homeowner's gas service bill by about 6 per cent per year. It should be noted that Opinion No. 770 applies only to the well-head cost of new gas. Wellhead cost represents less than 20 per cent of the overall cost of gas service to the consumer. Moreover, most gas flowing today is old gas sold under long-term contracts at prices well below the national ceiling and not affected by Opinion No. 770. For these reasons we expect there will be no excessive inflationary shock to the economy resulting from implementation of the new national rates. Rather, gas prices will gradually be readjusted upwards, phasing-out a dangerous aberration in natural gas prices and supplies which would otherwise result in much higher prices.

FPC's own analysis puts the increased consumer cost of the new rates at about $1.5 billion in the first year. Certain interests have seized upon this figure to substantiate charges that an intolerable financial burder will fall on consumers—rather than the realistic average cost of about $11 per year. Indeed a small price for assurance of supply. It is instructive to consider that of this $1.5 billion, the Commission estimates 55% will go to the U.S. Treasury in the form of taxes, 25% will compensate the industry for higher production, transmission and distribution costs, and only 20% will accrue to producers.

The requirement for effective long-range investment planning in the natural gas industry cannot abide the myriad uncertainties inherent in federal regulation. The overriding need, therefore, is for legislation to end federal price controls. The free market has proven itself to be the most responsive mechanism in the interests of supply and demand. Federal intervention is truly a poor substitute. Regulatory decisions can never keep pace with market forces and the resulting lag is injurious to consumers' interests. Witness the delay in securing FPC approval for an Alaskan natural gas transmission system. Further, we have seen that federal regulation imposes a high degree of uncertainty due to the unpredictable nature of litigation. Deregulation of new gas prices would remove these impediments and

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[1] H. Zinder & Assoc., Inc., "Studies as to the Cost to the Consumer of the Natural Gas Shortage and the Current Average Nationwide Cost of Finding and Producing Natural Gas," April 1975.

would end the debilitating coexistence of a two-market gas supply structure. So long as regulation continues, intrastate markets will outbid interstate suppliers to the detriment of consumers.

Senator STEVENSON. Who is next?

STATEMENT OF JOHN L. WILLIFORD, CHAIRMAN, LEGAL SUBCOMMITTEE, NATURAL GAS SUPPLY COMMITTEE

Mr. WILLIFORD. I am John L. Williford, senior counsel with Phillips Petroleum Co., in Bartlesville, Okla. However, this morning I appear in behalf of the Natural Gas Supply Committee.

At the outset, Senator, I should say that the producers, and my own company among them, are still studying this lengthy and complex opinion with the view toward the action on rehearing and reconsideration. My experience with the Commission tells me that it is likely that they will participate in that aspect of the decision and that they will likely participate in what I assume to be a certain judicial review of that opinion under section 19 of the Natural Gas Act.

Consequently, my remarks this morning cannot constrain or should not constrain either my company or any other producers as to the positions or views that they may take with respect to that opinion.

With very few exceptions, Senator—and I believe that massive hearing record that you have compiled in this committee would tend to corroborate this—it is agreed that supplies of natural gas continue, on a downward trend. Unless this trend is reversed, or at least halted natural gas consumers in the United States face the prospect of increased curtailment of natural gas, increased reliance upon higher cost alternatives, and increased prices for that gas they do receive as pipeline load factors decrease.

Over the last 3 years, this committee has heard enough about natural gas to make it hardly necessary to repeat the maze and the problems affecting natural gas regulation. Suffice it to say that this committee, and, indeed, the Senate itself, has seen the need for remedial legislation in the area of natural gas.

Had the House acted favorably upon the Senate-passed measure, S. 2310, I don't think there would have been a need or occasion to call these present hearings. But the House didn't act on S. 2310 and, consequently, the FPC remains the only congressionally mandated instrumentality by which the consumers in this country are to be assured of an adequate supply of natural gas consistent with the lowest reasonable cost.

It is the action of the FPC under that mandate that we are now considering, specifically its action in promulgating opinion 770, which prescribed various nationwide just and reasonable rates for new natural gas.

The very magnitude of these rates spawned a storm of criticism and resulted in the convening of this hearing and the announcement of a similar one in the House this month. Only 24 hours after the issuance of the decision, a judicial stay temporarily had been obtained in the circuit court of appeals.

As I stated, it is not so much that the Commission has established new rates that causes the furor as it is that those rates for the first time attempt to come to grips with the current cost of new natural gas and imply some recognition of its value as an energy commodity.

Those attempts on the part of the Commission translate to a price of $1.42 for gas first produced after January 1, 1975, $1.01 for gas first produced between January 1973 and December 31, 1974.

Understandably, the attention of many, including this committee, is upon the impact of these rates. While we would caution that one must look at the benefits to be achieved by these rates as well as the dollar impact, we would like to focus briefly upon the estimated impact upon consumers of the rates prescribed by 770 and examine the potential economic impact of the absence of these rates.

The APGA and those who have sought to stay the effectiveness of opinion 770 assert that the rates prescribed by the Commission will result, at a minimum, in an increase of approximately $367 million over the next 60 days, or approximately $2.2 billion on an annual basis. We believe that assessment to be significantly overstated. Correction of only two obvious errors shows that the impact is 50 percent too high, even accepting the same general approach and assumptions used by APGA.

APGA uses $1.63 as the ceiling price. That would have been the cost figure arrived at by the Commission had it not decided to use an escalation of the price in its discounted flow calculation. In so doing, though, the price for the beginning of the period is reduced to $1.42 per thousand cubic feet, and this is the current price and the figure that must be calculated or used in calculating the impact for a 2-month period, or near-term period, because that is all the producer can get. That same error of 21 cents per thousand cubic feet was made in the calculation with respect to the 1973–74 vintage gas.

The second obvious error was made in the impact calculation for limited term and emergency sale. Here, APGA estimates the volume of emergency sales as 159.25 billion cubic feet and the volume of limited-term sales as 253.25 billion cubic feet, for a total of 412.5 billion cubic feet. Estimates are based on average sales for the years 1971 through 1974, but volumes for those years are not indictive of the volumes currently being delivered or prospectively to be delivered.

The FPC publication, Gas Supply Indicators, which is cited in the memorandum that APGA filed with the District of Columbia circuit court in support of its petition, shows that the volume of those sales in 1975 was, in fact, negligible. As an example, the volume of limited-term sales for 1975 is shown as 6.3 billion cubic feet, in contrast to the figure of 253 billion cubic feet used by APGA.

Much is made in news accounts of the fact that the new field price of $1.42 represents an increase of 173 percent over the 52 cents presently in effect. But, what is overlooked is that this is the rate the Commission has found to approximate the average cost incurred by producers commencing in January 1, 1975.

No producer collected that rate in January of 1975. Nor, in any month following that. And, none can ever collect it from that date for the 19 months between that date and the date that this opinion was issued. And that is because Commission rate orders do not have retroactive application.

So, the producing industry starts off under this order, already having been deprived of the revenue for 19 months, which would result from the rates the Commission now says were just and reasonable during that period.

The efforts to stay the effectiveness of opinion 770 are simply attempts to stretch that 19 months to a longer period.

The Commission, on the other hand, estimates that for the near term, the cost to consumers under opinion 770, versus opinion 699–H, will be about $1.52 billion. Spread over the interstate volumes, this amounts to about 13 cents—would add, excuse me, about 13 cents to the average price paid the interstate pipeline.

In turn, this figure translates to an increase of $15.60 on the annual bill of the average residential gas consumer consuming 120,000 cubic feet.

Now, that does not take into consideration any offsetting decrease in consumption as a result of conservation efforts by consumers, but even without that, the impact is less than would be suffered under continuation of the status quo.

We submit that the absence of increased rates and remedial legislation has the potential for greater impact and change dislocations than do the rates prescribed by opinion 770.

The Commission has determined, and we agree, that there is a positive price supply relationship. The recent reaction of supply to increased prices in the Texas intrastate market demonstrates this relationship.

It's not possible to precisely quantify the supply response to the rates prescribed by opinion 770, but it's safe to assume that new supplies will be brought forth which would not have been found in the absence of those rates.

Failure to find those new supplies will result in increased curtailment of the diminishing supplies and consequent increased reliance on higher cost alternatives, and the price for that gas which is received, will increase as pipeline load factors decrease.

This is because major consumption centers are, for the most part, located far from the fields where natural gas is produced. This has resulted in the development of a separate and distinct element of the natural gas business—the interstate transmission companies. These companies purchase natural gas from producers in the fields where it's produced, and transport the natural gas through vast interstate pipelines systems to the several States.

The capital costs of that interstate piepline system have been incurred, and the Commission must allow recovery of those costs, whether the pipeline is running full or half full.

As has been stated to this Committee before, and as the Commission has recognized, the cost of moving and distributing natural gas from the point of production to the consumer accounts for about 80 percent of the ultimate cost to the consumer.

The evidence in the record compiled by the Commission in docket RM 75–14, the docket in which this opinion was issued, shows that if interstate supplies of natural gas continue to decline, the average load factor for the major interstate pipeline companies may decline from about 90 percent, where it was in 1973, to 52 percent, by 1980.

Stated simply, this means the pipelines will be running half full by 1980.

The fixed cost of those pipelines will not commensurately decline, rather, they will have to be spread over those much lower volumes. The average transportation costs to these pipelines is about 26 cents per thousand cubic feet in 1973. This cost could increase to about

71 cents per thousand cubic feet in 1980 if new gas supplies are not forthcoming.

In his dissent to the prior nationwide rate order issued December 4, 1974, Commissioner Rush Moody included a study showing the impact of deliverability decline upon a representative group of 15 pipelines and Commissioner Moody concluded "That increased curtailment may well cause a higher rate to consumers for less gas than will an increase in the price paid to producers."

We submit that any consideration of the impact on the consumer of an increase in the initial ceiling rate for new gas supplies must take this offsetting factor into account.

When the Commission issued opinion 770, it had a considerable amount of evidence before it. Among that, was the testimony of a witness for the United Distribution Co. companies serving approximately 10 million gas meters.

Looking at the impact of escalating curtailments, this witness estimated that an elimination of curtailments would save the ultimate interstate consumers some $8.6 billion per year by 1980, compared to what they would have to pay for both gas and all the natural fuels.

Consumers must have energy, and if it's not available in the form of natural gas, they must turn to higher cost alternatives.

The Commission examined the cost of alternatives or competitive fuels in testing the end result of the cost based rate it had established in opinion 770, and noted that they ranged from $1.28 per thousand cubic feet to $1.57.

The Commission also pointed out that the FEA current upper tier price for oil translates to a gas wellhead value of $1.67 per thousand cubic feet at 85 percent Btu parity.

Liquefied natural gas prices were noted to range as high as $3.24.

On balance the rates set by opinion 770 are well below the cost of substitute fuels.

Perhaps the staff of the Commission best put this effect of a too low price in perspective in the study they did appended to opinion 770 where it stated:

> A price 5 cents too low should lead to present consumers of gas saving about $30 million, while other consumers would be forced to spend about $80 million of alternate fuels.

In closing, I would mention that while the Commission action in promulgating the rates in opinion 770 must certainly be viewed as a progressive step, we cannot look upon that action as a panacea to the energy problems which beset the country.

The Commission's action represents only its attempt to cope with the situation within the framework of its responsibilities under the Natural Gas Act.

The defects and disabilities attendant to regulation of the natural gas producing industry have been detailed to this and other committees of Congress on numerous occasions.

The level of the rates prescribed by opinion 770 does not alter the problems we have enunciated on those prior occasions, nor does it diminish in any respect the urgent need for remedial legislation in the natural gas area.

Editorials in the Providence Journal-Bulletin in July and the Washington Post, August 1976, reiterate these problems and the need for legislation.

The Post says "The underpricing of gas, the cleanest and most efficient of fuels, is particularly foolish."

While the Journal-Bulletin observed that "Any price level that is set by a Federal regulatory agency is by definition arbitrary, the result of guesswork arrived at under conditions of constant political pressure."

I have appended copies of the text of these editorials to the statement.

We have characterized this action of the Commission as a progressive step because of our conviction that there is a positive price-supply relationship.

There can be no question that the rate set by the Commission should elicit supplies of natural gas which could not have been developed at previous rates.

However—and this cannot be ignored—we haxe described to this committee previously the necessary lead time to the development of new gas supplies.

Natural gas simply does not spring forth into the consumer's burner tip overnight.

Instead, geological and geophysical work must be done, leases acquired, exploratory wells drilled, and the results evaluated.

Certainly it is true that the industry has done preliminary work on some of the marginal prospects, those that could be drilled at $1.42, but not at 52 cents.

These marginal prospects could be drilled fairly soon, and if gas is found, it could begin to flow quickly.

But to alleviate the long-term gas supply problems of this country there must be remedial legislation to remove uncertainties which have long existed with respect to natural gas.

The Commission action and opinion No. 770 cannot, in itself, assure an adequate supply. It is a beginning, and only that, for the ratesetting authority of the Commission is only a part of the problem which is creating the shortage.

The whole specter of regulatory authority inhibits the development of an adequate supply of natural gas.

In recent months the regularory conditions imposed upon natural gas producers has been further beclouded by Commission orders raising the prospects that for the first time the Commission will assert authority over the details of exploration and production of natural gas properties and by implication overriding state law respecting interpretation of leases.

Understandably, these actions have alarmed many segments of the producing industry and exacerbate the total uncertainty faced by a producer selling natural gas in interstate commerce.

Turning again to Commissioner Moody's often phophetic dissent to opinion No. 699–H, we could paraphrase and apply it to 770.

The Commission in opinion 770 has again established producer rates according to what it perceives to be judicial direction—rates based on estimated rate base, estimated costs and estimated rate of return.

Here as in all prior cases the focus was backward, toward the average of costs spent in a test year, and not forward.

For the long run, average-cost-based ratemaking guarantees a decline in exploration.

Once the rate is announced drilling operations tend to limit themselves to the average and below average cost prospect—limiting exploration and development of a high-risk high-cost prospect.

Commissioner Moody at that time called for a more effective, more reasonable and more just method of regulating producer rates so long as Congress fails to amend the Natural Gas Act to decontrol wellhead prices.

The Commission has been accused of de facto deregulation by opinion No. 770.

While opinion No. 770 has significantly increased the rates for new gas, it has neither deregulated producer rates nor indeed has it even moved to the better method of regulation envisioned by Commissioner Moody.

That concludes my statement, Mr. Chairman.

[The attachments follow:]

[From the Providence Journal-Bulletin, July 31, 1976]

OVERDUE SPUR TO NATURAL GAS PRODUCTION

For 19 months the Federal Power Commission had sat on its hands and done nothing about the ever-shrinking U.S. reserves of natural gas, because it was waiting for Congress to do something besides talk about deregulating the price of gas. Apparently the obvious finally dawned on the FPC—that Congress would rather let the wells dry up and the consumer freeze than puts its imprimatur on any bill that would bring more profits to the big, bad, greedy oil industry.

Last Tuesday, the FCP screwed up its courage and voted, 3-to-1, to let gas producers raise the ceiling price for gas newly discovered or newly sold on the interstate market ("new" meaning after Jan. 1, 1975) to $1.42 per thousand cubic feet (mcf). That is nearly three times the old 52-cent rate. Gas discovered or committed between Jan. 1, 1973 and Jan. 1, 1975 will sell for up to $1.01 per mcf, but "old" gas (pre-1973) will stay down at 29.5 cents per cmf.

Normally we would be among the last people to endorse higher prices on anything, the more so on energy, already disproportionately high here in New England. But let us face the facts (even if Congress will not). In the 20 years since the federal government has thrust itself into the pricing of natural gas, the drilling of new wells has virtually slowed to a halt. Because the feds control only interstate sales, the price of natural gas in producer states has soared to three or four times the 52 cents per mcf level that the FPC has held as a ceiling on interstate sales. Meanwhile, the international oil producing cartel (OPEC) has been commanding prices close to $2 per mcf for imported liquefied natural gas (LNG). And natural gas is currently worth $2 or more as a substitute for oil.

In short, federal intervention in the pricing mechanism of natural gas has succeeded only in so distorting the system that it has created shortages and absurdities. In fact a disastrous shortage, that could have had enormous negative effects during the recent severe recession, was avoided only by the kindness of Mother Nature, who bestowed a couple of mild winters on the Middle Atlantic and Northeastern states.

We would not argue the correctness of the new price levels set by the FPC—any price level that is set by a federal regulatory agency is by definition arbitrary, the result of guesswork arrived at under conditions of constant political pressure. Only the self-regulating mechanism of the free marketplace can determine the "correct" or "fair" price of anything; but at least the latest FPC ruling is in the right direction.

As anticipated, a coalition of groups opposed to the rate hike has hauled the FPC into court to challenge its decision, and succeeded in getting a temporary stay order. Congress will haul it over the coals later on for doing what the legislators themselves had no stomach for doing. But if the FPC survives these ordeals—and, having offered itself up as a scapegoat, chances are that it will—the American consumer will find himself grumbling over a five or six percent increase in his fuel bills. But at least the gas will flow when he turns up the thermostat this winter.

[From the Washington Post, Aug. 6, 1976]

The FPC and Your Gas Bill

The decision to raise natural gas prices is the right one, and it is, if anything, long overdue. The Federal Power Commission held off its ruling for months, perhaps hoping that Congress might abolish gas price regulation altogether. But the deregulation bill is stuck fast in the great national stalemate over energy policy. The Senate and the administration are for it, while the House is adamantly against it. There the issue has stood since last winter, and there it will doubtless stand until another administration takes office next winter. The FPC has now done what it can, although its decision is already becoming entangled in litigation of who knows what duration.

Meanwhile the country goes groping along with both gas and oil under price controls set at levels at which domestic production keeps falling and demand for energy is once again rising like a rocket. Conservation is not going to be effective as long as Congress persists in holding fuel prices artifically low. For the consumer, the FPC's decision—when and if it goes into effect—will mean a moderate and gradual increase in gas costs.

The FPC would triple the price of newly discovered gas at the wellhead, from the present 52 cents a thousand cubic feet to $1.42. But that price would apply only to gas that has come into the interstate market since the beginning of 1975. It would be mixed with cheaper gas from older wells. The bite on the average consumer would be $15.60 a year at first, rising as old gas wells are exhausted and new ones come on stream. Nationwide, the average residential customer is currently paying about $220 a year in gas bills; here in the Washington area it's more, about $365 a year, because we're farther from the wells. Some three-fourths of the average residential gas bill is the cost of transportation and distribution.

The FPC's proposed price would raise gas costs to all customers by $1.5 billion in the first year. Who would get that money? The biggest beneficiary turns out to be the U.S. Treasury, which, the FPC estimates, would scoop up 55 percent of it. You will recall that early last year Congress abolished the famous depletion allowance for most gas producers. Congress was right to do it—but a substantial part of the depletion allowance's benefits were being passed on to consumers. If Congress raises sharply the taxes on the gas industry, it is reasonable to let the industry pass that tax increase on to the customers.

One of the FPC's members, Don S. Smith, has dissented from the proposed pricing because he believes that it overstates the cost of finding new gas. The argument here involves the statistical treatment of newly discovered reserves. Figures on the size of new reserves are notoriously soft and subject to manipulation. Mr. Smith is quite right about that. But the real trouble lies deeper. The whole theory of gas price regulation is based on an assumption that there is a clear and precise cost of production on which the FPC can base a fair price to the consumer. But the competition to natural gas is imported oil, which the OPEC cartel is selling for about twice as much as even the FPC's proposed price for gas. In order to make sense of this whole quarrel, you have to keep it in mind that the federal controls are keeping gas far cheaper than oil.

For that reason, production cost does not determine prices. It is precisely the opposite: The price allowed by the FPC will determine production costs. How deep do you drill for gas? How far offshore do you go? How far across the floor of the Gulf of Mexico will you lay a pipeline to bring gas ashore? All of those questions depend on the price that you can get for the gas. Gas exploration is a highly risky business. The higher the price, the more risks the industry will take.

The FPC hopes that a higher price will result in more discoveries and an increased supply. But there is a possibility that exploration will not be very successful. Perhaps there is less gas remaining to be discovered than the industry and the government expected. In that case a higher price is a necessary signal to the country that the shortage of gas is irreversible, and it is necessary to move more urgently than ever toward other sources of energy.

The under-pricing of gas—the cleanest and most efficient of fuels—is particularly foolish. But it is only a part of the country's continuing indecision over fuel and energy. The longer the basic decisions are delayed, the more painful and disruptive they are likely eventually to prove. The increase in gas prices would be justified if it did nothing more than give momentum to the floundering and ineffectual movement toward conservation.

Senator STEVENSON. Thank you, Mr. Williford.

I recognize that you are here on behalf of the Natural Gas Supply Committee, but that you are also an employee of Phillips Petroleum Co. Do you know if your compnay actually pays an effective Federal income tax rate of 48 percent on its natural gas production?

Mr. WILLIFORD. Let me say at the outset, I do not know, Senator, what income tax my company pays. I know my company pays income tax. I do not know what the amount of it is.

But let me point out one thing, that the income tax is paid on the basis of a consolidated return for the company, and not on some segment of its operation, such as natural gas.

Senator STEVENSON. Well, whatever form the returns take, you would concede, I trust, that paying an effective rate of 48 percent on natural gas production is highly unlikely, would you not?

Mr. WILLIFORD. I'm sorry, I didn't catch the last part of your question. Did you say I would agree that 48 percent on natural gas production was unlikely?

Senator STEVENSON. Not very likely.

Mr. WILLIFORD. Well, the difficulty I have, Senator, is in segregating out natural gas and saying they pay 48 percent or don't pay 48-percent rate on natural gas, as contrasted to some other area of operation.

They are subject under the Internal Revenue Code to a 48-percent rate. Now, this is one thing. And I may be getting a little far afield of my expertise, and the tax people would be quick to point out my ignorance in the area.

But as I understand it, the 48-percent rate is applicable. Now, what the ultimate effective tax rate paid by a given company is, may vary from that.

But Phillips, as are the other producers, is certainly subject to the 48-percent tax rate.

Senator STEVENSON. Thank you.

Mr. Brier, will you begin, please? I am going to have to excuse myself at some point to vote. I wish you would just keep right on going, and I will have staff conduct the rest of the hearing.

STATEMENT OF BILL BRIER, DIRECTOR OF ENERGY RESOURCES, NATIONAL COUNCIL OF FARMER COOPERATIVES

Mr. BRIER. Thank you. Agriculture is America's largest industry, pumping out almost $650 billion per year in food and fiber production. Farmer cooperatives are an important part of that system. Farmer cooperatives are large consumers of natural gas, both for input manufacturing and food and kindred products processing.

The National Council of Farmer Cooperatives is therefore vitally concerned with the issue of FPC order No. 770, and appreciates the opportunity to appear in these oversight hearings.

Our first concern is with charges that the recent FPC action permitting an increase in wellhead natural gas prices has thwarted congressional efforts to resolve the issue. While it appears the Senate may pass additional comprehensive reform legislation this year, it is doubtful the House will act, thus delaying a workable long-term solution for at least a year.

It should be noted, however, that legislation which has passed the Senate and which is now pending on the Senate Calendar provides wellhead price relief to natural gas producers which is significantly in excess of opinion No. 770.

In an effort to gage the appropriateness of $1.42 per thousand cubic feet for new natural gas, we, as consumers, should also consider the prices of substitute fuels.

For example, U.S. consumers of Canadian natural gas now pay a wellhead price of $1.60 per thousand cubic feet—already scheduled to increase to $1.80 per thousand cubic feet shortly. Prices of alternate fuels such as distillates and residual oil cost the equivalent of $2 to $2.25 per thousand cubic feet while LNG and SNG cost $3 to $5.25 per thousand cubic feet.

Obviously, one of the greatest concerns of major industrial and agricultural users is the continuing availability of domestic natural gas supplies at a price which, under opinion No. 770, is still significantly below the cost of alternate fuels. The Commission recognized this when it stated on page 121 of the opinion that:

> * * * The availability of increased gas supplies to the industrial sector, particularly to those industries where gas cannot be efficiently replaced with other fuels, will contribute to the increased productivity and a growing national economy.

At the same time, a recent FPC report (Bureau of Natural Gas, June 1976) predicts natural gas curtailments for major interstate pipelines (April 1976 through March 1977) at 3.6 trillion cubic feet or 25 percent of total requirements.

This subcommittee should keep these facts in mind when examining the opposition of some consumer groups to wellhead natural gas price increases. These consumer groups in some cases represent residential consumers of interstate natural gas, who have, in our judgment, the best of both worlds.

First, they are not required to conserve or limit their energy in the use of natural gas, and at the same time, as a result of FPC order No. 467, they face almost no chance of natural gas curtailments.

Second, they currently pay rates for natural gas that range from 20 percent to 30 percent below comparable fuel oil costs and as much as 200 percent below some electricity costs.

By contrast, increasing curtailments of natural gas brought on by declining domestic production and increasing demand can have a severe effect on the ability of agriculture to meet this Nation's food and fiber production goals.

Order No. 770 can have the effect of encouraging conservation by discouraging wasteful uses of natural gas by residential users and low priority industrial users. The order will also encourage additional exploration for and development of more domestic natural gas supplies. This is extremely important to agriculture since natural gas is the food and fiber sector's most important energy source, providing 40 percent of its total energy requirements.

Direct and indirect uses of natural gas in agriculture are unique because in most cases substitutes, excluding propane, are difficult under current technology. Input manufacturing, such as anhydrous ammonia plants—source of nitrogen fertilizers—and petrochemical plants—source of herbicides, pesticides, plastic wrappings for food

processing—designed to use natural gas as the source of feedstock, generally cannot convert to other feedstocks because they are not designed or built to do so. At the same time, technological problems of purity, odor, taste and appearance prevent use of alternate fuels such as fuel oil in some types of food processing—milk drying, for example. Since most of agriculture's propane consumption is on-farm, and often as a substitute for electricity or natural gas further substitutions are generally impractical.

As higher wellhead prices of natural gas are considered, an important issue is the effect of energy costs on food prices. Energy costs vary and are roughly between 6.5 and 8.5 percent of the total cost of food.

In July 1975, the Department of Agriculture estimated that the average cost of energy used in the food sector was $2.33 per million Btus. Thus, the impact of order No. 770 on food prices appears minimal when compared with alternatives.

It should be obvious that the capital costs associated with converting existing facilities and the use of even higher priced fuel would have a far more serious impact on food production and food prices.

Interestingly enough, researchers at Iowa State University have concluded that a far more important issue to the consumer than higher energy prices is an adequate supply of energy for agricultural production. Their report found that a doubling of energy costs results in a much smaller increase in food costs than a 10 percent energy reduction in agricultural production. This is explained by a very low demand elasticity for energy.

Energy demand becomes more inelastic as energy use declines. Thus, additional energy reductions cause successively large increases in food costs.

This subcommittee and the Congress are now faced with the fact that the FPC has acted on the critical issue pertaining to the wellhead prices of interstate natural gas. The casual observer might feel that the FPC opinion and order No. 770 eliminates the need for further congressional action on the issue. In the National Council's opinion, the FPC action should be viewed only as a step in the right direction—not a long term solution to the problem.

What is actually required is a fundamental restructuring of the FPC regulatory authority over natural gas production and sales. This restructing would permit significant reform of current FPC policies and attitudes on important issues such as producer regulation, low priority uses of natural gas, conservation of natural gas, and the development of curtailment priorities leading to sound end-use regulations.

The chairman and most members of this subcommittee are to be commended for their past efforts in this regard. Recent efforts to compromise differences by proposing S. 3422 are to be applauded. While the National Council continues to support wellhead price deregulation as the best long term solution, the Council is prepared to support sound compromise legislation which promotes comprehensive reform of current FPC authority.

Senator STEVENSON. Thank you, Mr. Brier, for a good statement and for that sort of half-hearted plug for S. 3422. It's half-hearted, but it's the most we have ever got. My day is brightened. Things aren't so bad after all.

I am going to have to run in a second. Let me ask this of all of you.

How much additional gas do you think will be produced at $1.42 over the old 52 cent price? The FPC assumed, certainly, the same net additions for next year as we actually experienced last year. What production do you predict for the first year and subsequent years as a result of that increase in price?

Mr. BRIER. Primarily as consumers of natural gas, Mr. Chairman, I wouldn't really have any idea, except to say we have no reason to quarrel with the FPC figures at this time.

Obviously, our interest is one of bringing gas to the——

Senator STEVENSON. Keep talking. I have to run or I will miss the vote. Counsel will proceed with the hearing.

Mr. LAWRENCE. Our projections and studies to indicate that prices in the range of $1.50, which are comparable to what the FPC has concluded in opinion No. 770, would continue to maintain production in the range of 20—20½ trillion cubic feet per year through 1985, whereas if continued regulations at the 52 cent level were kept in effect, it would drop to the range of, I think, 13 or 12 trillion cubic feet per year.

Mr. LIPPEK. Your view is then, in contrast to the current situation, where there are declining reserve additions and declining production under the old rate, with this new rate, production to the interstate market should remain at current levels?

Mr. LAWRENCE. We would be able to stop the decline.

Could I make one other point? This is a difficult thing to grapple with, but on the subject the Senator referred to, the impact of price rises on GNP, et cetera, we have given some attention to that, and it is indeed a very illusive number—the jobs lost, et cetera. And I don't know as we can shed any light on that, but we do know, and I think it's a matter of record before this committee, that there is a very close correlation between the GNP and energy consumption.

So that, if declining supplies and production rates continue, we can expect an adverse impact on the GNP.

Mr. LIPPEK. Mr. Williford, would you care to comment on how much additional natural gas would be produced as a result of the increased prices?

Mr. WILLIFORD. Mr. Lippek, let me at the outset disclaim any expertise on the vast number of models that I understand exist which attempt to calibrate mathematically or econometrically what given increment of supply will result from what given increment of price.

However, I think that simple logic tells me that when a business decision is undertaken and a property is reviewed, that it might not have been economical to undertake at 52 cents, it will be economical at some greater price.

This is why I come to the positive conclusion and assertion that there will be additional supplies of natural gas brought forth by the rates in this opinion.

I think it's just simple logic that you will do more for this level of price than you would for the prior level of price.

Now, one thing that the projections of price/supply relationship do not take into account, that gives us further problem when we deal with the interstate gas supply situation, are the vagaries of regulation itself.

As I mentioned in my statement, there are other problems with regulation which we have detailed to the Commission—to the committee before—besides the rates that it sets. These things may have an effect on what sort of gas supplies are brought forth to the interstate market—just the mere fact of the other regulatory constraints and uncertainties.

Mr. LIPPEK. Does Phillips Petroleum have contingent plans for increased exploration and development of natural gas in the interstate market as a result of these price increases?

What changes will occur in your company as a result of this price change?

Mr. WILLIFORD. First of all, Mr. Lippek, I am not aware of any contingent plans, plans for development of oil and gas properties or natural gas properties which are contingent upon a given FPC action or a given congressional action.

However, I think it's safe to say that my company sets out at the beginning of the year with an exploration and production program. As the year progresses, it may or may not be able to undertake that program as it assesses each prospect in light of the economics that exist at that time.

I would assume that, based on this Commission decision, the planning people in my company—as would be the case in other companies—are presently reviewing those prospects which, during the past 9 months—19 months—whatever period of time, going back, have been rejected as uneconomical, to determine whether or not, in view of this rate, they would be economical.

Mr. LIPPEK. Can you supply for the record for the Committee those prospects which were formerly rejected but which will now be explored, developed and produced as a result of this price increase?

Mr. WILLIFORD. I frankly do not know, Mr. Lippek. We don't characterize these things in a fashion that I think you are alluding to. Our decision with respect to a given oil or natural gas prospect is made on the basis of the market, on the basis of what our geology, geophysical information is.

The interstate market or the intra-state market factors are to be considered, but it's an overall decision, and we don't categorize, we don't go down and have a list and categorize prospects A, B, or C as being thrown out because the interstate price is too low.

Mr. LIPPEK. You don't throw out prospects because they do not appear economic under current price levels?

Mr. WILLIFORD. No, I didn't say that. If I misled you, I apologize.

I thought I earlier said that Phillips—as do all companies—proceeds on the basis of economics in assessing what action they will take with respect to a given prospect or even acquiring a lease on a given prospect.

So, yes, a given market, I am sure, is ground into the economic considerations. It has to be.

Mr. LIPPEK. But wouldn't you have a list of prospects that would be economical at given prices during a given year, and if the price increased then an additional number of prospects would then be ready for development?

Mr. WILLIFORD. If, Mr. Lippek, such a list exists, it would—and I am guessing, based on my experience—but I would say that it would

be for a very short term, because if you throw out a prospect—and I will use that term, throw out a prospect—if you don't undertake to develop a given lease, then you generally surrender or release that lease.

It's not something that you keep forever and ever and just pull off of the shelf when you decide you want to use it.

So, unfortunately perhaps, I don't think we have a closet full of prospects on the shelf that we can go down and tabulate and pull out to test against any given economic criteria.

Mr. LIPPEK. Mr. Lawrence, you had mentioned that the current residential rates for natural gas are about $1.75 per Mcf. But this assumes a wellhead price of just over 30 cents.

If the *average* price of natural gas at the wellhead increased to $1.42, then the price to residential users, assuming that the cost of transportation and distribution remained the same, would increase to about $2.90, higher than the price of oil, assuming that there is no inflation in the future either in the price of gas or in the price of oil.

Do you anticipate that natural gas prices to residential consumers in the long run will then substantially exceed the price of oil, and, if so, do you expect a shift of those consumers to other fuels?

Mr. LAWRENCE. I don't track your arithmetic. If the average field price of gas would suddenly increase to $1.42 levels, that would still comprise roughly 30 percent of the burner tip price or something in the range of—it still would not increase the level at the burner tip the proportional amount; it would increase an absolute amount by that much.

Mr. LIPPEK. Let me give you the numbers. Out of the current residential price of $1.75, about 30 cents is the current wellhead price for natural gas. This leaves about $1.45 as the amount required to transport and distribute natural gas today.

If the average wellhead price increased from 30 cents to $1.42, an increase which may take a considerable amount of time, then assuming for a moment that there is no further inflation in the price of natural gas or in the price of oil, then you come up with a price of $1.42 plus $1.45, equaling $2.87 as the residential price for natural gas.

Again, if there is no inflation in oil or in gas, the price of gas to the residential consumer would be at or above the price of oil.[1]

Mr. LAWRENCE. Well, your original arithmetic got it to $2.87, which is cheaper than the price of fuel oil even today.

I think we are going to continue to be competitive with fuel oil, and certainly very competitive with the residential market.

I would certainly agree that before that average price rise would occur in the field, it would take place over a period of as much as a decade. It would be a very gradual increase, because of the prospective application.

I think, too, though, we should give—and I don't think you can take it as given that the field prices or imported prices of crude oil during this period would remain at their present levels.

But laying that aside and focusing on the area where the residential consumer will probably have to be served, it's probably down to a battle between natural gas at the burner tip and electricity at the burner tip. And because of the inefficiencies, we think there will

[1] Monthly Energy Review, Federal Energy Administration, August 1976 at 59 indicates that the average selling price of residential heating oil is 40.1 cents per gallon, the equivalent to about $2.90 per Mcf of natural gas.

always be a magnitude of 100 to 400 percent disparity in our favor there.

And this is a tremendous benefit to the consumer that should be preserved. Right now, as I mentioned, that average electric space heating is about $9.50 per million Btu. We project through 1985 that natural gas prices will be in the range of $3.50 per million Btu under regulation and reasonably expected inflation, and yet, at that time, we anticipate consumer point price of electricity in the range of $20.

So the disparity we think is going to continue very much in our favor.

Could I just inject a point of clarity for the record?

The projections of anticipated new gas production that I gave you in the range of 20½–21 trillion cubic feet per year through 1985, that contemplated a deregulated price right now of approximately $1.50. It didn't contemplate a Commission-imposed price of $1.50.

We think some of the uncertainties that continued regulation would impose that Mr. Williford mentioned will undoubtedly have effect.

Just for the record, that $1.50 level over the next few years was an assumed deregulated price.

Mr. LIPPEK. Is there anything else anyone would like to add?

Senator Stevenson has indicated that he would not return after this rollcall. So this hearing will be adjourned.

Thank you very much.

[Whereupon, at 1:50 p.m., the hearing was concluded.]

[The following information was subsequently received for the record:]

STATEMENT OF A. V. JONES, JR., PRESIDENT, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

My name is A. V. Jones, Jr. I am a partner in Jones Company, Ltd., an independent oil and gas exploration-producing organization at Albany, Texas. I am appearing here as President of the Independent Petroleum Association of America (IPAA), a national organization of more than 4,000 independent oil and natural gas producers who operate in every producing area.

The July 27 order by the Federal Power Commission setting the national rate for new natural gas at $1.42 and establishing new rate schedules for flowing gas will not, in our opinion, overcome the shortages already experienced and those anticipated. It was a substantial step in the right direction. We commend the Commission for its action which was a substantial breakaway from two decades of unrealistic price regimentation that has brought on our present natural gas shortages.

The increase from 52¢ per MCF to $1.42 for new natural gas has been touted widely in the press as a tripling of gas prices to American consumers. Those who have parroted this line of attack should know better.

The price of natural gas has been depressed and is inadequate and unrealistic by any means of judging either the fairness to producers or counterproductive effects on consumer supplies. For purposes of putting gas prices, both as they have been and are proposed by FPC, into perspective, I offer the following observations:

1. As the FPC has pointed out, the rolling in of the higher priced gas ($1.42 for gas dedicated after 1/1/75, and $1.01 for that dedicated from 1/1/73 thru 12/31/74) will impact minimally on consumers. The average residential gas bill would increase about $15 to $16 per year, or about 6 percent.

While the consumer impact would be moderate, the economic impact on natural gas exploration and development could be—in our opinion—immediate and extensive. The stimulus to develop very deep sedimentary basins and so-called "tight" formations onshore, and difficult and costly offshore reserves—all uneconomic at present prices—would be evident within months. If these new exploratory initiatives succeed in bringing on substantial additional natural gas committed to the interstate markets, the future impact on consumers will be much less than if they are left to depend on far more expensive alternatives.

If these initiatives are not successful in bringing on sufficient new gas to alleviate present shortages, then the cost to consumers will be *nothing*. They still would have to shift to more expensive alternatives, the cost of which is not to unaffected by the FPC rate.

2. Even after the immediate $1.5 billion increases in producer rates, the average wellhead price of natural gas sold in interstate commerce will be less than 39 cents per thousand cubic feet. This equates to crude oil selling at $2.34 a barrel. By contrast, the composite price of domestic crude oil under federal controls is about $7.80 and the laid-down cost of imported oil approximates $13.50 per barrel.

It is important to realize that much of our growing dependence on insecure foreign oil which can be cut off at any time is attributable to the domestic shortage of natural gas, because the unmet demand for gas has been offset primarily by increasing oil imports.

3. Even the maximum price for domestic natural gas established by the FPC, $1.42 per MCF, is belo walternative energy options available to consumers. It is below the cost of imported oil. It is below the price of liquefied natural gas (LNG) that can be imported, and lower than synthetic natural gas (SNG). It is cheaper than Canadian gas which presently sells for $1.60 and has been raised by the government in Ottawa to $1.94 per MCF, effective next January.

Significantly, the price suggested by the FPC also is below the price of natural gas in the intrastate market, and is lower than the new gas price ($1.60 per MCF) in the pending bill (S. 3422) approved by the Senate Commerce Committee.

4. In 1975, the 10,000 producers of petroleum fuels in the United States produced at the wellhead 39.9 quadrillion British Thermal Units (Btu's) of energy, 22.2 quadrillion Btu's or about 55.6 percent in the form of natural gas, the remainder being crude oil. The total wellhead value of both gas and oil was $31.9 billion dollars, of which $23.1 billion was the value of the crude oil produced, while the total value of natural gas production, both inter and intrastate, was only $8.8 billion.

Domestic production of natural gas has exceeded crude oil production on a Btu basis since 1964. While natural gas production in 1975 accounted for 56 percent of the combined oil and gas Btu production, it contributed only 28 percent of the combined wellhead value of oil and gas. The underpricing of natural gas relative to oil and other energy sources has persisted far too long and the prescribed new rates are a belated but much needed step to correct this situation.

It is even more significant that after adding in the $1.5 billion increase in natural gas revenues advocated by the Federal Power Commission, if we assume the 1975 production ratios between crude oil and natural gas, revenues for natural gas still would represent only 30.9 percent of the gross value of domestic petroleum fuels at the wellhead.

In spite of this, critics of our industry are not satisfied with these facts and have sought to block the new rate in the courts. Which brings us, the producers, to wonder what motivates these critics. We have been described by them as "negative" simply because we continue to repeat the well known fact that domestic oil and gas prices must rise if we are to bring on more production in the deeper formations onshore and in the more expensive offshore domains. We are criticized by them for pointing out that for every Btu consumed that is not produced domestically, we have to import that Btu from insecure, expensive, foreign sources.

In response to these charges, we are compelled to ask some questions of our own. Where is their answer to our precarious energy problem? What do they propose? How long can they tell hundreds of thousands of American families denied new natural gas hook-ups that they are second class citizens when it comes to energy? If it's not new oil and gas production, what is it? Nuclear? The same critics of oil and gas shout even louder "no's" to nuclear. Oil shale and tar sands? Continued government price fixing of oil and gas, which keep those fuels at artificially low prices, leave those sources from our reach. Coal? Again, the same critics have a whole laundry list of reasons why we can't and shouldn't mine and use our abundant coal reserves.

To these critics we say it is time they took a positive stance and came forth with some answers for Americans who want reliable sources of energy at fair prices. If their answer is nationalization, we need only to point to the Postal Service and numerous urban transit authorities to prove that government operation of business ventures has been and continues to be a disaster from the standpoint of the consumer and the taxpayer.

In conclusion, we hope the legal issues can be resolved quickly so that the new FPC order can take effect soon. Likewise, we hope the Congress will take no action

counter to the FPC order. In fact, we are here today to urge the Congress to move ahead on its unfinished business of decontrolling new natural gas prices once and for all.

STATEMENT OF THE AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

The action of the Federal Power Commission in almost tripling the price of "new" natural gas is completely unjustified and unwarranted. It is the largest rate increase in the history of the Commission and while it does not constitute deregulation of natural gas prices, it is a giant step in that direction.

If natural gas prices are to be deregulated, an action to which we are opposed, that step should be taken by the Congress, not by a regulatory agency whose legislative mandate is to regulate natural gas prices at reasonable levels based on the public interest.

In addition to permitting the price of natural gas produced since January 1, 1975, to increase from 53¢ per MCF to $1.42 per MCF, the FPC would allow gas which came into production from January 1, 1973, to December 31, 1974, to be raised in price from 53¢ per MCF to $1.01 per MCF. The theory behind this is that higher prices will act as an incentive for the production of more gas.

That same argument was used by proponents of higher oil prices. We know, however, that despite the fivefold increase in the price of new oil, domestic oil production has actually declined since the Arab embargo. And we would suggest to you that the major result of this extraordinary increase in the price of natural gas would be an escalation in the profits of natural gas producers. Calculations by the Commission's staff based on cost factor produced a rate recommendation of 56.6¢ to 61.7 per MCF.

Project Independence, in its survey of the natural gas industry, projected little or no difference in the production of natural gas beyond a rate of 80¢ per MCF. Even allowing for cost escalation, the Project Independence figure would be considerably less than the $1.42 per MCF approved by the FPC.

The contention is also made that the $1.42 rate would divert natural gas from the unregulated intrastate market, where much of the gas has low priority usage, to the interstate regions that are faced with a natural gas shortage. In effect, what the $1.42 rate will do is to establish a $1.42 minimum for the intrastate market. And all the purchasers in the unregulated intrastate market will have to do is bid in the natural gas at a few cents higher than the $1.42 rate and continue getting as much natural gas as they did before.

The basic effect of the FPC ruling, if it is allowed to stand, would be to increase consumer costs as well as the gas producers' profits. By the Commission's own figures, consumer cost will be increased by $1.5 billion in the first year. Consumer groups estimate costs to the consumer to increase by $2.2 billion in the first year. The increase to consumers will, of course, be larger in subsequent years.

We are aware that it is necessary to adopt a uniform and acceptable policy that will make the best use of the limited amount of gas available. However, raising prices is not the way to do it.

We urge the Congress to take steps as it can to revoke the action of the Federal Power Commission and to enact measures that would:

1. Ban the use of natural gas as a boiler fuel in newly constructed industrial plants.
2. Provide for the orderly conversion of power plants using natural gas to an alternate fuel.
3. Provide for the allocation of natural gas to minimize undue hardship in selected geographical areas, giving preference to residential, agricultural and small commercial users.
4. Extend regulation of natural gas prices to the intrastate market.
5. Require all producers holding leases on federal public lands to produce at optimum rates or forfeit their leases.

August 27, 1976.

Hon. ADLAI E. STEVENSON,
U.S. Senate
Washington, D.C.

DEAR SENATOR STEVENSON: We were distressed to note that one of the witnesses before your special Subcommittee on Oil and Natural Gas Production and Distribution, Mr. James F. Flug, saw fit to devote a major segment of his testimony on August 9 to an attack on Mobil Oil Corporation.

Most of the charges made by Mr. Flug have been made previously by others, and have been refuted by Mobil. Since, however, Mr. Flug chose to raise them again at the hearing, we respectfully request that you make the attached statement part of the hearing record.

Sincerely yours,

HERMAN J. SCHMIDT.

MOBIL OIL CORP. RESPONSE TO TESTIMONY BY JAMES F. FLUG, DIRECTOR, ENERGY ACTION COMMITTEE

James F. Flug, director of the Energy Action Committee, devoted a large segment of his testimony before the Senate Subcommittee on Oil and Natural Gas Production and Distribution on August 9, 1976 to a wholly unwarranted and miselading attack on Mobile Oil Corporation.

Most of Mr. Flug's charges have been made previously by others, and have been refuted by Mobil. The following comments, however, are needed to set the record straight.

Charge

Mr. Flug says that Mobil was "a major exploiter of an FPC loophole allowing over 1 trillion cubic feet of offshore gas a year to be diverted into intrastate markets."

Fact

This allegation implies Mobil in some way has evaded FPC rules, or else Mr. Flug is characterizing FPC policies as a "loophole." We don't recognize where Mr. Flug got the 1 trillion cubic feet figure or his idea that Mobile is a "major exploiter." The facts are as follows:

Under certificates issued by the FPC, Mobil uses a portion of the gas produced from 2 blocks in Federal waters off the Louisiana coast at the company's Beaumont, Texas refinery. This gas comes from Mobil production at our East Cameron Blocks 14 and 270. Volumes from Block 14 are quite small as the property has declined to a low rate of production. Volumes up to 45–47 million cubic feet a day have been obtained during the 1976 summer season from the Block 270 area, but Mobil got no gas from this area during the past winter because of conditions in the certificate which interrupt our right to this reserved gas when Texas Eastern—which has first call on this gas—is in the position of curtailing gas usage of a high priority customer.

As far as we can understand it, the thrust of Mr. Flug's complaint is that Mobil should not use its own offshore gas production at Beaumont, which incidentally is interstate gas because it comes into Texas from Federal waters. This type of usage, however, has been endorsed not only by the FPC but by the Supreme Court of the United States in prior decisions. And Mr. Flug's accusation that Mobil is selling this reserved gas at $1.90 is totally inaccurate. The gas flows directly into the refinery and is not sold to others. It is Mobil gas which is used by Mobil. The usage is just as legitimate as a farmer's use of some of the food he produces to feed his own family.

Charge

Mr. Flug states that "another House subcommittee was hearing that Mobil refused to accept an FPC permit and began deliveries from a proven field with hundreds of billions of cubic feet of gas."

Fact

The statement refers to Mobil's interest in the Grand Isle 95 field offshore Louisiana. In March, 1975, Mobil entered into a gas sales contract with Trunkline Gas Pipeline and applied for FPC certificates so as to be able to begin production expected to be ready in November, 1975.

Production, however, was delayed—not, as Mr. Flug charges, because Mobil refused to accept an FPC permit—but because the FPC staff attempted to dictate changes in the contract terms between Mobil and Trunkline. Jack E. Earnest, Mobil's Manager for Natural Gas, made this clear in a testimony before a House Commerce Subcommittee in January, 1976.

Furthermore, the FPC on June 29, 1976 issued Opinions No. 766 and 767 which were decisions on the very points raised by the staff in delaying Mobil's certificate. In all instances, the FPC agreed with positions taken by Mobil while the company was seeking to secure certificates and start production.

Specifically, the FPC held in these opinions.—

(*a*) That the FPC could not require production in a specified period, and in any case did not need to do so because of its other powers under the Natural Gas Act. (An earlier opinion also made this point.)

(*b*) That the FPC could not require a producer to guarantee a certain volume of reserves or production rate unless he has willingly entered a contract to do so.

(*c*) That depth restrictions and limitations would not adversely affect consumers and are not contrary to the public interest, at least in offshore areas.

We currently expect production from Grand Isle Block 95 to commence in early September, 1976.

Charge

Mr. Flug added the gratuitous comment that "while talking the language of incentives for exploration, Mobil was pouring nearly a billion dollars of its ready capital not into oil and gas but into Montgomery Ward."

Fact

Mobil's acquisition of Marcor was part of a long-standing policy of diversification which Mobil has pursued since 1968 in an effort to broaden its earnings base, necessitated in part by political attacks on the oil industry in Congress which have added new uncertainties to oil industry investment.

The Marcor purchase was not made at the expense of energy development. Mobil continues to make huge outlays to find and develop new reserves of gas and oil, including capital and exploration outlays of $1.4 billion in 1975. Mobil has, indeed, been the most aggressive of the major oil companies in acquiring offshore leases—it made the highest bid for a single block in the August Atlantic offshore lease sale—and plans to remain strong and competitive in the oil business. We expect our expenditures for capital and exploration to be higher in 1976—about $1.6 or $1.7 billion.

We might have invested even more except for onerous legislation and talk of divestiture whipped up by Mr. Flug and others.

Mr. Flug also attacked Mobil for its institutional advertising, and some comments on Mobil advertisements on the subject of natural gas are in order.

Mobil published an advertisement in the New York Times on December 18, 1975, warning that continued control of natural gas prices in interstate commerce "could leave a lot of schools and homes cold this winter and throw additional hundreds of thousands of Americans out of work."

Contrary to Mr. Flug's testimony, the facts support the Mobil statement. Under controls, natural gas reserves have declined for the past five years. At year-end 1975, reserves stood at 228 trillion cubic feet—no more than an 11-year supply at current consumption rates. The seriousness of the natural gas position has been masked in recent years by a series of milder-than-normal winters. A cold 1975–76 winter could very well have resulted in shortages of gas in homes and factories.

In our advertising generally, Mobil has had recourse to a variety of techniques—including humor—to get across what we want to say on energy issues. Hence the particular ad to which Mr. Flug apparently took exception, entitled "How the Squirrel Found Himself up a Tree," and dealing in allegory with the subject of natural gas price controls.

The story related how, when the squirrel found it more expesnsive to supply nuts to his customers, the animals set up a Furry Persons Committee to control the price of nuts. We did not say this was a Funny Persons Committee—Mr. Flug did.

Nevertheless, we do think the ad was funny, as well as timely and relevant! Could it be that Mr. Flug has lost *his* sense of humor?

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