

L.N. = 725
4

~~098308~~ 098306
~~76-0161~~
098306

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
EXPECTED AT 11:30 AM
MONDAY, JANUARY 26, 1976



STATEMENT OF
HENRY ESCHWEGE, DIRECTOR
RESOURCES AND ECONOMIC
DEVELOPMENT DIVISION
BEFORE THE
SUBCOMMITTEE ON ENERGY AND POWER
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
HOUSE OF REPRESENTATIVES
AMOUNT OF NATURAL GAS
THAT COULD BE RELEASED FROM
FEDERAL PRICE REGULATIONS UPON
EXPIRATION OF CONTRACTS FROM 1975 THROUGH 1985

WAC 0023

027-3

C2

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

WE ARE HERE AT YOUR REQUEST TO DISCUSS DATA WE COMPILED LAST YEAR ON THE AMOUNT OF NATURAL GAS THAT COULD BE RELEASED FROM REGULATION UPON EXPIRATION OF CONTRACTS FROM 1975 TO 1985. THIS IS AN AREA OF INCREASING CONCERN TO THE CONGRESS AS IT CONSIDERS THE IMPACT OF NATURAL GAS DEREGULATION ON CONSUMERS.

C1

ON SEPTEMBER 8, 1975, THE COMPTROLLER GENERAL ISSUED A REPORT (RED-76-11) TO SENATOR HENRY M. JACKSON AND CONGRESSMAN JOHN E. MOSS. WE WERE ASKED TO PROVIDE INFORMATION ON THE FOLLOWING FOUR AREAS.

C3

--VOLUMES OF NATURAL GAS, UNADJUSTED FOR PRODUCTION DECLINE, TO BE RELEASED UNDER EXPIRING CONTRACTS FOR EACH YEAR FROM 1975 THROUGH 1985 AND CUMULATIVELY,

--SAME VOLUMES OF GAS AS ABOVE BUT WITH ADJUSTMENTS FOR PRODUCTION DECLINE,

~~702827~~ 098306

--AMOUNT OF GAS UNDER CONTRACTS WITH INDEFINITE PRICING CLAUSES, AND

--ADEQUACY OF THE FEDERAL POWER COMMISSION (FPC) DATA USED IN PROJECTING

THE VOLUMES OF GAS TO BE RELEASED FROM CONTRACT.

GAS TO BE RELEASED FROM CONTRACTS

THE NATION'S NATURAL GAS PRODUCTION FOR INTERSTATE COMMERCE PEAKED DURING 1971 AND 1972 AT 14.2 TRILLION CUBIC FEET (TCF) AND HAS BEEN DECLINING SINCE THEN. MOST GAS SOLD IN INTERSTATE COMMERCE IS SOLD UNDER LONG-TERM CONTRACTS BETWEEN PRODUCERS AND INTERSTATE PIPELINE COMPANIES. EVEN THOUGH THE CONTRACTS USUALLY EXPIRE IN 20 YEARS, THE GAS CONTINUES TO FLOW UNTIL THE OPERATION BECOMES UNECONOMICAL AND FPC AUTHORIZES ABANDONMENT OF OPERATIONS. UPON EXPIRATION OF THE PRIMARY 20-YEAR CONTRACT, PRODUCERS AND INTERSTATE PIPELINES GENERALLY NEGOTIATE NEW CONTRACTS WHICH ARE ALSO SUBJECT TO FPC APPROVAL.

IN AUGUST 1973 FPC REQUIRED LARGE PRODUCERS TO REPORT THEIR 1972 SALES VOLUMES AND CONTRACT DATES AND TERMS FOR EACH CONTRACT ON FILE WITH FPC. ON THE BASIS OF THIS DATA WHICH RECEIVED LIMITED VERIFICATION AND WAS SOMEWHAT INCOMPLETE, WE ESTIMATED THE VOLUME OF GAS THAT MIGHT BE RELEASED FROM CONTRACTS EXPIRING DURING THE PERIOD FROM 1975 TO 1985.

IF THE LAW WERE TO REMOVE THE PRICE REGULATION OVER NATURAL GAS, THE VOLUME OF GAS RELEASED FROM CONTRACT MAY ALSO BE FREED FROM PRICE CONTROLS. WE REPORTED THAT UPON THE EXPIRATION OF SALES CONTRACTS AN ESTIMATED 29 TCF OF NATURAL GAS COULD BE RELEASED FROM REGULATION OVER THE PERIOD 1975-85. THIS ESTIMATE ASSUMES THAT THE PRODUCTION FROM EXISTING WELLS CONTINUES AT A CONSTANT RATE.

AS YOU KNOW, HOWEVER, GAS DOES NOT CONTINUE TO FLOW FROM RESERVOIRS AT A CONSTANT RATE INDEFINITELY. THEREFORE, ANY PROJECTION OF THE GAS AVAILABILITY IN THE FUTURE DEPENDS ON THE RATE AT WHICH GAS WILL BE FORCED FROM THE RESERVOIR.

THREE METHODS WHICH HAVE BEEN DEVELOPED OVER THE PAST SEVERAL YEARS-- THE DAVIS DECLINE CURVE, THE NATIONAL AVAILABILITY CURVE (NAC), AND THE TOTAL ENERGY RESOURCES ANALYSIS (TERA) CURVE--CAN BE USED TO DETERMINE AT WHAT RATE PRODUCTIVITY FROM EXISTING RESERVOIRS WILL DECLINE.

OUR REPORT DISCUSSED EACH OF THESE CURVES AND CONCLUDED THAT THE CUMULATIVE VOLUME OF GAS THAT WOULD BE RELEASED FROM REGULATION OVER THE 1975-85 PERIOD WOULD BE 9.1 TCF ASSUMING THE DAVIS DECLINE CURVE, 12.7 TCF ASSUMING THE NAC METHOD, AND 7.7 TCF ASSUMING THE TERA CURVE.

AMOUNT OF GAS UNDER CONTRACT WITH INDEFINITE PRICING CLAUSES

INDEFINITE PRICING CLAUSES INCLUDED IN MANY OF THE CONTRACTS BETWEEN PRODUCERS AND INTERSTATE PIPELINES PROVIDE FOR FUTURE CHANGES IN THE PRICE OF GAS SOLD, DEPENDING ON CERTAIN ECONOMIC FACTORS OCCURRING. SOME INDEFINITE PRICING CLAUSES MAY HAVE AN EFFECT ON THE AMOUNTS OF GAS THAT WOULD BE FREED FROM PRICE CONTROLS IF DEREGULATION LEGISLATION WERE ENACTED. ASSUMING THIS OCCURS, THE AMOUNT OF GAS CURRENTLY UNDER CONTRACT WHICH WOULD BE DEREGULATED BECAUSE OF INDEFINITE PRICING CLAUSES WOULD DEPEND ON THE PROVISIONS OF THE DEREGULATING STATUTE AND/OR FPC RULEMAKING ACTIONS.

THE MORE COMMON TYPES OF INDEFINITE PRICING CLAUSES IN NATURAL GAS CONTRACTS FOLLOW.

- THE RENEGOTIATION CLAUSE ALLOWS FOR PRICE CHANGES AT SOME SPECIFIC TIME.
- THE REDETERMINATION CLAUSE IS SIMILAR TO THE RENEGOTIATION CLAUSE IN ITS EFFECT AND PROVIDES FOR PRICE ESCALATIONS TO THE FAIR-MARKET PRICE WHICH MAY BE HIGHER THAN THE FPC-ACCEPTED PRICE LEVEL.

--THE FAVORED-NATION CLAUSE ALLOWS FOR INCREASED RATES IF OTHER CONTRACTS IN THE AREA SPECIFY HIGHER RATES.

--THE DEREGULATION CLAUSE PERMITS HIGHER RATES IF REGULATORY CONTROL IS REMOVED.

--THE AREA RATE CLAUSE ALLOWS PRICES TO ESCALATE TO THE FUTURE FPC-ESTABLISHED RATES FOR THE AREA COVERED BY THE CONTRACT.

OF THE ABOVE CLAUSES, ONLY THE AREA RATE CLAUSE APPEARS TO BE PERMISSIBLE UNDER FPC REGULATIONS.

DATA FILED BY PRODUCERS SHOWED THAT ABOUT 33 PERCENT OF THE GAS WAS SOLD UNDER LONG-TERM CONTRACTS HAVING ONE OR MORE OF THE IMPERMISSIBLE INDEFINITE PRICING CLAUSES, WHILE 30 PERCENT OF THE GAS WAS SOLD UNDER CONTRACTS HAVING THE PERMISSIBLE AREA RATE CLAUSE.

RECENT TRENDS IN LONG-TERM CONTRACTING BY GAS PRODUCERS SEEM TO BE TOWARD INCLUDING DEREGULATION CLAUSES IN CONTRACTS. WE NOTED IN OUR REPORT THAT OVER HALF THE LONG-TERM CONTRACTS FILED WITH FPC IN RECENT MONTHS CONTAINED SUCH CLAUSES, PRESUMABLY ANTICIPATING SOME FORM OF GAS DEREGULATION BY THE CONGRESS.

BECAUSE FPC REGULATIONS (18 CFR 154.93) MAKE MOST INDEFINITE PRICING CLAUSES INOPERATIVE AND OF NO EFFECT AT LAW, FPC BELIEVES THAT LEGISLATION WHICH REMOVES PRICE CONTROLS ON NEW GAS WILL NOT NECESSARILY PERMIT GAS UNDER EXISTING CONTRACTS TO BE RELEASED FROM REGULATION BECAUSE OF SUCH CLAUSES.

I WANT TO REEMPHASIZE, HOWEVER, THAT THE AMOUNT OF GAS DEREGULATED BECAUSE OF INDEFINITE PRICING CLAUSES WOULD DEPEND ON PROVISIONS OF THE DEREGULATING STATUTE AND/OR COMMISSION RULEMAKING ACTIONS.

ACCURATE AND COMPLETE DATA NEEDED

OUR PROJECTIONS AS WELL AS THE PROJECTIONS OF FPC WERE BASED ON FPC SALES VOLUME DATA FOR A SINGLE YEAR--1972. THIS DATA WAS OBTAINED BY AN AUGUST 1973 FPC ORDER, ON A ONE-TIME ONLY BASIS AS PART OF A RULEMAKING PROCEDURE TO ESTABLISH JUST AND REASONABLE RATES FOR NATURAL GAS. NO OTHER DATA WAS AVAILABLE FOR PROJECTING THE AMOUNT OF GAS THAT WOULD BE RELEASED FROM PRICE CONTROLS IF DEREGULATION LEGISLATION WERE ENACTED.

TO INSURE THE PROJECTIONS' RELIABILITY, THE BASE YEAR DATA'S ACCURACY AND COMPLETENESS MUST BE VERIFIED. FPC DID ONLY LIMITED VERIFICATION OF THE DATA REPORTED. WE NOTED SEVERAL DIFFERENCES IN THE 1972 SALES DATA SUBMITTED BY PRODUCERS PURSUANT TO THE AUGUST 1973 ORDER AND THE 1972 SALES DATA THAT THEY SUBMITTED IN RESPONSE TO OTHER FPC REQUIREMENTS. FPC WAS AWARE OF SOME OF THE DIFFERENCES BUT COULD NOT EXPLAIN THEM.

FPC OFFICIALS STATED THAT DATA COLLECTION AND COMPILATION TOOK A YEAR AND 3 MONTHS BECAUSE OF (1) THE LARGE NUMBER OF REPORTS FILED, (2) INCORRECT OR INCOMPLETE DATA SUBMITTED BY THE PRODUCERS, NECESSITATING FOLLOWUP REQUESTS BY FPC, AND (3) FAILURE OF SOME PRODUCERS TO FILE THE DATA PROMPTLY.

NEVERTHELESS, THE FINAL RESULTS DID NOT CONTAIN ALL REQUIRED DATA. WE NOTED FOUR PRODUCERS WHO SIMPLY DID NOT FILE THE DATA REQUESTED AND MANY PRODUCERS WHO FILED INCOMPLETE DATA WHICH, IN SOME INSTANCES, WAS CRITICAL IN DETERMINING THE AMOUNT OF GAS THAT WOULD BE RELEASED FROM CONTRACT DURING CERTAIN PERIODS.

CONSIDERING THE TREND TOWARD SHORTER TERM CONTRACTS AND THE INCLUSION OF DEREGULATION CLAUSES, WE BELIEVE THAT FPC MUST MAINTAIN CURRENT INFORMATION SO THAT NEEDED DATA IS READILY AVAILABLE FOR USE IN FUTURE CONGRESSIONAL AND FPC DECISIONMAKING.

WE RECOMMENDED THAT THE CHAIRMAN, FPC, IMPLEMENT PROCEDURES TO ENSURE THAT DATA ON THE STATUS OF GAS FLOWING UNDER CONTRACTS IS REASONABLY CURRENT AND RELIABLE.

THE CHAIRMAN, FPC HAS INITIATED ACTION TO IMPLEMENT OUR RECOMMENDATION. ON DECEMBER 17, 1975, THE COMMISSION ISSUED NOTICE OF PROPOSED RULEMAKING, DOCKET NO. RM76-10, WHICH IF ADOPTED, WOULD REQUIRE NATURAL GAS COMPANIES TO FILE A FORM SHOWING THE AMOUNT OF GAS FLOWING IN INTERSTATE COMMERCE. THE FORM WILL ALSO PROVIDE (1) A DETAILED BREAKDOWN OF THE IMPORTANT PROVISIONS OF ALL RATE SCHEDULES ON FILE WITH THE COMMISSION, (2) A BASIS FOR ESTIMATING THE REVENUE IMPACT OF NATIONWIDE AND/OR AREA RATEMAKING PROPOSALS BY PRICING AREA, STATE AND PURCHASER, AND (3) A MEANS OF DETERMINING THE POTENTIAL EFFECTS OF PERIODIC PRICE ESCALATIONS AND INDEFINITE PRICING PROVISIONS.

THE NEW FORM ENCOMPASSES SEVEN SCHEDULES WHICH AFTER INITIAL FILING WILL BE FILED ANNUALLY OR AS CHANGES OCCUR DEPENDING UPON THE TYPE OF INFORMATION INVOLVED.

MR. CHAIRMAN, THIS COMPLETES MY PREPARED STATEMENT; WE WILL BE GLAD TO RESPOND TO YOUR QUESTIONS.