WITHDRAWAL SHEET
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File Folder: Natural Gas Decontrol Box 11 ~~box 9112~~ **Date:** 2/2/99

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
1. Memo	Ken Duberstein to Dick Darman Re: deregulation, 3p	2/2/82	~~P5~~
2. Memo	Cabinet Council to Reagan Re: natual gas, 3p	8/28/81	~~P5~~
3. Memo	Murray Weidenbaum to Dick Darman, Craig Fuller Re: natural gas, 1p	2/2/82	~~P5~~
4. Memo	Richard Williamson to Darman, Fuller Re:natural gas, 1p	2/3/82	~~P5~~
5. Memo	David Stockman to Darman, Fuller Re: natural gas, 3p (1-p memo + 2-p issue paper)	2/1/82	~~P5~~
6. Memo	James Edwards to Darman, Fuller Re: natural gas, 3p	2/2/82	~~P5~~
7. Memo	Stockman to Darman, Fuller Re: natural gas, 3p [copy of documents in item #5]	2/1/82	~~P5~~
8. Memo	Weidenbaum to Darman, Fuller Re: natural gas, 1p [copy of item 3]	2/2/82	~~P5~~
9. Memo	Duberstein to Darman Re: natural gas, 3p	2/2/82	~~P5~~
10. Memo	Williamson to Darman, Fuller Re: natural gas, 1p [same document as in item 4]	2/3/82	~~P5~~ CCS 10/18/00

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]
P-1 National security classified information [(a)(1) of the PRA].
P-2 Relating to appointment to Federal office [(a)(2) of the PRA].
P-3 Release would violate a Federal statute [(a)(3) of the PRA].
P-4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA].
P-5 Release would disclose confidential advice between the President and his advisors, or between such advisors [(a)(5) of the PRA].
P-6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA].

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F-2 Release could disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA].
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F-6 Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA].
F-7 Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA].
F-8 Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA].
F-9 Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA].

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JAB not seen Document No. ______

WHITE HOUSE STAFFING MEMORANDUM

DATE: 3/1/82 ACTION/CONCURRENCE/COMMENT DUE BY: ______

SUBJECT: STATEMENT RE DECONTROL OF NATURAL GAS

	ACTION	FYI		ACTION	FYI
VICE PRESIDENT	☐	☐	GERGEN	☑	☐
MEESE	☐	☑	HARPER	☑	☐
BAKER	☐	☑	JAMES	☐	☐
DEAVER	☐	☑	JENKINS	☐	☐
STOCKMAN	☐	☐	MURPHY	☑	☐
CLARK	☐	☐	ROLLINS	☑	☐
DARMAN	☐P	☑SS	WILLIAMSON	☑	☐
DOLE	☑	☐	WEIDENBAUM	☑	☐
DUBERSTEIN	☑	☐	BRADY/SPEAKES	☑	☐
FIELDING	☐	☐	ROGERS	☐	☐
FULLER	☐	☐	______	☐	☐

Remarks:

The President has made his decision and will delay sending forward legislation to accelerate the decontrol of natural gas. A formal decision will be announced this evening at 5:00 p.m. The attached statement should be used to brief the appropriate individuals within your area of responsibility.

Richard G. Darman
Assistant to the President
(x2702)

Response:

The President announced today that he will not ask Congress to accelerate the current schedule of partial natural gas decontrol at this time. After extensive consultation with congressional leaders and groups representing producers and consumers, the President concluded that much-needed changes to the Natural Gas Policy Act of 1978 would overload an already-heavy legislative agenda.

In making this announcement, the President stressed that natural gas decontrol remains an essential component of a sound energy policy.

THE WHITE HOUSE

WASHINGTON

18 February 1982

MEMORANDUM FOR JAMES A. BAKER
MARTIN ANDERSON
DAVE STOCKMAN
ELIZABETH DOLE
KENNETH DUBERSTEIN
CRAIG FULLER
ED ROLLINS
RICHARD WILLIAMSON
DANNY BOGGS

FROM: KENNETH CRIBB TKC

SUBJECT: Natural Gas Decision

This is to confirm that a meeting is scheduled in Ed Meese's office on Monday, 22 February 1982 at 2:00 p.m. to discuss a final recommendation to the President on the nature and timing of his decision on natural gas.

Attached is a copy of the briefing materials for your review prior to the meeting. Ed Meese requests that you hold these materials closely.

cc: Jim Jenkins

THE WHITE HOUSE

WASHINGTON

February 17, 1982

MEMORANUDM FOR ED MEESE

FROM: CRAIG FULLER

SUBJECT: Natural Gas Background Material

I have assembled pertinent materials for use in making a recommendation to the President with regard to the nature and timing of a decision on accelerating the decontrol of natural gas.

The following documents are attached:

Tab A: A draft decision memo by Danny Boggs that provides an assessment of the options that currently exist.

Tab B: A congressional assessment from Ken Duberstein (he had no changes in the memo he submitted on 2/2/82).

Tab C: A summary I assembled from the report by Merrill Lynch on natural gas (dated 1/82).

Tab D: A list of groups supporting and opposing decontrol. I might add that Dick Richards indicated that from his perspective, now would not be the time to introduce decontrol.

Tab E: The original decision memo submitted to the President on August 28, 1981.

Tab F: The comments that Dick and I received when we asked for views about a week ago.

Tab G: The Merrill Lynch paper.

Attachment

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

DRAFT

February 16, 1982

MEMORANDUM FOR THE PRESIDENT

Issue: What decision should be taken on the issue of decontrol of natural gas?

Background: In August 1981, the Cabinet Council on Natural Resources and Environment recommended that the Administration propose legislation to change the current law regulating natural gas to provide for smooth and complete decontrol by 1985, rather than the sudden and partial decontrol now in the law. That recommendation has not ben acted on, and key congressmen agree that a bill must be submitted this month if it is to have any chance of passing in 1982.

The passage of time without a decision has undoubtedly reduced the chances for a successful Administration effort in support of a bill. "Consumer" groups who support all price control efforts have become increasingly vocal and successful in arousing opposition. On the other hand, supporters of decontrol, who include a wide variety of groups, have been fairly silent, waiting for an Administration lead. If a proposal is made, a surprising amount of support may be generated from producers of competing energy sources, such as coal, oil and renewables, supporters of conservation, environmental protection, and energy security. Most academic and editorial opinion will also be favorable, though many may support some type of tax on additional revenues.

Discussion: During the 1980 campaign, President Reagan pledged to "rapidly phase out price controls on oil and natural gas." This promise was intended to improve America's energy situation by preventing serious imbalances in supply and demand which are the usual results of price controls. To the average observer, there is no "natural gas problem" at this very moment. Congressmen and interest groups who respond best to "crises" have taken this as a license to urge that there is no need to worry about natural gas right now.

Indeed, it is just barely possible that we will struggle through to 1985, and see about half of natural gas deregulated as scheduled, which should lead to market-clearing prices for consumers and market prices for producers. However, for this happy state of events to occur, oil prices will have to drop substantially and stay low. If prices just hold steady, or rise, then we will see a number of serious problems, if the current law is not changed.

(1) Market distortion-- Already, different pipelines are paying very different prices for gas. Pipelines in the producing states are generally paying more than those in consuming states, because they formerly had a free market. This may well lead to increasing shortages in the producing areas, as those pipelines are unable to compete for deregulated supplies becuase of their higher average cost.

(2) Inadequate drilling and exploration--The current drilling boom has been fueled almost entirely by oil. Since phased decontrol of oil began, new oil wells have grown 40% annually; new gas wells only about 10%. In 1980, as much oil was found as was produced. Gas found without any connection to oil fell fas short of replacing our production of that gas. With true decontrol in 1985 increasingly uncertain, drilling and exploration will be constrained by low prices under the current law, and fear of a repetition of the betrayal by a previous President of his pledges to work for decontrol.

(3) Unless oil prices fall markedly, the current law sets the stage for a sharp and instant price rise on January 1, 1985. If the rise takes place, it will undoubtedly cause a far more severe shock than if the price increase were phased in. The threat of that increase is certain to lead to demands for continued or "stretched-out" controls. This will be a very difficult issue to deal with in the middle of the 1984 campaign.

Options: I. DO NOTHING

If the Administration does not make a proposal for decontrol in the next two weeks, it is virtually certain that the current law will not be changed in 1982, and very unlikely that it will be changed before 1985.

ADVANTAGES:

--Avoids a major Congressional fight, freeing energies for other matters
--Allows the possibility that the current law will solve problems.
--Avoids question of a tax, since there is no "windfall" to tax.

DISADVANTAGES:

--Forfeits opportunity to improve America's energy position, put additional pressure on OPEC, encourage production and discourage wasteful consumption.
--Violates a campaign pledge
--May lead to continued controls beyond 1985
--Disheartens and dissolves the strong coalition of allies ready to work for decontrol

[NOTE: If this option is chosen, we could issue a statement ascribing our decision to the impossibility of success, and attempting to put some distance between the current ("Carter") law and its possible disasters, and this Administration. We could also direct DOE to take a more active role in encouraging the FERC in doing what it can to try to improve matters, though FERC will be subject to severe challenge in court for any action it takes.]

Option: II. SUBMIT ADMINISTRATION BILL SIMILAR TO CABINET COUNCIL PROPOSAL

This would involve a smooth phase out of controls on all gas by 1985, and removal of all restrictions on use of gas. Would probably contain some negotiated provisions to reduce or prevent inordinate price increases upon decontrol due to outdated contract clauses.

ADVANTAGES:

--Fulfills campaign pledge.
--Offers best hope of a smooth transition to decontrol
--Will increase exploration and production of gas, as well as conservation.
--Will put additional pressure on OPEC to reduce oil prices, also aiding our allies.
--Will encourage alternatives to gas, especially coal, solar and nuclea
--Stability of supply will encourage oil-to-gas switches.

DISADVANTAGES:

--Will cause great outcry in some quarters, adding to charge that Administration is hurting "the poor."
--Proposal could well fail, thus incurring political cost needlessly.
--By non-monetarist reasoning, would lead to higher inflation, thus also reducing real GNP.
--Would lead to almost irresistable demands for a "windfall" tax.

[NOTE: So long as a tax is confined to the "windfall" of additional revenue provided under a new law as opposed to the revenue possible under current law, decontrol with a tax is preferable to no decontrol, as our experience with oil has shown.]

Option: III. SUBMIT SOME PARTIAL DECONTROL PROPOSAL

This would convey the appearance of "moderation", trying to do something with regard to decontrol without raising as much opposition. The two variants most often suggested are to decontrol "new" gas only (gas from wells drilled after 1981 or 1982), and to ask only for changes in demand restrictions such as the Fuel Use Act or incremental pricing [special high prices for large boilers].

ADVANTAGES:

--Would appear to move toward fulfilling campaign pledge
--New gas decontrol could increase new exploration as opposed to current law.
--Increasing demand for gas could increase producers incentive to produce and raise the price that currently deregulated gas could receive.
--Would not appear to affect consumers as much as a full program of phased decontrol.

DISADVANTAGES:

--Would appear to be a "gimmick" adopted in the face of rising opposition.
--New gas decontrol almost certainly could not pass. Producing state interests fear that such a plan would insure that all new supplies would go out of state.
--If it could pass, a strong argument would be made to continue pre-1981 gas under controls forever.
--Fuel Use Act has already been effectively repealed. Consumer groups would bitterly oppose doing away with incremental pricing, as adding more costs to consumers.
--"Patchwork" solutions do not attack the basic problem of the necessity of allowing supply and demand to come into balance on a uniform basis.

THE WHITE HOUSE

WASHINGTON

February 2, 1982

MEMORANDUM TO: Dick Darman

FROM: Ken Duberstein Ken D.

SUBJECT: Deregulation of Natural Gas--Optimal Time for Transmittal of Legislation

It is our judgement that the next optimal time for submission of legislation deregulating natural gas would be early in the next session of Congress. This would:

1. Remove the issue as an '82 election issue in most areas, with the possible exception of Louisiana, where the intrastate market problems have hit crisis proportions and are adversely affecting its state industries.

2. Give us time to get back on the offensive on this issue. We're on the defensive because of off-again, on-again signals, because of the windfall profits tax issue and because of the bad winter.

3. Give us almost two years before the anticipated fly-up of costs in which to seek and achieve complete deregulation.

You should know that:

- o There is no consensus or consensus bill. Phil Gramm intends to introduce a bill reflecting his most recent efforts to forge a consensus, but AGA and INGA are still opposed.

- o There is overwhelming consensus that a WPT will be enacted and, given the deficit issue, there is concern among producer state members that such a WPT will be fashioned to address the deficit. Majors would accept a WPT; independents are said to be split.

- Senator Howard Baker and others have told us that the only way we can get deregulation of natural gas is by agreeing to back off on our profits tax position on natural gas. A number of Senators are with us in principle on this issue. The overall outlook in the Senate is a very close call with passage conditioned on two things: (1) aggressive White House and Presidential support, and (2) accepting a windfall profits tax on natural gas.

- Louisiana, Texas, Oklahoma, some California members and Tom Corcoran (R-Ill) continue to want to press for deregulation this session but very few would say definitively that we can get a bill this year. All would say that the President would have to be personally involved and that natural gas dereg would have to be a top priority (one of the "musts"...).

- Other Republicans like Michel, Latta, Emery, midwesterners, and northeasterners say that they would have to have a WPT. Even with a WPT many have deep reservations about deregulation this year because of this nasty winter and the impending election. They feel that the price for deregulation would be the heads of vulnerable R's (and maybe not-so-currently vulnerable R's).

- Energy and Commerce Fossil Fuels subcommittee Chairman Phil Sharp will hold hearings later in the year on NGPA. This would provide us with an excellent opportunity to aggressively air the problems with the NGPA, even though Sharp and Dingell remain opposed to deregulation.

- Frank Horton, ranking Republican on the House Government Operations Committee, believes strongly that sending up natural gas dereg now would jeopardize many other initiatives, such as DOE reorganization. His concern is legitimate.

- Sending it up now does get us into the middle of an expensive heating season. That will complicate deliberations. But those high heating bills will be remembered even in the spring, and those who are inclined to use that issue will play it for all its worth well into the summer.

- Senator Jim McClure, Chairman of the Energy Committee and a proponent of the accelerated decontrol of natural gas, has stated repeatedly if we don't submit legislation before the end of February, it is dead for this session.

In summary, our submission of legislation, regardless of timing, will provoke protracted controversy. With all our other priorities, the need for Presidential involvement in those issues, and the upcoming congressional elections, we believe submission early in 1983 would be advisable.

SUMMARY OF POINTS FROM: NATURAL GAS MONTHLY/JANUARY, 1982
A MERRILL LYNCH INDUSTRY REVIEW

Political

-- As far as the current year is concerned, we believe that the November elections eliminate the possibility of passage of decontrol legislation. However, passage could be accomplished in 1983, but not without a bitter struggle.

-- ...the lobby against decontrol against decontrol appears awesome: it includes various consumer groups, distribution companies, pipeline companies, and many gas producers, primarily those producing large quantities of deep, deregulated gas. Consequently, for those reasons as well as reasons that we have outlined in past publications, we believe that the chances are high that decontrol will occur as scheduled in the Natural Gas Policy Act of 1978 (NGPA).

Supply and Prices

-- Old natural gas production has been depleting at an average annual rate of approximately 12% and that gas is being replaced by high-priced new gas.

-- We estimate that the average wellhead price for natural gas approximated $1.85 per MCF in 1981, up from $1.50 a year earlier. For 1982, we believe that the average wellhead price could rise to approximately $2.40-$2.50 per MCF.

-- 1982 sources of gas and prices:

o Section 102 gas rises at the rate of inflation plus a real growth factor of 4.0%. It is estimated to be $3.15 for 1982.

Section 103 gas, which rises annually at the rate of inflation, is estimated to be priced at $2.65.

These two categories under NGPA will comprise about 45% of total production in 1982.

- o tight gas, near-deep gas and deep-water gas could collectively account for approximately <u>10%</u> of the 1982 production at an average price of $5.15-$5.30 per MCF.

- o Deep-drilling activity has soared since the passage of the NGPA. It is estimated that deep gas prices could average about $7.00 in 1982 and may account for <u>4.0%</u> of total production.

- o approximately <u>40.0%</u> of the remaining gas production of 1982 is projected to be in the older categories established by the NGPA with average prices between $1.25-$1.50 per MCF.

-- The average wellhead price of gas in a decontrolled environment is an unknown factor. We believe that the average wellhead price of natural gas, once decontrolled, will be no greater that $4.00-$4.25 per MCF. (This is because of the other energy sources with which natural gas would be competing.)

-- <u>We disagree with the gas industry, as well as politicians, who believe that a substantial price spike will occur in 1985 when gas is decontrolled under the NGPA.</u> At the end of 1984, we estimate that the average price of natural gas will be $3.75-$4.00 per MMBtu. (or, $4.00-$4.25 per MCF).

TYPES AND SPECIFIC GROUPS SUPPORTING NATURAL GAS DECONTROL

Oil and Gas Producers

1. American Petroleum Institute

2. Independent Petroleum Association of America

3. Regional groups, such as Mid-Continent Oil and Gas Association, Rocky Mountain Oil & Gas Association, etc.

4. Natural Gas Supply Association

Individual Companies

Amoco, Tenneco, Sun, and Getty have been especially active.

Producers of Competing Energy Sources

1. National Coal Association

2. Producers of solar products.

3. Producers of conservation supplies and materials.

Public Interest Groups concerned with America's Energy Security

1. Americans for Energy Independence (production-oriented)

2. Alliance to Save Energy (conservation-oriented -- Senator Percy heavily involved with)

3. American Jewish Committee

Energy Scholars

1. Charles Chichetti (liberal ex-Chairman of Wisconsin Public Service Commission)

2. Daniel Yergin (Harvard)

3. Al Alm (Harvard)

4. Paul McAvoy (Yale)

5. Robert Pendyck (MIT)

GROUPS SUPPORTING DECONTROL

Oil Distributors

1. National Oil Jobbers Council

2. New England Alliance for Energy Equity

3. Midwest Oil Jobbers

Major Industrial Users of Gas

1. Chemical Manufacturers Association

2. Rubber Manufacturers Association

3. Petrochemical Energy Group

4. Process Gas Consumers Group
   (General Motors, Alcoa, 3-M, Corning, etc.)

5. American Textile Manufacturers Institute

6. The Society of the Plastics Industry

Major Business Groups

1. National Association of Manufacturers

2. Chamber of Commerce

3. Business Roundtable

Gas Pipelines

Most intrastate pipelines (Delhi, Houston Natural, Valero, etc.)

Interstate Natural Gas Association of America (if certain accommodations are made)

Environmental Groups

1. Environmental Policy Center

2. Resources for the Future

3. Other environmental groups, though some may be quiet because of connections with consumers groups.

TYPES AND SPECIFIC GROUPS OPPOSING NATURAL GAS DECONTROL

"Consumer" Groups

1. Citizen-Labor Energy Coalition
2. Energy Action
3. Consumer Federation of America

Producers Already Receiving Decontrolled Prices

Robert Hefner

Some other "deep" drillers

Distributors of Natural Gas

American Gas Association

THE WHITE HOUSE

WASHINGTON

August 28, 1981

MEMORANDUM FOR THE PRESIDENT

FROM: CABINET COUNCIL ON NATURAL RESOURCES AND ENVIRONMENT
JAMES G. WATT, CHAIRMAN PRO TEMPORE

Jim Watt

ISSUE: Should the Administration support legislation to accelerate the decontrol of production and use of natural gas?

BACKGROUND

Since 1954, gas sold across state lines ("interstate") has been closely regulated by federal agencies, while gas produced and sold in the same state ("intrastate") was free of price regulation. In 1978, Congress adopted the Natural Gas Policy Act (NGPA), which controls the price of all gas, under a wide variety of categories and selling prices. Those prices were allowed to escalate at or slightly above the rate of inflation. Under the law, some gas (about half of production in 1985), would be deregulated on January 1, 1985, while the remainder would remain under controls forever.

However, because of the rapid increase in oil prices following the fall of the Shah of Iran, the current controlled prices are well below any equivalent oil prices. The top price permitted for any natural gas today[†] is the equivalent of about $17 a barrel for oil, and the average price is less than $12. Even at the time of decontrol, the very top controlled price will be less than $20 per barrel for oil in today's dollars. This would mean that if the current law is not changed, natural gas prices would probably rise enormously at the time of decontrol in 1985. This makes it very likely that there will be great political pressure to prevent even that partial decontrol from taking place.

At the same time, the gas market has been distorted by other energy laws which prevent the use of natural gas in certain areas, or require arbitrarily high prices for users in certain sectors.

The NGPA has generally retarded gas drilling efforts. As soon as it was passed, the number of rigs at work began to fall steadily, dropping 18% in five months. It is true that since that time, drilling rigs at work have increased very rapidly

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[†] Except for a very small amount of gas from wells deeper than 15,000 feet.

(about a 40% annual rate of increase since phased decontrol of oil began). But that drilling has primarily been for oil and as a result of oil prices. Over the past 18 months, the number of new oil wells completed has increased at about a 40% annual rate; the number of gas wells completed at only about a 6% annual rate.

DISCUSSION

Many "modelers" predicted disaster in the event of oil decontrol. The actual effectiveness of oil decontrol, with price stability and increased conservation, greater innovation in marketing, production, and use of oil, and a reduction in imports, indicates that modeling of energy results is not an exact science. Nonetheless, it is important to have some estimate of the results of this major policy step. The Department of Energy estimates that any policy leading to complete decontrol of natural gas will provide substantial benefits in economic efficiency in the economy. The more immediate and complete the decontrol, the greater the efficiency gain, but also the greater the immediate impact on consumers, and the more rapidly the economy must adjust to the new situation.

The Cabinet Council recommends that the preferred policy on natural gas should be a phase-out of price controls by allowing prices to rise steadily from their levels on January 1, 1982 on a smooth path toward an oil equivalent price on January 1, 1985, when complete decontrol would take place. The Council also recommends that some category of "new" gas be allowed to rise immediately to the oil equivalent price, so as to create a greater immediate incentive for increased production.† Finally, the Council recommends that all demand restraints on natural gas be repealed.

The Council also agreed that the preferred method of presentation would be an Administration announcement of the general outline of this policy relatively soon, to be followed by consultation with affected groups on the exact details of a bill for presentation after the end of the Congressional recess.

ESTIMATE OF EFFECTS

Again, emphasizing that modeling is not an exact science and frequently underestimates the adaptability of the market place and consumers under conditions of freedom, the following are Department of Energy and Council of Economic Advisers estimates

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† "Oil equivalent price" means a wellhead price for gas such that, when the cost of transporting and distributing the gas is added, it can be sold to consumers at a price equivalent to residual fuel oil. In practice, this would be about 70% of the equivalent price of crude oil, excluding taxes.

of effects of this policy. (All numbers are in 1980 dollars and are net present value where a stream of benefits is involved):

- o Increase in average residential natural gas price in first year -- 14% to 32%. (Increase over past 5 years has averaged 8% to 10%.)
- o Increase in average wellhead price in first year -- 30% to 60%.
- o Increase in national average heating bill for gas-heated homes in 1982 -- up to $90.
- o Efficiency gains to American economy 1982 to 1995 -- $15 to $20 billion.
- o Decrease in oil imports 1982 to 1995 -- 100 to 400 million barrels.
- o Increase in Consumer Price Index and decrease in GNP in first year -- CEA argues no effect will necessarily occur; others will argue an effect of up to 2% in the first year and an average over three years of up to 1%.
- o By 1985, prices will be about the same as under the current law.

RECOMMENDATION

The Cabinet Council recommends that the policy outlined above be adopted.

Advantages

- o Moves toward a free market as rapidly as is politically possible.
- o Allows greater efficiency in use of gas by removing demand restraints.
- o Stimulates increased exploration for and production of natural gas, while also increasing conservation of gas.
- o Improves foreign relations by eliminating an American energy subsidy that has been troublesome to our allies.
- o Greater availability of gas both through increased production and conservation will place additional downward pressure on oil markets.
- o Will prevent the likelihood of extension of controls beyond 1985 due to massive immediate price increases scheduled at that time.

Disadvantages

- o Will create a major political and Congressional controversy, which we have no assurance of winning.
- o Will increase consumer prices somewhat more than otherwise and we will undoubtedly be blamed for the entire increase.
- o Could disadvantage industries that are major current users of natural gas.
- o Will create substantial transfer of wealth ($40 to $50 billion from 1982 to 1995) from consumers to producers of natural gas.

PRELIMINARY DRAFT OF STATEMENT ANNOUNCING POLICY

Today, natural gas is America's largest source of domestic energy production. We have great potential for additional discoveries of natural gas, and for wiser use of the gas we now have. The United States Geological Survey estimates that there are over 600 Trillion Cubic Feet of natural gas that remain undiscovered in the United States.

But our current natural gas policy discourages exploration for natural gas, and encourages inefficient consumption. There has been a great drilling boom in America over the past few months, but it has been for oil, not gas. In the past 18 months, the number of new oil wells has grown by 65% -- the number of new gas wells less than 10%.

At the same time, our current laws have forbidden some industries to use gas, while allowing others to have gas at a very low price, relative to other fuels.

We now have a law that is supposed to lead to decontrol of natural gas -- but it is not working and will not work. First, it will not deregulate all gas, even in 1985 or 1987. That means some companies and customers will have access to cheap gas and others will not. This is exactly the situation that gave us the "entitlements" program for oil, which we have just ended. Second, the current law keeps gas controlled at a very low price until 1985, then allows a large and sudden price increase. This creates vast pressures against allowing any decontrol at that time, and also creates uncertainty in the meantime. Producers and consumers can't know how the politicians of 1985 will deal with the situation created by the current law, and so will be less able to plan wisely.

A change in policy is needed. It is not good enough simply to wait until 1985 and try to deal with the large price increases and regulatory complexity caused at that time by half-hearted decontrol. And we can't wait until 1985 for the benefits in efficiency, productivity, and reduced oil imports that decontrol can bring.

Therefore, the Administration will seek the passage of legislation with the following features:

1) The wellhead price of all natural gas will be decontrolled by January 1, 1985.

2) Between 1982 and 1985, the price of all gas will be allowed to rise smoothly from its current price to a price equivalent to the price of oil, allowing for differences in

transmission and distribution costs. The price of all types of gas will arrive at this "oil-equivalent price" in January 1985. This should be very close to the free market price after decontrol.

3) A special category of "new" gas will be allowed to rise immediately to the oil-equivalent price in order to create the greatest incentive for additional production.

4) All statutory restrictions on the use of natural gas will be repealed upon passage of the legislation, as well as special pricing rules such as "incremental pricing," which were designed to discourage certain customers from using gas.

Because of the enormous complexities of the current regulatory scheme, actual legislation will require considerable detail work to deal with these problems during the period of phased deregulation. Administration officials will be consulting with all interested parties over the next month, with the purpose of determining a specific piece of legislation for introduction in the fall. We seek the aid and advice of all Americans in that effort.

We have seen the many benefits created by the final decontrol of oil: greater exploration, increased competition, reduced imports. And we have seen how these results have confounded the many "analysts" and doom-sayers who predicted dire results. We anticipate that gas decontrol will have the same general effects. Americans will produce more natural gas, and consume less total energy, leading to further eductions in oil imports and downward pressure on oil prices.

Consumer prices will probably rise somewhat more rapidly between now and 1985 than under the current law, but there will not be the sudden and explosive rise now scheduled for 1985. Prices thereafter will be the same or lower under our plan than otherwise.

The time has come to take the final major step in freeing all Americans to produce and use energy most efficiently, freed from arbitrary and misguided government controls.

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

February 2, 1982

MEMORANDUM FOR DICK DARMAN
CRAIG FULLER

FROM: MURRAY WEIDENBAUM MW

SUBJECT: Timing of Natural Gas Deregulation

The sooner the better. Further delay in transmittal of legislation to accelerate natural gas decontrol worsens the following problems:

1. Price increases under phased decontrol become progressively steeper as the time available for phasing (between enactment of legislation and the date for expiration of the current law, 1/1/85) becomes shorter. The only way to avoid this is to extend the current law beyond 1/1/85, a thorny problem.

2. Under current law, resources are being wasted in drilling for non-price controlled deep gas and in a myriad of other ways that arise when excessive use is made of a below-market priced commodity.

3. Further delay may increase the complications posed by the Congressional elections, and thus increase the problems mentioned in (1) and (2).

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THE WHITE HOUSE

WASHINGTON

February 3, 1982

MEMORANDUM FOR ED MEESE
JAMES BAKER

FROM: RICHARD DARMAN
CRAIG FULLER

SUBJECT: Natural Gas Decontrol

We have polled cabinet members and White House staff on the question of decontrolling natural gas. We asked for views on the issue of whether or not to accelerate decontrol and for views on when such an action should occur. The responses are attached.

Favoring action now: Energy, OMB, CEA

Favoring action in April, 1982: Dole

Favoring action next year: Duberstein

THE WHITE HOUSE

WASHINGTON

February 1, 1982

MEMORANDUM FOR: SECRETARY EDWARDS
DAVID A. STOCKMAN
MARTIN ANDERSON
ELIZABETH H. DOLE
KENNETH M. DUBERSTEIN
MURRAY L. WEIDENBAUM
RICHARD S. WILLIAMSON
EDWARD J. ROLLINS

FROM: RICHARD G. DARMAN
CRAIG L. FULLER

SUBJECT: Deregulation of Natural Gas

Would you please provide an updated assessment of the optimal time for transmittal of legislation to accelerate the deregulation of natural gas (assuming this might be approved by the President). Please explain the reasoning that underlies your conclusion.

This matter may be considered by either a Cabinet Council or the Legislative Strategy Group this week.

Thank you.

THE WHITE HOUSE

WASHINGTON

February 3, 1982

MEMORANDUM FOR RICHARD G. DARMAN
CRAIG L. FULLER

FROM: RICHARD S. WILLIAMSON Rich

SUBJECT: DEREGULATION OF NATURAL GAS

Please consider the following comments in response to your request for an assessment of the optimal time for transmittal of legislation to accelerate the deregulation of natural gas.

1. The harsh winter weather which much of the country has suffered the past few months has created a situation which suggests that this legislation should be delayed at least until the Spring and perhaps until after the November 1982 elections.

The core of Republican Gubernatorial support for the President's economic initiatives has come from the Midwest Governors. Many of these Governors are up for reelection in 1982 and others have decided to retire, leaving open races in their states (Republican Governors up for reelection - Pennsylvania, Illinois, Wisconsin, Iowa, South Dakota; Republican Governors who have retired, leaving open races - Ohio, Michigan, Minnesota). Deregulation of natural gas would give the Democrat candidates in all of these Gubernatorial races the opportunity to suggest that Administration policies would be responsible for higher natural gas prices. This would be an awkward situation for our Gubernatorial supporters.

2. An argument can be made that having delayed as long as we have, it is no longer advisable to transmit such legislation until after the November elections for the same reasons outlined above.

By late Fall, the predicted economic upturn should have occurred, inflation should have continued to ease, and the unemployment picture should have improved. All of these factors would improve the political climate in which deregulation would be received.

cc: Meese
Baker

CLF - 2/4/82 gom

EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

February 1, 1982

MEMORANDUM FOR RICHARD DARMAN
CRAIG FULLER

FROM: DAVID A. STOCKMAN DAS

SUBJECT: Timing on Natural Gas Decontrol

Summary:

For both political and policy reasons, I believe the ideal time to transmit natural gas decontrol is right now.

Discussion:

-- Current law is distorting the marketplace by keeping gas relatively inexpensive and dampening drilling other than for certain narrow types of production.

-- Delaying transmittal will force extension of controls beyond the current 1985 date because of the necessity for a two- to three-year phase-in.

-- Current projections of stable or declining real oil prices are the ideal backdrop for a gas decontrol debate; with the passage of another year or two, these forecasts could easily change.

-- Recent experience of declining gasoline prices under oil decontrol may not persist as refiners and marketers adjust; this could produce price increases (from higher margins) just as gas decontrol debate begins next year.

-- Loss of even a small number of seats in the 1982 elections would make decontrol more difficult.

-- Industry groups have geared up in anticipation of Administration announcment; retreat now would be seen as abandonment of basic goal.

-- Congressional committees dealing with decontrol would be deflected from efforts to frustrate Administration DOE initiatives on reorganization and budget.

-- Any potential embarrassment to the President from linkage of decontrol to a windfall tax would be minimal because of congressional pressure; tax would probably pass by more than two-thirds vote, making veto problematic (oil windfall tax adopted by huge margins).

-- A secondary option, such as transmittal later this year, would be worse than waiting until next year.

February 1, 1982

ISSUE: Should the Administration send natural gas decontrol legislation to Congress in the immediate future?

Advantages:

-- Decontrol is sound policy; will increase energy supply and enhance conservation, thereby reducing oil imports.

-- Capitalizes on extensive industry effort now building in support of decontrol.

-- Starting in 1982 permits longer time for phase-in while retaining January 1, 1985 decontrol date of existing law.

-- Current oil glut is ideal backdrop for gas decontrol; can capitalize on gasoline price declines of recent months.

-- Avoids major risks attendant on deferring decontrol debate to 1983:

  o Almost certain extension of controls beyond current 1985 date to 1986 or later.

  o Current projections of stable or declining oil prices may be replaced by forecasts of real increases, which would make decontrol more traumatic because of linkage between decontrolled gas prices and oil prices.

  o Electoral politics will be an even larger factor as 1984 approaches.

-- May deflect attention of congressional energy committees from DOE dismantlement, thereby weakening principal source of opposition to Administration plan.

-- Potential for congressionally-mandated windfall tax may strengthen prospects of quick action on decontrol as partial solution to deficit problem.

Disadvantages:

-- Highly controversial addition to legislative agenda that will strengthen hand of those who charge that Administration is insensitive.

-- Severe cold weather may have elevated public awareness of heating costs; decontrol would look like final blow. Administration would get the blame for scheduled price increases under current law as well as incremental increase from decontrol.

-- Lengthy consideration of last decontrol bill may indicate limited possibility of action before election; Administration would thus take criticism for decontrol without accompanying results.

-- Key congressional actors (McClure, Domenici, Baker) are tepid on proceeding; House Democrats may demagog the issue (Dingell repeated his "over my dead body" objections recently, though has also made more neutral comments).

-- The President will be placed in a difficult situation if decontrol is tied to windfall tax (English letter).

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

January 29, 1982

MEMORANDUM FOR RICHARD G. DARMAN

FROM: DAVE STOCKMAN

SUBJECT: Legislative Strategy Group Consideration of Gas Decontrol

In the course of a conversation with Jim McClure today, the subject of how to proceed on natural gas decontrol came up.

We both came to the conclusion that it would be highly desireable to have a discussion in the very near future that would bring key congressional actors together with our Legislative Strategy Group.

There are many competing alternative paths here. This discussion would get us the congressional consultation we need before making a final judgment.

Recommended Action:

Devise list of key congressional actors; call consultation meeting for sometime next week.

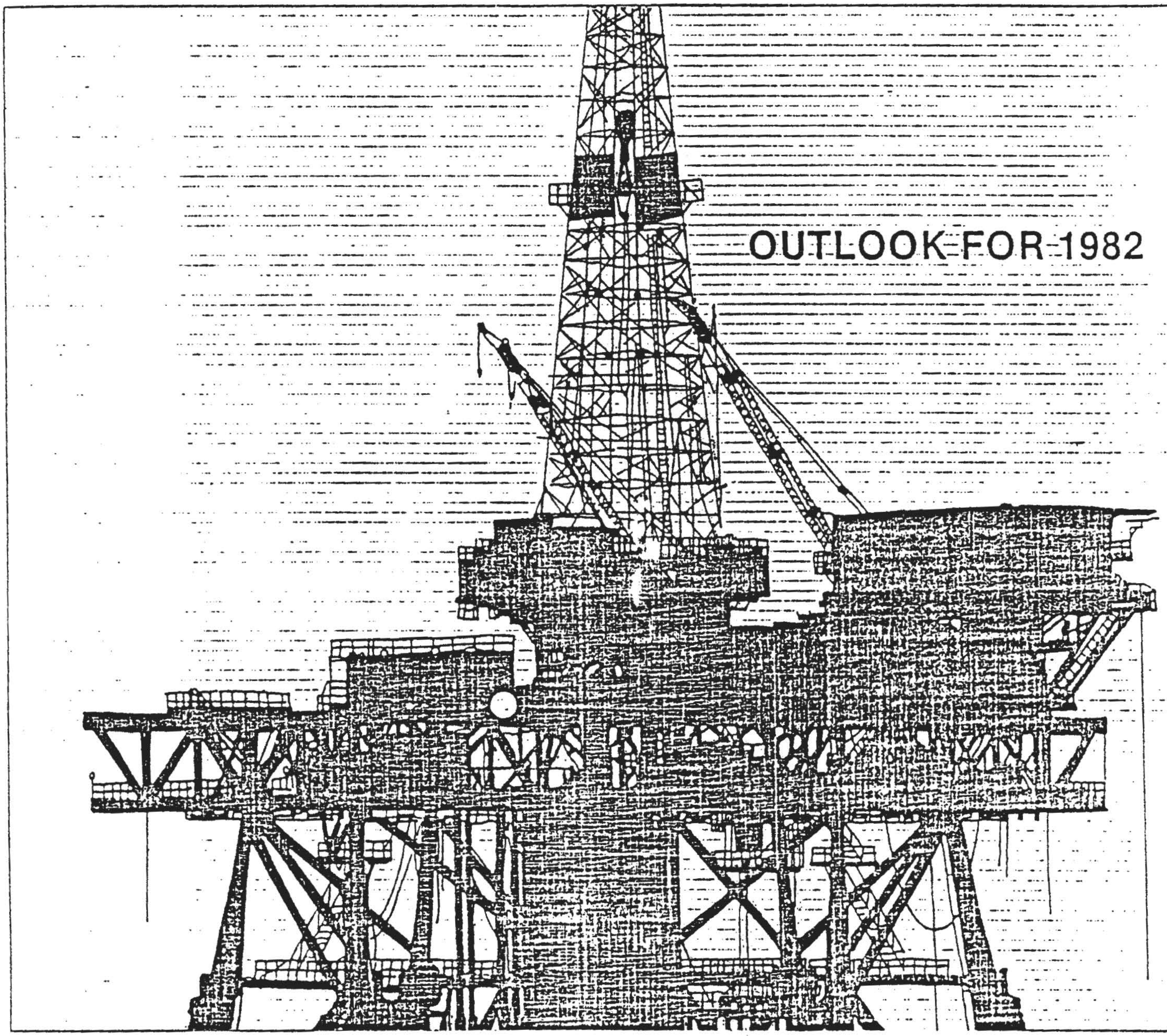
Perhaps Danny Boggs could prepare a brief summary of strategy options in consultation with Duberstein's office as a basis for the discussion.

Merrill Lynch

January 1982

Natural Gas Monthly

A Merrill Lynch Industry Review



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OUTLOOK FOR 1982

January 12, 1982

THE OUTLOOK FOR 1982

The natural gas industry, after struggling through the gas-short years of the 1970's, has thus far experienced good record years in the starting 1980's. We expect that 1982 will continue that favorable record, but the rest of the 1980's will not be without problems. As we see it, difficulties created by decontrol could be more severe for many companies than were the troubles caused in the gas-short years. This report will attempt to anticipate several potential problems as well as provide commentary on several of today's most frequently asked questions.

NATURAL GAS DECONTROL

Natural gas decontrol will probably be the most important energy issue considered by Congress in 1982. Upon reconvening on January 25, the Congress will have a full 29 weeks to consider legislation prior to adjourning on October 8. The first Congressional priority will probably be to tackle the Administration's plan for dismantling the Department of Energy (DOE). Once that issue is resolved, the center of attention is expected to be natural gas decontrol.

The Administration, which anticipates sending its initial deregulation bill to Capitol Hill in February, has two basic decontrol schemes from which to choose. Most observers believe that Mr. Reagan will support a program that calls for the deregulation of all natural gas prices between January 1, 1983 (after the November 1982 elections), and January 1, 1986 (one year after decontrol is scheduled to occur under the Natural Gas Policy Act of 1978 (NGPA). Supposedly, the Administration will not include a windfall profits tax (WPT) provision in such a program.

The second option is one that may receive more consideration in the future, especially if Administration worries continue to mount concerning future budget deficits (estimated to be in excess of $100 billion in both fiscals 1982 and 1983). If full decontrol is effected, we estimate that a WPT could result in incremental government revenues of $35.0 billion, including additional income taxes that would be paid by producers. Proceeds from a WPT of this magnitude appear to be the only reason that many Congressmen will even consider positive action on the controversial decontrol issue. We estimate that a WPT in a phased decontrol program would produce funds no greater than $70 billion in the first year of decontrol.

As far as the current year is concerned, we believe that the November elections eliminate the possibility of passage of decontrol legislation. However, passage could be accomplished in 1983, but not without a bitter struggle. Certainly decontrol foes, including Representative John Dingell (D-Mich.) and Senator Howard Metzenbaum (D-Ohio), will do their utmost to thwart any Congressional decontrol action. In addition, the lobby against decontrol appears awesome: it includes various consumer groups, distribution companies, pipeline companies, and many gas producers, primarily those producing large quantities of deep, deregulated gas. Consequently, for those reasons as well as reasons that we have outlined in past publications, we believe that the chances are high that decontrol will occur as scheduled in the NGPA.

NATURAL GAS PRICES

The average wellhead price for natural gas has been rising at an approximate rate of 30% for the last two years. Those above-average increases can be attributed to three factors: (1) Producers have been very aggressive in seeking the highest maximum ceiling price possible under the NGPA for their production; (2) Prices of deep gas and tight formation gas have been rising very rapidly, and production from those categories has been increasing; (3) Old natural gas production has been depleting at an average annual rate of approximately 12% and that gas is being replaced by high-priced new gas. We estimate that the average wellhead price for natural gas approximated $1.85 per MCF in 1981, up from $1.50 a year earlier. For 1982, we believe that the average wellhead price could rise to approximately $2.40-$2.50 per MCF. Our reasoning for such a substantial increase is presented below:

- The price of Section 102 gas rises each year at the rate of inflation plus a real growth factor of 4.0%. That price is currently $3.00 per MCF and we estimate that it will average approximately $3.15 for the current year. Section 103 gas, which rises annually at the rate of inflation, is currently $2.57 per MCF and is expected to average about $2.65 for 1982. We estimate that those two categories will comprise about 45% of total production in 1982.

- The FERC is in the process of finalizing an incentive price for two categories of high-cost gas: deep-water gas and near-deep gas. The incentive price for gas produced in water depths in excess of 300 feet will command a price equal to 200% of the Section 103 price (the same formula governing tight-gas prices), or $5.14 per MCF in the current month. That price has an annual escalator equal to the rate of inflation and is expected to average about $5.30 in the current year. A final rule has not been written for near-deep gas (gas produced from wells drilled 10,000-15,000 feet)because the FERC needs additional cost data in order to determine a realistic incentive price. However, preliminary indications are that the price will be equal to 150%-200% of the Section 103 price. In addition, production from wells drilled in early 1977 could qualify for the incentive price, which would be a significant windfall for producers. We estimate that tight gas, near-deep gas, and deep-water gas could collectively account for approximately 10% of 1982 production at an average price of $5.15-$5.30 per MCF.

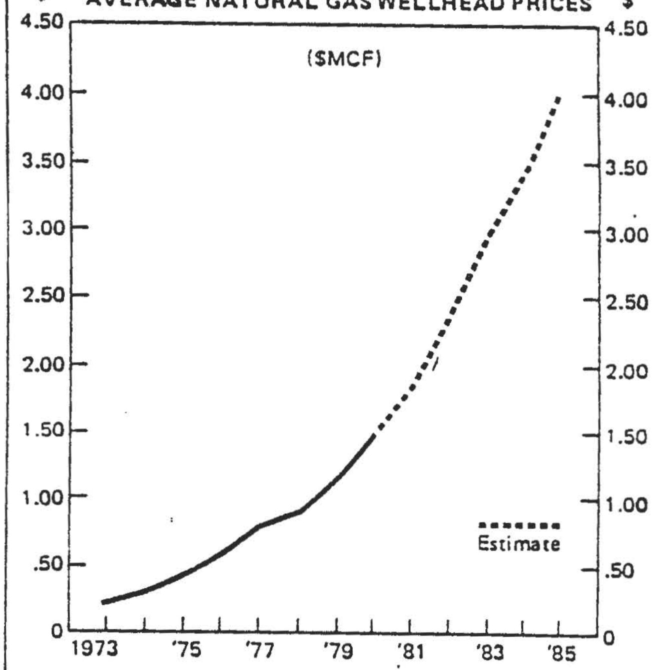
- Deep-drilling activity has soared since the passage of the NGPA primarily because of the high prices being paid for natural gas in this deregulated category. We estimate that deep gas prices could average about $7.00 in 1982 and may account for approximately 4.0% of total production.

- Approximately 40% of the remaining gas production in 1982 is projected to be in the older categories established by the NGPA. We estimate for 1982 that the average price of that gas will approximate $1.25-$1.50 per MCF.

The average wellhead price of gas in a decontrolled environment is an unknown factor that is currently being deciphered by both industry and investment analysts. We believe that the average wellhead price of natural gas, once decontrolled, will be no greater than $4.00-$4.25 per MCF. Basically, natural gas competes with No. 6 (residual) fuel oil on the industrial level, and the price of No. 6 to the end user is approximately $5.00-$5.25 per MCF. If the end-use price of natural gas is to be competitive with residual fuel oil, we believe that the wellhead price cannot be greater than $4.25 per MCF. If producers insist on receiving substantially higher prices, the result could be plummeting gas sales. The marginal user of natural gas is the industrial customer, accounting for 60% of total gas consumption (including electric utilities). However, approximately 7 out of 10 industrial users possess a dual fuel-burning capability, and are able to switch to residual fuel oil, and will do so when the economics are justified. Consequently, we believe that as long as stability prevails in the world oil markets, the threat of industrial fuel switching could prevent the wellhead price of gas from soaring to unrealistic levels.

The gas industry, as well as politicians, are concerned that a substantial price spike will occur in 1985 when gas is decontrolled under the NGPA. We disagree. At the end of 1984, based on an annual inflation rate of 8.0%, we estimate that the average price of natural gas will be $3.75-$4.00 per MMBtu (Chart 1). Consequently, if the average wellhead price after decontrol is in line with our estimate of $4.00-$4.25, a dramatic price spike will not occur. In fact, our estimates indicate that if the NGPA were to remain in effect beyond January 1, 1985, the average price of gas in that year would approximate $4.00-$4.25 per MCF, which is also our decontrolled price estimate.

Chart 1
AVERAGE NATURAL GAS WELLHEAD PRICES



WINDFALL PROFITS TAX (WPT)

We do not believe that any natural gas decontrol measure can escape Congress without the inclusion of a WPT. In fact, the government's need for revenues that could be generated by such a tax is the only argument that we believe could lead to prompt action on the decontrol issue in 1982. We estimate that the proceeds from such a tax in a fully decontrolled environment, including increased taxes that would be paid by producers, could approximate $35 billion (no more than an estimated $10 billion in the first year of a phased decontrol program), if the decontrolled wellhead price of natural gas falls into our projected range of $4.00-$4.25 per MMBtu. To date, President Reagan continues to oppose a WPT; however, we believe that he could change his mind during 1982. His justification for that anticipated change may well be his belief that a WPT will be a lesser evil than a budget deficit in 1983 that could approach the $150 billion level.

There has been a great deal of speculation as to what form the WPT would take. Below, we have summarized our thoughts as to the possible structure of a WPT:

- The WPT is expected to be in the form of an excise tax. We anticipate that it will probably be a very stiff tax, considering the government's need for additional revenues. Initially, an average tax rate of 75% or more would not surprise us.

- The government recognizes that there is little to be accomplished by creating additional price incentives for flowing gas. Consequently, the most onerous provisions (perhaps a tax bite well above 75%) of a WPT could be aimed at older categories of natural gas, including new gas as defined by the NGPA.

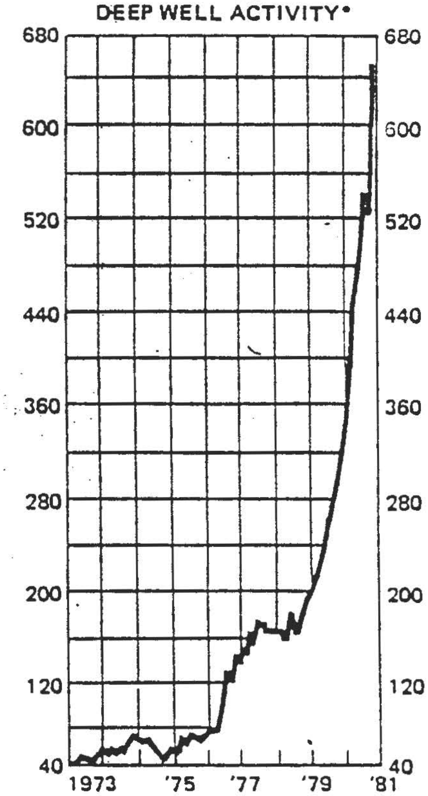
- We believe that incentive-priced natural gas (Section 107 gas including deep gas, tight gas, gas produced from coal seams, gas produced from Devonian shale, near-deep gas and deep-water gas) could escape the WPT. As mentioned above, the price of Section 107 gas is expected to decline significantly from current levels in a fully decontrolled environment. Some of that gas will not be profitable to produce at the decontrolled prices that we are projecting. If a WPT is placed on that production, there would be no profit incentive to explore for Section 107 gas. Section 107 gas is very necessary from a long-term supply standpoint because of its high deliverability and long-lived reserves. According to estimates prepared by GHK Companies of Oklahoma City, approximately 70% of the estimated potential recoverable natural gas reserves in the U.S. are thought to be Section 107 gas (see Chart 3 on page 7). Consequently, any WPT that is devised by Congress must take great care not to reduce further the incentive for finding Section 107 gas. Otherwise, a great deal of damage will be inflicted on the supply outlook for long-term natural gas in the U.S.

DEEP GAS

Under Section 107 of the NGPA, producers are entitled to receive a deregulated price for natural gas produced from wells drilled 15,000 feet or deeper. For 1981 we estimate that the average price of deep gas at $6.25 per MMBtu, and for 1982 we believe that average price could rise to the $7.00-$7.50 range. Several recent contracts have called for deep gas prices in excess of $10.00 per MMBtu. Although prices of that magnitude are the exception rather than the rule, many contracts have priced deep gas at approximately $8.00-$8.50 per MMBtu. Pipelines have been willing to pay such a high premium to our projected deregulated market-clearing price of $4.00-$4.25 for two reasons: (1) Most pipelines enjoy the benefit of a low-cost cushion because the lion's share of their total supplies is both old gas and low in price. Consequently, if a pipeline is paying a substantial premium for deep gas, its average cost of gas is not materially affected because most of its supply is priced below current NGPA prices; (2) the deep-gas reserves are usually characterized by a long life and a high rate of deliverability. The presence of both usually dictates a premium price. However, because the average wellhead price of gas is rising so rapidly, we believe that deep gas prices could begin to stabilize and then soften beyond 1982.

As a result of the high prices that are being received for deep gas, deep drilling activity has surged since deep gas prices were decontrolled in late 1979. In the Anadarko Basin alone, probably the premier area from a deep drilling standpoint, the number of deep wells drilled increased from about 160 in 1979 to approximately 650 at the end of 1981 (Chart 2). Currently, we estimate that deep gas accounts for approximately 4.0% of total U.S. natural gas production, and GHK estimates that it could account for almost 20% of total potential recoverable reserves.

Chart 2
DEEP WELL ACTIVITY*



*Deep Anadarko Basin

Source: Oil & Gas Journal

Many investors believe that deep gas will continue to commmand a significant premium to the market-clearing price after complete decontrol has been effected. Generally, they believe that those prices are protected by long-term contracts. We do not agree with this premise. With very few exceptions, contracts governing deep gas production contain buyer-escape clauses or market kick-out clauses. Those clauses provide relief to the purchasing pipeline under the following circumstances: (1) when a pipeline is not allowed by the FERC to pass on the cost of the purchased gas to its customers, or (2) when a pipeline discovers that the price of the gas is not economic and cannot be marketed when the higher prices are incorporated into its rates. If a buyer-escape clause is triggered, the producer and the pipeline attempt to renegotiate to an economic price level. If a contract does not contain either of those two clauses, we believe that producers might be willing to renegotiate; if not, pipelines unwilling to pay those current high prices could walk away from those contracts once decontrol has been effected. At best, deep gas might command a modest premium to the average decontrolled price; our estimate is for a price of approximately $4.50 per MMBtu (compared to our estimate for the average deregulated price of $4.00-$4.25 per MMBtu).

If our projections are correct, the excessive cost of drilling the majority of deep wells may render those wells uneconomical to drill. That could virtually put an end to exploration in the deep Tusçaloosa Trend of southern Louisiana as well as some portions of the Anadarko Basin. After decontrol occurs, webelieve there will be a definite change in drilling patterns. Activity is expected to slow down substantially in the deeper zones but should accelerate at depths of approximately 10,000 feet. Such a development could have a serious effect on deep drillers as well as producers.

INDEFINITE PRICE ESCALATORS

As the battle over decontrol heightens in 1982, the effects of triggering indefinite price escalators (IDPE) and most favored nations (MFN) clauses (as a result of natural gas decontrol) are subjects that should continue to receive great attention. IDPE's are clauses in contracts that specify the methods to be used in determining contract prices in the event of decontrol. Most of the clauses call for a redetermination of contract prices at the seller's request within 30 to 180 days of the date that decontrol of gas prices becomes effective. Price redetermination caused by IDPE clauses is usually based on either the highest one-to-three contract prices for gas from the same area of the country or the BTU equivalent of a specified type of oil (usually 110.0% of No. 2 fuel oil). An American Gas Association study recently estimated that approximately 70% of all contracts contain either IDPE or MFN clauses.

Many industry observers fear that implementation of such clauses due to natural gas decontrol could push the wellhead price of gas to a level equal to 110.0% of No. 2 fuel oil. Such a price could result in a significant decline in natural gas sales because of gas-to-oil fuel switching. The industry is lobbying feverishly for a provision in future decontrol legislation that would prohibit IDPE and MFN clauses from becoming effective so that substantial gas sales declines could be averted.

We do not believe that IDPE or MFN clauses are going to create the problems portented by the industry. Producers could ultimately agree to settle for prices well below the cost of No. 2 fuel oil, otherwise pipelines may not be able to market the gas. As a result, a significant gas surplus could develop. Pipelines would not be able to take all of the gas they had contracted for, and we doubt that they would honor the take-or-pay provisions contained in their contracts. That could ultimately force producers to settle for lower prices.

RESERVES, DEMAND, THE SURPLUS, NATURAL GAS LIQUIDS, AND PIPELINE PROFITS

Rising natural gas prices are expected to have a profound impact on future reserve additions, demand for natural gas, the natural gas liquids business, and potential interstate and intrastate pipeline profits. Below, we have attempted to summarize our thoughts on those subjects:

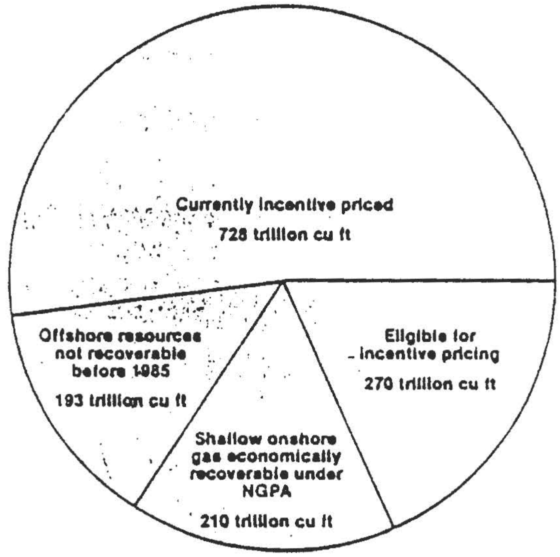
Natural Gas Reserves

Chart 3, which was prepared by GHK Companies of Oklahoma City and appeared in the December 28, 1981 issue of the Oil & Gas Journal estimates potential recoverable natural gas reserves in the United States at approximately 1,400 trillion cubic feet (TCF). As we pointed out in the previous section covering natural gas pricing, future price incentives are expected to be aimed at areas that contain the greatest portion of potential recoverable reserves. That should result in a significant improvement in future natural gas reserve additions. As chart 5 indicates, natural gas reserve additions bottomed at 6.8 TCF (32% of 1973 production of 21 TCF) in 1973 when the average wellhead price of natural gas approximated $0.35 per MCF. However, given the substantial price increase that has occurred since that time, the industry was able to add approximately 16.8 TCF (89% of 1980 production of 18.7 TCF) to reserves in 1980. We estimate that 1981 production approximated 18.5 TCF, and that reserve additions declined modestly to the 16.5 TCF level (a replacement ratio of 89%). After natural gas decontrol has been effected, we anticipate that annual production may finally begin to be offset by new reserve additions.

Demand and Sales

With Real GNP expected to be flat in 1982, gas sales are projected to be 20.7 TCF compared to an estimated 20.4 TCF in 1981. We do not anticipate a material increase in future natural gas sales until industrial consumption of natural gas begins to accelerate. However, industry is very reluctant to make a permanent commitment to natural gas because of uncertainty concerning the future price of gas after decontrol. That uncertainty is understandable, especially considering that many gas industry represen-

Chart 3
POTENTIAL RECOVERABLE NATURAL GAS



Legend

	Trillion cu ft
Potential/recoverable natural gas supplies which are already incentive priced	
Onshore beneath 15,000 ft (1)	240
Tight sand formations (2)	383
Coal seams (3)	45
Devonian shale (4)	60
Subtotal	728
Share of total potential supply	52%
Potential Recoverable natural gas supplies which can be incentive priced under NGPA	
Onshore between 10,000 and 15,000 (5)(6)	211
Offshore beneath 200 m (1)(7)	59
Subtotal	270
Share of total potential supply	19%
Potential natural gas supplies which because of permitting and logistical requirements cannot be recovered before January 1, 1985 regardless of price	
Offshore above 200 m (1) (Note: Also gas located beneath 200 m listed above)	193
Subtotal	193
Share of total potential supply	14%
Remaining potential natural gas which is economically recoverable under NGPA	
Onshore above 10,000 ft (5)	210
Subtotal	210
Share of total potential supply	15%

(1) Potential Gas Committee, Potential Supply of Natural Gas in the United States, December 31, 1980.

(2) Ibid. Mid-point high and low estimates presented by the Committee.

(3) National Petroleum Council (1930).

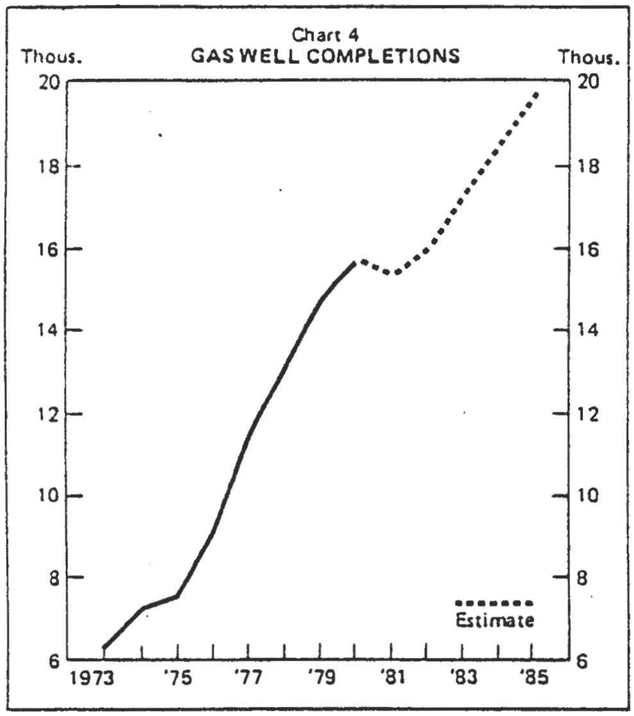
(4) Potential Gas Committee. Use of high estimate from range presented by the Committee reflects high incentive price now available under NGPA.

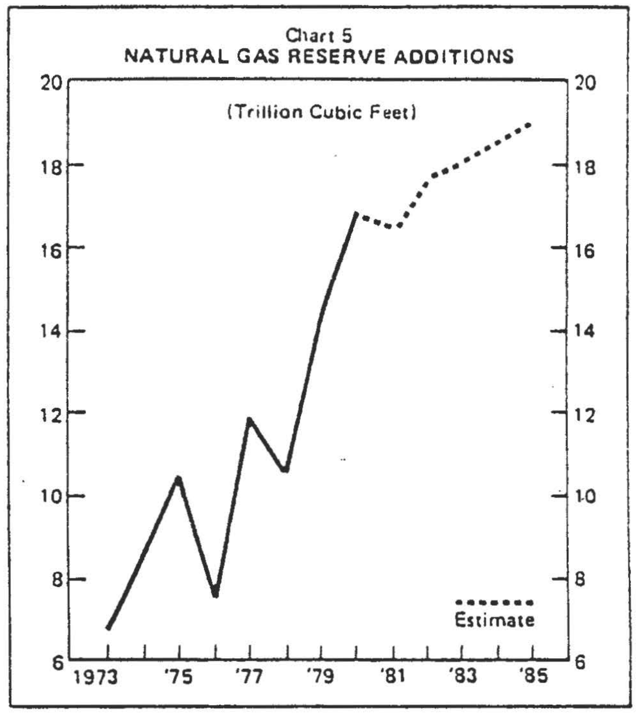
(5) GHK estimate based on Potential Gas Committee projection of the potential supply of gas located onshore above 15,000 ft and on recent drilling experience in major producing areas.

(6) FERC has proposed incentive price equal to 150% of NGPA Section 103 price.

(7) FERC has proposed incentive price equal to 200% of NGPA Section 103 price for gas drilled 300 feet or deeper.

Source: Oil & Gas Journal





tatives have estimated that the price of deregulated gas could be in a range of $4.00-$7.00 per MCF.

The Surplus

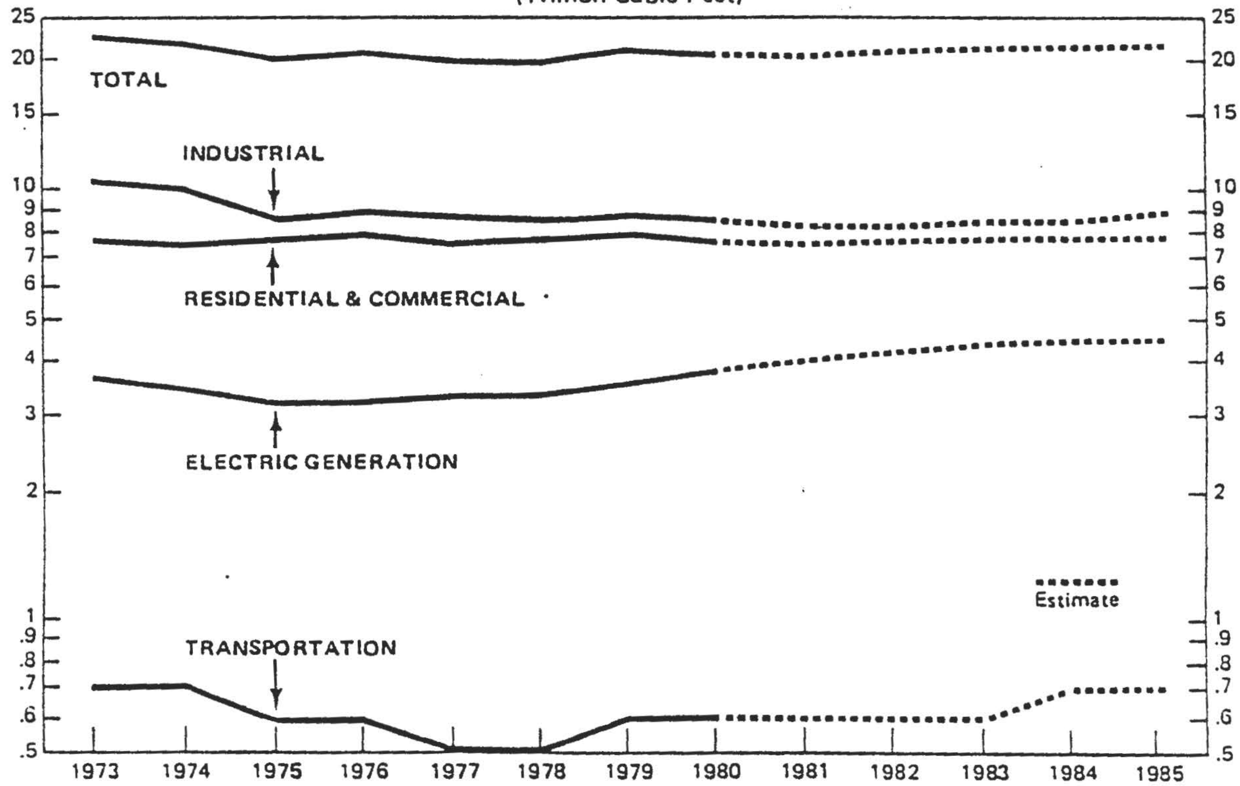
The current surplus (excess deliverability) of natural gas in the United States is estimated to be a range of 1.0-1.5 TCF. However, given the improved success ratios that are being experienced by exploration companies and the fact that demand is expected to increase modestly in 1982 because of weak economic conditions, that surplus could approximate the 1.5-2.0 TCF level by the end of the current year. In fact, until an acceleration in industrial consumption occurs, we believe that a substantial surplus of natural gas could prevail in the United States.

Pipeline Profits

We anticipate that federal regulation will continue to be generous to interstate pipelines during 1982. Because of the high cost of capital, returns should continue to trend upward. Increases in gas sales that have occurred during the last few years are expected to slow in the years ahead as gas prices rise under the NGPA schedule, and especially after gas prices are totally decontrolled. In an environment of declining sales, we would not anticipate any material decline in the profitability of jurisdictional pipelines. Should sales decline, we believe that the FERC would allow pipeline rates to rise high enough to offset lower sales, which was the case during the 1970's when the gas shortage was most acute.

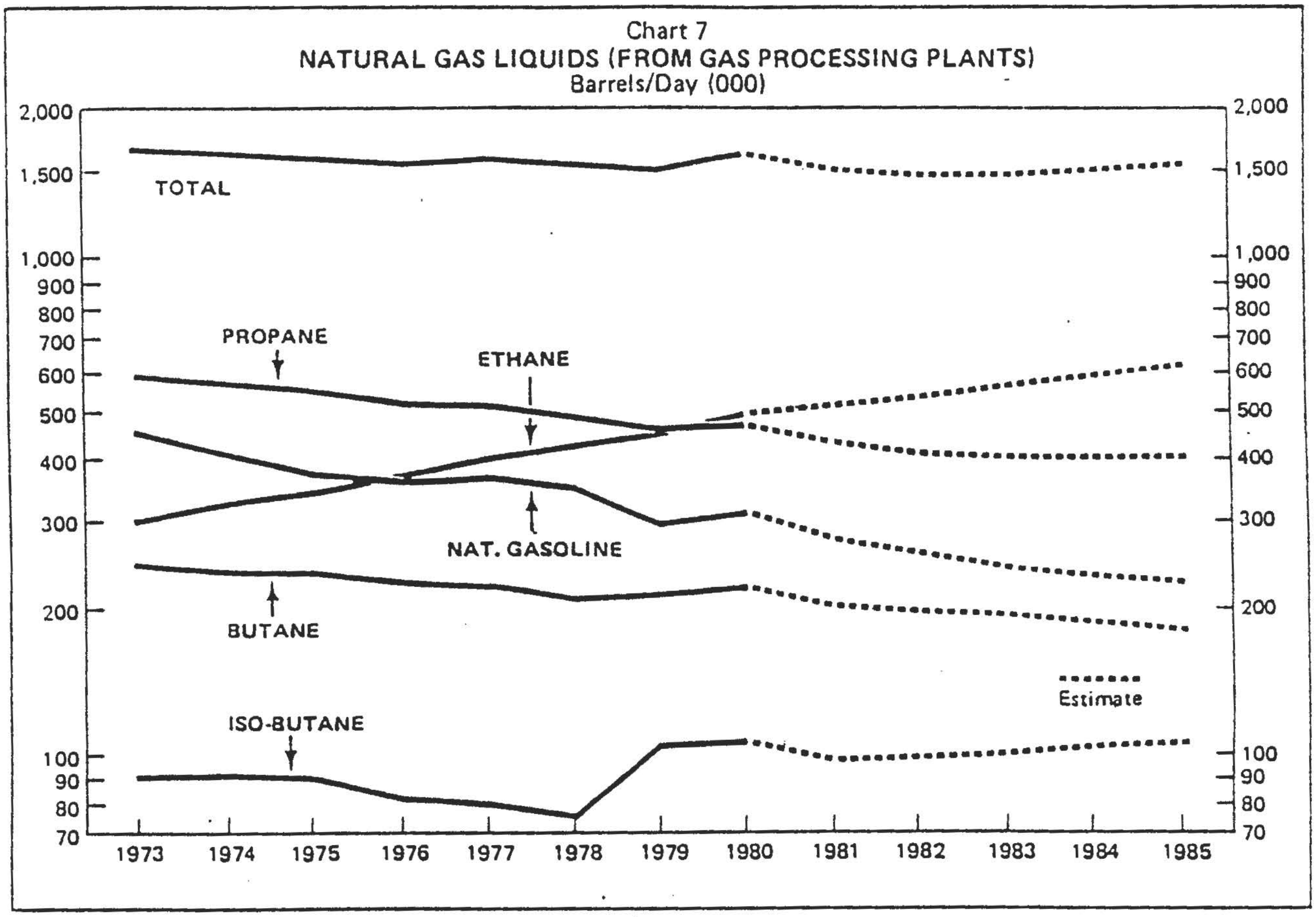
Many intrastate pipelines are benefitting from the fact that several major oil companies can no longer meet the gas requirements of their customers. Consequently, we believe that most intrastate pipelines could experience an increase in sales in 1982, despite the economy, by supplying customers that are being curtailed by oil company gas pipelines. However, we would expect to see intrastate sales growth begin to decline as gas prices accelerate. In fact, in a deregulated environment, sales are expected to decline because of potential conservation and fuel switching. In order to improve sales after decontrol, nonjurisdictional pipelines may have to cut margins in order to bring the price of their supplies down to a marketable level. As a result, profits would suffer.

Chart 6
NATURAL GAS CONSUMPTION
(Trillion Cubic Feet)



Natural Gas Liquids

With the potential for natural gas decontrol approaching, natural gas processing companies are faced with altering their long-term strategies. The boom in processing plant construction that was ignited by decontrol of most liquid products in January of 1980 will probably grind to a halt by the end of 1982. The major reason is that as gas prices rise, the profit margin of the processing business declines. Profit erosion could accelerate to a degree in 1982 because the average cost of gas is expected to rise by about 30%; however, we doubt that those higher costs can be offset by higher prices. Petrochemical industry demand is slowing because of a weakening economy. As a result, we anticipate that 1982 liquids prices will be flat at approximately $0.45-$0.47 a gallon. Most natural gas companies involved in the processing business are expected to experience higher sales in 1982, primarily because the overall supply of liquids products is expected to decline. With refinery runs projected to be at low levels and the rapid depletion of their natural gas reserves expected to continue, the major oil companies (the principal producers of gas liquids) are expected to experience lower output once again in 1982.



SUPPLEMENTAL SUPPLIES

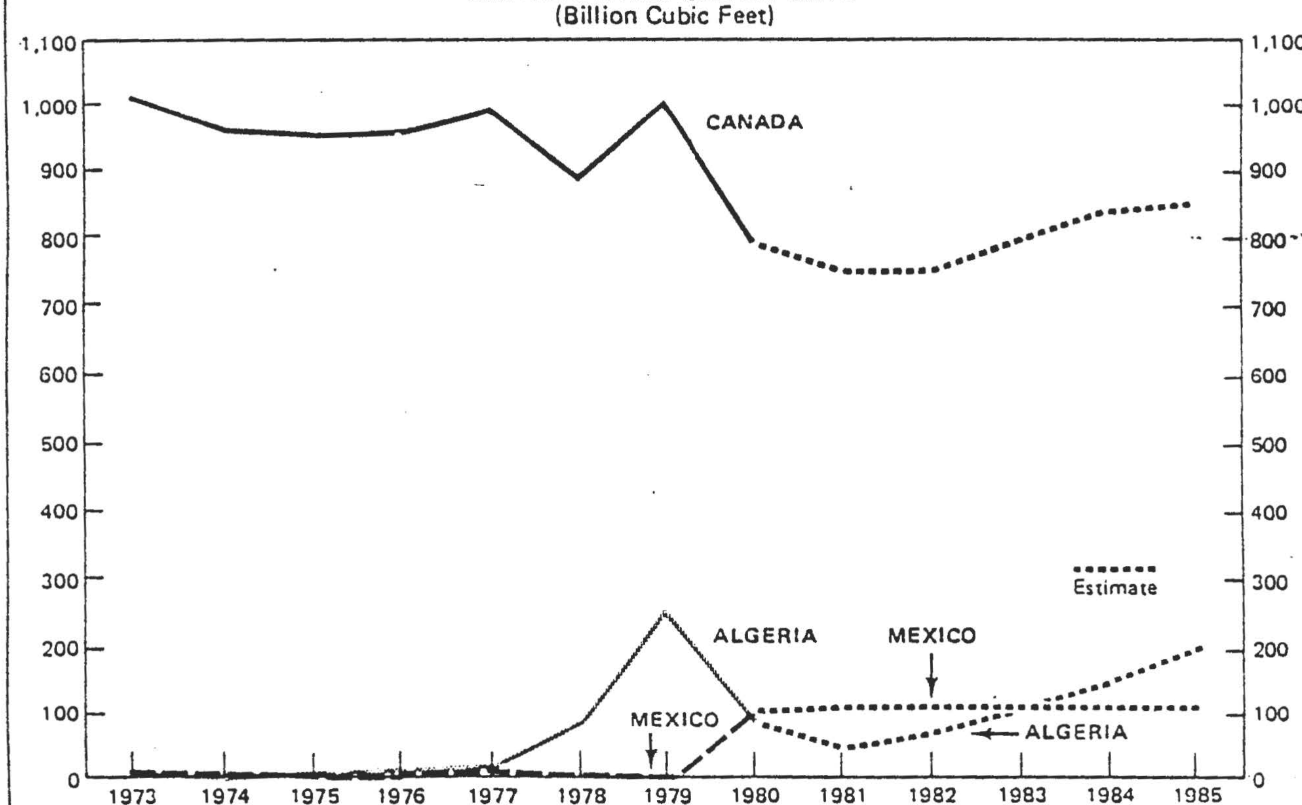
Decontrol is a very sensitive issue to supporters of supplemental natural gas projects. Supplemental sources may have a chance of being marketed effectively if decontrol is delayed and pipelines can roll in the high cost of supplemental gas with low cost, older gas supplies. However, once gas is decontrolled, supplemental gas may not be competitive in the market place. Consequently, natural gas decontrol could spell economic ruin for several supplemental gas supply projects. Below, we comment on the current outlook for several sources of supplemental gas supplies:

Liquified Natural Gas

Although Algeria has maintained a hardline policy toward LNG pricing, we believe that her attitude has softened somewhat. Both Trunkline Gas

Co. and the Southern Natural-Columbia Gas-Consolidated Natural consortium have reported a noticeable change in the Algerian position in their latest discussions with Algeria. We believe that three factors are contributing to Algeria's change of heart: (1) fear that the Soviet Union, which has decided to sell Siberian gas to West Germany at a price of $4.70 per MMBtu, will capture a growing portion of Algeria's potential market; (2) decline of world oil prices and the fact that in order to increase much needed revenues, more LNG must be sold and; (3) fear that new LNG projects (such as the recently announced Argentine-United States project) will be able to replace the LNG that was originally to be supplied by Algeria. Further evidence that Algeria's attitude is softening is the fact that, after a meeting between French President Francois Mitterand and Algerian President Chadli Benjedid, the French External Relations Ministry announced that a pricing agreement had been reached between the two countries, thus ending the 22-month-long pricing dispute. While the pricing formula must still be worked out, it appears as though Algeria has decided not to continue pressing for parity between the price of LNG and the price of oil, especially with world oil prices falling. Rather, the Algerian-French pricing structure is expected to be based on the price of industrial goods that are traded between the two countries. We do not believe that the Department of Energy (DOE) will appprove a price

Chart 8
UNITED STATES GAS IMPORTS
(Billion Cubic Feet)



structure subject to industrial goods prices, but we do believe, based on recent events, that the United States again could receive Algerian LNG in the not too distant future.

In view of the pricing dispute with Algeria, the DOE's attitude toward approving additional LNG projects has not been very constructive. Yet, that did not stop several U.S. companies (Natural Gas Pipeline Co. of America, Gulf Interstate Co. and Appalachian Co.) from announcing a $2.3 billion project for exporting Argentine LNG to the U.S. The project, which would involve the sale of 163 BCF a year for a 20-year period, is slated for completion in 1986. The $2.3 billion price tag includes the cost of building a liquefaction plant and export facilities in Argentina. No terminals will be constructed in the U.S. because existing terminals will be utilized for the project. The delivered price of the gas was not released, but considering the cost of the project, the financing costs, the small amount of gas to be delivered, the use of other companies' terminals and the price paid to producers, the price to U.S. consumers could approximate $15.00 per MMBtu. In light of the improved gas supply outlook in the U.S. and our estimate that the price of decontrolled gas in 1986 could be below $5.00 per MCF, we believe that winning DOE approval of this project will be very difficult.

The Alaskan Pipeline

The Alaskan Pipeline won a new lease on life as 1981 came to a close when Congress approved a controversial package of waivers to the 1976 law. Project sponsors claimed that the waivers were absolutely essential if financing for the project was to be procured. While it might appear as if the Alaskan pipeline's last major obstacle has been overcome, we believe that one problem still lies ahead, even with the waiver package in hand: the ultimate financing of the pipeline. If the project is completed as scheduled, the gas will be competing with decontrolled gas in the lower-48 states. The Alaskan gas is projected to cross the Canada-U.S. border at a price of $15.00 per MMBtu and reach the end-user at a price of $20.00 or more. There is a risk that this gas cannot be marketed even if it is rolled in with lower-cost gas. The risk also exists that distribution companies will encounter a great deal of difficulty from regulatory commissions in attempting to pass on costs of that magnitude to consumers. Consequently, it may be difficult to find enough lenders willng to take the risks associated with financing the $30-billion Alaskan portion of the project. We continue to believe that successful completion of the Alaskan project, as currently scheduled, is a long shot.

Canada

The current border price of Canadian gas is $4.94 per MMBtu, a price that is not competitive with domestically produced gas or alternative fuels. Pipeline and distribution companies that derive a substantial portion of their gas supplies from Canada have experienced a significant decline in sales because of conservation and fuel switching. Consequently, imports from Canada have declined during the last year. Imports from Canada could be up moderately in the next few years as the Eastern and Western legs of the Alaskan Pipeline commence operation. However, given the improved supply outlook in the lower-48 states, additional imports of Canadian gas are unnecessary at this point in time and may not be necessary in the future.

Synfuels

The enthusiasm that prevailed in 1980 for the rapid development of a synfuels industry is gradually diminishing. Although a substantial amount of progress has been made on the Great Plains coal gasification project, which won a $2.02 billion Energy Department loan guarantee, several other projects have been slowed or scrapped completely. The $3.0 billion (1980 dollars) Occidental Petroleum-Tenneco Cathedral Bluffs shale oil recovery project in western Colorado is being delayed. Costs have escalated much more rapidly than the sponsors had anticipated, interest rates have risen to extraordinarily high levels, and oil prices have finally stabilized. Substantially higher oil prices are required if the project's product can be competitively priced at a level that can produce a profit. A second project that has been slowed is the WyCoal Gas coal gasification project that was to start construction in 1982. However, two of the three original project sponsors have dropped out, and the project may die.

Stable oil prices and the eventual decontrol of natural gas could spell the demise of the fledgling synfuels industry. Table 1 indicates what prices various synfuels products would have to command (depending on the price of oil when construction of the project is started) for full equity recovery. The only project that is close to making economic sense is the Tosco II shale oil project, which has a projected product price of about $36.20 a barrel ($6.24 per MMBtu), assuming a $30.00 price of oil during the construction period.

Table 1
EQUITY RECOVERY PRICE FOR SYNFUEL PROJECTS

	Oil Price: $/Barrel				
	9	30	50	75	100
Process	Projected Synfuel Cost in New Plants: $/Barrel of Oil Equivalent				
H-Coal (Syncrude Mode)	27.82	61.78	81.60	100.72	117.72
EDS	25.10	55.57	73.88	90.72	105.76
Fischer-Tropsch	62.03	137.41	183.22	227.06	267.13
Lurgi/Methanation	25.15	54.82	72.54	90.47	106.87
Methanol Synthesis from Coal	34.66	76.75	101.77	125.93	147.59
Tosco II Shale Oil	17.11	36.18	49.97	63.75	76.80
Ethanol from Corn	59.03	101.66	125.52	152.76	177.24

Source: House Subcommittee on Energy Development & Applications

At some point, a synfuels industry will be necessary if we hope to replace conventional sources of energy. However, for the near term, because of abundant gas supplies, low gas prices, and stable oil prices, few synfuels projects can be expected to be profitable. We believe that those economics can be changed only by another substantial increase in the price of oil. Many companies believe that the current losses that synfuels projects will experience are justified by the longevity of reserves that can be produced by the facilities. The stock market, however, has a differing view on that subject.

OUTLOOK FOR NATURAL GAS STOCKS IN 1982

Natural gas stocks were disappointing investments in 1981, compared to a year of stellar performance in 1980. Gas stocks could perform much better in 1982 if the market continues to react favorably toward positive decontrol news. However, we believe that any positive performance based on decontrol could be short-lived. Our reasoning is based on the fact that many lines of business (nonjurisdictional pipelines, natural gas liquids, deep gas production) operated by natural gas companies could be impaired in the initial years of decontrol. If a stiff WPT is included in decontrol legislation, the negatives that we have highlighted would not be offset by increased profitability from old gas production. In Table 2 we have attempted to demonstrate the effect that we believe natural gas deregulation (based on our decontrol assumptions including a very stiff WPT on old gas production) would have on our projected growth rates for the companies that we follow. As a broad generalization, it is interesting to note that many of the companies that are in the negative and

Table 2
DECONTROL'S POSSIBLE EFFECT
ON OUR CURRENT PROJECTED GROWTH

Negative	Neutral	Positive
Central Lousiana Energy /A/	Arkla	Alaska Interstate
El Paso Co. /E/ /A/	ENSERCH	American Natural Res.
InterNorth	Houston Natural Gas*	Coastal Corp.
Mitchell Energy	Panhandle Eastern /A/	Columbia Gas /A/
Northwest Energy	Texas Gas Transmission*	Consolidated Natural Gas /A/
ONEOK	------	ENTEX
Pioneer Corp.	All Distribution	Kansas Nebraska
Southern Union	Companies	MidCon Energy
Texas Oil & Gas		Mountain Fuel Supply
United Energy /A/		NICOR /A/
Valero Energy		Southern Natural Res. /A/
		Tenneco /A/
		Texas Eastern
		Transco /A/

* - modest negative effect.

neutral columns are companies that we consider to possess the best managements. Consequently, after an initial adjustment period, it would not surprise us to see many of those companies turn adversity to their advantage, a feat that well-managed companies are capable of accomplishing.

Given the uncertain outlook that we believe will exist until the decontrol issue has been resolved, we advise a conservative approach toward natural gas stocks in 1982. We encourage investors to buy high-quality issues with solid fundamentals only when the stocks have declined to the low end of their

Table 3

	Price 1/08/82	Ind. Div.	% Yield	EPS 1980	EPS 1981E	EPS 1982E	1981E	1982E	P/E Low	Avg.	Hi
Diversified											
Alaska Interstate	16 7/8	$0.60	3.6%	$6.21	$3.20	$3.85	5.3	4.4	6.0	9.0	12.0
Central La. Energy	30 5/8	0.48	1.6	3.95	4.10	5.00	7.5	6.1	5.0	8.0	11.0
Coastal Corp.	35 5/8	0.40	1.1	4.52	2.00	3.75	17.8	9.5	4.0	6.5	9.0
ENSERCH Corp.	23 1/4	1.36	5.9	2.82	3.60	4.40	6.5	5.3	6.0	8.5	11.0
Houston Natural Gas	41	1.50	3.7	5.06	5.94a	7.30	6.9	5.6	6.0	8.0	10.0
MidCon Corp.	26	2.08	8.0	3.78	3.74a	4.50	7.0	5.8	6.0	7.0	8.0
Mitchell Energy*	18 7/8	0.24	1.3	2.10	2.50	3.10	7.6	6.1	6.0	8.5	11.0
Panhandle Eastern	33 5/8	2.00	6.0	4.86	6.45	7.50	5.2	4.5	5.0	6.5	8.0
Pioneer Corp.	27 7/8	1.00	3.6	2.44	3.05	4.30	9.1	6.5	6.0	8.0	10.0
Sonat Inc.	30 1/2	1.10	3.6	6.85	4.05	5.00	7.5	6.1	6.0	7.5	9.0
Tenneco, Inc.	31 1/4	2.60	8.3	5.95	5.90	6.50	5.3	4.8	6.0	7.5	9.0
Texas Eastern	53	3.80	7.2	8.72	8.20	9.15	6.5	5.8	6.0	7.0	8.0
Texas Gas Trans.	33 3/4	1.92	5.7	5.17	6.45	6.50	5.2	5.2	5.0	7.0	9.0
Texas Oil & Gas	33 1/2	0.24	0.7	1.48	2.01a	3.15	16.7	10.6	7.0	11.5	16.0
Transco Cos.	44	1.60	3.6	4.72	5.35	6.75	8.2	6.5	5.0	8.0	11.0
United Energy Res.	38	1.92	5.1	6.38	7.80	8.75	4.9	4.3	4.0	5.5	7.0
Valero Energy	22	0.32	1.5	2.44	4.00	4.50	5.5	4.9	5.0	6.5	8.0
Pipeline											
American Nat. Res.	36	2.84	7.9	4.59	6.00	7.25	6.0	5.0	7.0	8.0	9.0
Arkla, Inc.	18 5/8	0.80	4.3	1.46	1.75	2.15	10.7	8.7	7.0	9.5	12.0
Columbia Gas	31 1/2	2.70	8.6	5.02	5.00	5.50	6.3	5.7	6.0	7.0	8.0
Consolidated Natural	48 3/4	3.76	7.7	5.73	6.50	7.15	7.5	6.8	6.0	7.0	8.0
El Paso Co.	27 3/8	1.48	5.4	2.30	3.15	4.00	8.7	6.9	6.0	7.5	9.0
Entex	13 1/2	1.00	7.4	1.87	2.03a	2.50	6.7	5.4	6.0	7.5	9.0
InterNorth	29 7/8	2.12	7.1	4.70	5.50	5.80	5.4	5.2	5.0	6.5	8.0
Kansas Nebraska	26 3/8	1.48	5.6	2.68	3.05	3.35	8.7	7.9	6.0	8.0	10.0
Mountain Fuel	33	2.44	7.4	4.10	2.85	3.30	11.6	10.0	7.0	9.5	12.0
NICOR	33	2.84	8.6	5.00	5.45	6.10	6.1	5.4	6.0	7.0	8.0
Northwest Energy	20 1/8	1.20	6.0	3.23	3.90	4.30	5.2	4.7	4.0	6.0	8.0
ONEOK, Inc.	28 1/4	2.20	7.8	4.24	4.42a	5.50	6.4	5.1	5.0	7.0	9.0
Southern Union Co.	21	1.56	7.4	3.70	3.85	4.70	5.5	4.5	5.0	6.5	8.0

* - Fiscal years end 1981, 1982E and 1983E, respectively.
a - Actual.

five-year average p/e ratio ranges. Conversely, when issues advance to the higher end of those ranges, we would advise lightening positions. Table 3 presents a simple p/e ratio model that we have published in recent months as a guide to investors. Several high-quality issues with solid fundamentals that currently stand out in the model (on an intermediate-term basis) include ENSERCH, Houston Natural Gas, and Texas Gas Transmission. Although Transco has become less attractive on the model in recent weeks because of price appreciation, we believe it is one of the best situated companies to take advantage of decontrol as well as deep-water gas incentive pricing.

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CHANGES SINCE DECEMBER 1981 NATURAL GAS MONTHLY

Changes in 1981 Earnings Estimates

Company	From	To	Comment
Central Louisiana Energy	$4.25	$4.10	Lower gas sales than anticipated.
Panhandle Eastern Corp.	6.75	6.45	Establishment of helium reserve.

Changes in 1982 Earnings Estimates

Company	From	To	Comment
Central Louisiana Energy	$5.30	$5.00	Lower gas liquids prices.
ONEOK, Inc.	5.10	5.50	Stronger utility earnings than expected.
Texas Gas Transmission	7.00	6.50	Lower production rates.
Valero Energy	5.00	4.50	Lower gas liquids prices.

Changes in 1983 Earnings Estimates

Company	From	To	Comment
ONEOK, Inc.	$5.80	$6.25	Higher gas production than expected and change in oil & gas accounting methods.

QRQ Code: 1=Buy; 2=OK to Buy; 3=Neutral; 7=Qualified for Income, High Yield; 9=Qualified for Income, Low Yield.

NEW YORK TIMES

February 8, 1982

Gas Price Decontrol: Hopes Dim

BY ROBERT D. HERSHEY Jr.

Special to The New York Times

WASHINGTON, Feb. 7 — Prospects that the Reagan Administration will press its plan for accelerated decontrol of natural gas prices have dimmed noticeably in the past few weeks.

Severe winter weather, a continued economic slump and a rapidly closing deadline for new legislation have combined to spread the view among supporters and opponents alike that a bill for faster decontrol now has probably a less than 50-50 chance of approval by Congress this year.

For the past six months, President Reagan has had before him a proposal by his chief energy advisers that he submit a bill that would phase out price controls on natural gas. Repeatedly he was thought to be on the verge of doing so, but each time the President pulled back, apparently on the advice of those who warned him that Congress was not receptive.

A Complex Issue

Decontrol of gas prices, which under a 1978 law are being partly and gradually allowed to rise by a factor based on the inflation rate, is both highly complex and extremely sensitive politically.

Consumer groups and others, including utilities that distribute natural gas, have already mounted strong campaigns against decontrol, which they estimate could double the prices paid by consumers.

Producers, however, insist that such a move would raise prices, which are rising anyway, relatively little, and that much of the increase in gas prices would be offset by lower prices for oil.

This is because higher profits would encourage more spending for greater production and would force more effi-

Continued on Page D6

Hopes Dim for the Speedy Decontrol of Gas Prices

Continued From First Business Page

cient use of gas. These additional supplies could be substituted for substantial amounts of imported oil, thereby further depressing world oil prices.

There are several signs, however, of increased resistance to a legislative move to speed up the current decontrol schedule, under which about half of all gas is to be freed of controls on Jan. 1, 1985, while most other gas prices remain under restriction. Much of the resistance reflects the fear that gas prices, now averaging about half the price for a comparable amount of oil in energy-equivalent terms, would rise sharply.

Last week, for example, Edwin Meese 3d, a Presidential adviser, conspicuously omitted natural gas from a discussion of the White House legislative agenda.

When asked about this by a participant at the session, held at the United States Chamber of Commerce, Mr. Meese responded by pointing to concerns in Congress and repeating the official Administration position that the issue is still under consideration.

Resistance in Congress

A Department of Energy legislative specialist also acknowledged increased resistence to gas decontrol in Congress.

He said the President would have to make up his mind in the next week or two "to fish or cut bait."

Officially, the White House continues to declare its commitment to a long-standing pledge to abolish all controls on the wellhead price of natural gas, the only fuel that remains under Federal price restrictions. President Reagan lifted the last price controls on domestic crude oil, gasoline and propane shortly after taking office in January 1981.

Danny J. Boggs, a Presidential energy adviser, said when asked last week about submitting the bill that has already been drafted "There's been no Presidential determination."

Unsympathetic Response

Another source said that the White House had formally asked the Department of Energy last week for its latest assessment of sentiment on Capitol Hill. The Administration was advised, among other things, not to send up a bill unless it was prepared to fight for its passage.

It is still possible that President Reagan will push ahead. But many observers think that if he does, it will be because of the tax revenue it would produce — although some say the gains would be offset by lower tax liabilities of business consumers — and from a "windfall profits" tax that is widely expected to be the price Congress would exact for passage.

The President has promised Representative Glenn English, an Oklahoma Democrat, that he would veto a bill containing such a tax.

Should his proposed budget for the fiscal year 1983 not be well received, particularly by the bond market, it is thought that Mr. Reagan might have to press for gas decontrol.

"I see a little weakening of the Administration's resolve," said John A. Riggs, staff director of a House energy subcommittee. "But there might be a willingness to let revenue needs drive the process."

The political risks, however, appear great. "A lot of Democrats are licking their chops, hoping we will introduce the bill because they want to run against it," said the Energy Department legislative specialist.

THE WHITE HOUSE

WASHINGTON

February 3. 1982

To Cicconi FYI 2/3/82

MEMORANDUM FOR ED MEESE
JAMES BAKER

FROM: RICHARD DARMAN
CRAIG FULLER

SUBJECT: Natural Gas Decontrol

We have polled cabinet members and White House staff on the question of decontrolling natural gas. We asked for views on the issue of whether or not to accelerate decontrol and for views on when such an action should occur. The responses are attached.

Favoring action now: Energy, OMB, CEA

Favoring action in April, 1982: Dole

Delay till Spring or till after Nov : Williamson

Favoring action next year: Duberstein

THE SECRETARY OF ENERGY
WASHINGTON, D.C. 20585

February 2, 1982

MEMORANDUM FOR Richard G. Darman
Craig L. Fuller

FROM: James B. Edwards

SUBJECT: Deregulation of Natural Gas

In response to your request for an assessment of the optimal time for transmittal of legislation to accelerate the deregulation of natural gas, I believe legislation should be submitted in February, 1982. Because we will need one to two weeks after a Presidential decision to firm up our support for the proposed legislation, a decision is needed this week to meet the February timetable. Five considerations argue for this timetable:

Politics of 1982 and 1984: President Reagan is the second Presidential candidate to promise natural gas deregulation. Jimmy Carter made the same promise in 1976, and the "oil patch" states provided his margin of victory over former President Ford.

Because cold weather occurs once a year, and elections every two, there is never a politically "good time" to propose deregulation. However, if legislation were introduced in February and passed by July, the issue could be well behind us by the Fall elections. A delay until 1983 has two flaws: an increased tendency to "let the NGPA run its course" and a faster rate of price increases to consumers under our proposal.

If the NGPA is not amended by 1985 and produces the sharp price increases and market disorder we have predicted, the Reagan Administration will be faced with the unpleasant prospect of taking the blame for the NGPA's failures or reregulating Jimmy Carter's deregulated gas. The issue will surely be a major campaign topic in the 1984 Presidential elections. Failure to enact legislation before mid-1983 could cost the Republican party substantial support in the South (including critical states which President Ford lost to candidate Carter in 1976).

The Industry Consensus: For the first time in many years, there appears to be a broad consensus among producers, intrastate pipelines, industrial users and some interstate pipelines that accelerated deregulation is the best course. These groups agree that the existing legislation is counterproductive and that the Administration draft bill corrects the key deficiencies in current law. Most distribution companies and the major interstate pipeline associations are not part of this consensus.

A clear Presidential decision and a firm timetable for legislation are needed to solidify support for the Administration proposal. I believe that the current consensus can be expanded to include a major interstate pipeline association once a firm decision on timing has been made.

Court of Appeals Decision: A recent D.C. Court of Appeals decision finding the one-House veto unconstitutional may require FERC to start charging higher wellhead costs to interstate industrial users by the end of the month. While it is likely to be appealed, this decision creates tremendous uncertainty for industrial gas users and enhances their support for legislation.

Support in Congress: The industry support for accelerated decontrol and concern over incremental pricing will help on the Hill. Chairman McClure has told us that if the Administration submits a bill in February, he will make every effort to get it through the Senate by June 30. He feels (and industry agrees) that legislation submitted after March 1 will be too late.

Our draft specifications have the support of Senators McClure and Domenici, as well as Senator Johnston, who would take the lead for us among Senate Democrats. I believe Senators Bentsen and Tower would also be supportive. With this support, our chances of getting a bill out of the Senate Energy Committee this year are good.

Although Chairman John Dingell of the House Energy and Commerce Committee has opposed re-opening the NGPA, the Court decision on incremental pricing may change his mind. However, under the leadership of the Republicans, led by Ranking Minority Member Jim Broyhill, we believe we can attract enough conservative Democrats (e.g., Louisiana's Billy Tauzin, Texas' Phil Gramm and Ralph Hall) to our bill. We believe that, ultimately, we can get the 22 votes we need to prevail--as do most of the key industry lobbyists.

The Costs of Delay to January 1983: As January, 1985 (the date of partial decontrol under the NGPA) approaches, the substantative arguments for accelerated or phased decontrol become weaker and the political consensus among our supporters becomes more fragmented. In the intervening year, our base of support will be weakened. Many producers may decide they are better off with the NGPA without the risk of a tax--either because their gas is deregulated in 1985 or because they hope administrative action at FERC will raise their prices--than with new legislation.

Opponents will argue that we may as well wait until 1985 to see how the NGPA plays out. All of these arguments become stronger over time.

Conclusion

This Administration has been debating the best timing for natural gas decontrol since July, 1981. If the Administration does not submit legislation this month, with strong backing from the President, we may have relinquished the issue for the President's first term. Further delay can only make decontrol more difficult to achieve.

cc:
Martin Anderson
Elizabeth H. Dole
Kenneth M. Duberstein
Edward J. Rollins
David A. Stockman
Murray L. Weidenbaum
Richard S. Williamson

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

February 1, 1982

MEMORANDUM FOR RICHARD DARMAN
CRAIG FULLER

FROM: DAVID A. STOCKMAN DAS

SUBJECT: Timing on Natural Gas Decontrol

Summary:

For both political and policy reasons, I believe the ideal time to transmit natural gas decontrol is right now.

Discussion:

-- Current law is distorting the marketplace by keeping gas relatively inexpensive and dampening drilling other than for certain narrow types of production.

-- Delaying transmittal will force extension of controls beyond the current 1985 date because of the necessity for a two- to three-year phase-in.

-- Current projections of stable or declining real oil prices are the ideal backdrop for a gas decontrol debate; with the passage of another year or two, these forecasts could easily change.

-- Recent experience of declining gasoline prices under oil decontrol may not persist as refiners and marketers adjust; this could produce price increases (from higher margins) just as gas decontrol debate begins next year.

-- Loss of even a small number of seats in the 1982 elections would make decontrol more difficult.

-- Industry groups have geared up in anticipation of Administration announcment; retreat now would be seen as abandonment of basic goal.

-- Congressional committees dealing with decontrol would be deflected from efforts to frustrate Administration DOE initiatives on reorganization and budget.

-- Any potential embarrassment to the President from linkage of decontrol to a windfall tax would be minimal because of congressional pressure; tax would probably pass by more than two-thirds vote, making veto problematic (oil windfall tax adopted by huge margins).

-- A secondary option, such as transmittal later this year, would be worse than waiting until next year.

February 1, 1982

ISSUE: Should the Administration send natural gas decontrol legislation to Congress in the immediate future?

Advantages:

-- Decontrol is sound policy; will increase energy supply and enhance conservation, thereby reducing oil imports.

-- Capitalizes on extensive industry effort now building in support of decontrol.

-- Starting in 1982 permits longer time for phase-in while retaining January 1, 1985 decontrol date of existing law.

-- Current oil glut is ideal backdrop for gas decontrol; can capitalize on gasoline price declines of recent months.

-- Avoids major risks attendant on deferring decontrol debate to 1983:

  o Almost certain extension of controls beyond current 1985 date to 1986 or later.

  o Current projections of stable or declining oil prices may be replaced by forecasts of real increases, which would make decontrol more traumatic because of linkage between decontrolled gas prices and oil prices.

  o Electoral politics will be an even larger factor as 1984 approaches.

-- May deflect attention of congressional energy committees from DOE dismantlement, thereby weakening principal source of opposition to Administration plan.

-- Potential for congressionally-mandated windfall tax may strengthen prospects of quick action on decontrol as partial solution to deficit problem.

Disadvantages:

-- Highly controversial addition to legislative agenda that will strengthen hand of those who charge that Administration is insensitive.

-- Severe cold weather may have elevated public awareness of heating costs; decontrol would look like final blow. Administration would get the blame for scheduled price increases under current law as well as incremental increase from decontrol.

-- Lengthy consideration of last decontrol bill may indicate limited possibility of action before election; Administration would thus take criticism for decontrol without accompanying results.

-- Key congressional actors (McClure, Domenici, Baker) are tepid on proceeding; House Democrats may demagog the issue (Dingell repeated his "over my dead body" objections recently, though has also made more neutral comments).

-- The President will be placed in a difficult situation if decontrol is tied to windfall tax (English letter).

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

February 2, 1982

MEMORANDUM FOR DICK DARMAN
CRAIG FULLER

FROM: MURRAY WEIDENBAUM MW

SUBJECT: Timing of Natural Gas Deregulation

The sooner the better. Further delay in transmittal of legislation to accelerate natural gas decontrol worsens the following problems:

1. Price increases under phased decontrol become progressively steeper as the time available for phasing (between enactment of legislation and the date for expiration of the current law, 1/1/85) becomes shorter. The only way to avoid this is to extend the current law beyond 1/1/85, a thorny problem.

2. Under current law, resources are being wasted in drilling for non-price controlled deep gas and in a myriad of other ways that arise when excessive use is made of a below-market priced commodity.

3. Further delay may increase the complications posed by the Congressional elections, and thus increase the problems mentioned in (1) and (2).

THE WHITE HOUSE

WASHINGTON

February 2, 1982

MEMORANDUM FOR RICHARD DARMAN

FROM: ELIZABETH H. DOLE

SUBJECT: Natural Gas Deregulation

The optimal time for transmittal of legislation to accelerate the deregulation of natural gas is April 1, 1982. Any sooner runs the risk of announcement occurring during what experts predict will be a very harsh winter March. Any later will force the discussion into the election period and possibly preclude action this year.

In going forward several items need to be considered:

a. Private sector input indicates the Hill can be counted upon to attach a windfall profits tax to deregulation legislation.

b. The business community is very concerned about undertaking a battle for deregulation at the same time we are trying to abolish DOE. This opinion is based upon the experience of dealing with clean air legislation while being involved with EPA.

c. The producers and users can be counted upon to provide strong support; however, their focus and resources will be dispersed until the Clean Air Act legislation is signed.

d. Distributors have yet to agree to a willingness to wage the deregulation battle at this time and the American Gas Association remains uncommitted.

e. Rather than considering this summer or fall, it is felt that deregulation legislation should be deferred until January of 1983 in the event it is decided not to raise the issue this spring.

Craig

THE WHITE HOUSE

WASHINGTON

February 2, 1982

MEMORANDUM TO: Dick Darman

FROM: Ken Duberstein Ken D.

SUBJECT: Deregulation of Natural Gas--Optimal Time for Transmittal of Legislation

It is our judgement that the next optimal time for submission of legislation deregulating natural gas would be early in the next session of Congress. This would:

1. Remove the issue as an '82 election issue in most areas, with the possible exception of Louisiana, where the intrastate market problems have hit crisis proportions and are adversely affecting its state industries.

2. Give us time to get back on the offensive on this issue. We're on the defensive because of off-again, on-again signals, because of the windfall profits tax issue and because of the bad winter.

3. Give us almost two years before the anticipated fly-up of costs in which to seek and achieve complete deregulation.

You should know that:

- There is no consensus or consensus bill. Phil Gramm intends to introduce a bill reflecting his most recent efforts to forge a consensus, but AGA and INGA are still opposed.

- There is overwhelming consensus that a WPT will be enacted and, given the deficit issue, there is concern among producer state members that such a WPT will be fashioned to address the deficit. Majors would accept a WPT; independents are said to be split.

- Senator Howard Baker and others have told us that the only way we can get deregulation of natural gas is by agreeing to back off on our profits tax position on natural gas. A number of Senators are with us in principle on this issue. The overall outlook in the Senate is a very close call with passage conditioned on two things: (1) aggressive White House and Presidential support, and (2) accepting a windfall profits tax on natural gas.

- Louisiana, Texas, Oklahoma, some California members and Tom Corcoran (R-Ill) continue to want to press for deregulation this session but very few would say definitively that we can get a bill this year. All would say that the President would have to be personally involved and that natural gas dereg would have to be a top priority (one of the "musts"...).

- Other Republicans like Michel, Latta, Emery, mid-westerners, and northeasterners say that they would have to have a WPT. Even with a WPT many have deep reservations about deregulation this year because of this nasty winter and the impending election. They feel that the price for deregulation would be the heads of vulnerable R's (and maybe not-so-currently vulnerable R's).

- Energy and Commerce Fossil Fuels subcommittee Chairman Phil Sharp will hold hearings later in the year on NGPA. This would provide us with an excellent opportunity to aggressively air the problems with the NGPA, even though Sharp and Dingell remain opposed to deregulation.

- Frank Horton, ranking Republican on the House Government Operations Committee, believes strongly that sending up natural gas dereg now would jeopardize many other initiatives, such as DOE reorganization. His concern is legitimate.

- Sending it up now does get us into the middle of an expensive heating season. That will complicate deliberations. But those high heating bills will be remembered even in the spring, and those who are inclined to use that issue will play it for all its worth well into the summer.

- o Senator Jim McClure, Chairman of the Energy Committee and a proponent of the accelerated decontrol of natural gas, has stated repeatedly if we don't submit legislation before the end of February, it is dead for this session.

In summary, our submission of legislation, regardless of timing, will provoke protracted controversy. With all our other priorities, the need for Presidential involvement in those issues, and the upcoming congressional elections, we believe submission early in 1983 would be advisable.

THE WHITE HOUSE

WASHINGTON

To Cicconi - 2/5/82 MDT

February 3, 1982

MEMORANDUM FOR RICHARD G. DARMAN
CRAIG L. FULLER

FROM: RICHARD S. WILLIAMSON Rich

SUBJECT: DEREGULATION OF NATURAL GAS

Please consider the following comments in response to your request for an assessment of the optimal time for transmittal of legislation to accelerate the deregulation of natural gas.

1. The harsh winter weather which much of the country has suffered the past few months has created a situation which suggests that this legislation should be delayed at least until the Spring and perhaps until after the November 1982 elections.

The core of Republican Gubernatorial support for the President's economic initiatives has come from the Midwest Governors. Many of these Governors are up for reelection in 1982 and others have decided to retire, leaving open races in their states (Republican Governors up for reelection - Pennsylvania, Illinois, Wisconsin, Iowa, South Dakota; Republican Governors who have retired, leaving open races - Ohio, Michigan, Minnesota). Deregulation of natural gas would give the Democrat candidates in all of these Gubernatorial races the opportunity to suggest that Administration policies would be responsible for higher natural gas prices. This would be an awkward situation for our Gubernatorial supporters.

2. An argument can be made that having delayed as long as we have, it is no longer advisable to transmit such legislation until after the November elections for the same reasons outlined above.

By late Fall, the predicted economic upturn should have occurred, inflation should have continued to ease, and the unemployment picture should have improved. All of these factors would improve the political climate in which deregulation would be received.

cc: Meese
Baker ✓