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MEMORANDUM FOR THE CABINET COUNCIL ON NATURAL RESOURCES
AND ENVIRONMENT

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PUBLIC POLICY GOAL

A rational natural gas pricing policy which maximizes consumer welfare by providing gas supplies adequate to satisfy demand in both the short and the long run at reasonable market prices.

As our experience with oil controls and decontrol has shown, a free market operating under decontrol generally leads to lower prices and greater consumer benefits than would otherwise be the case. Under natural gas control, consumer prices have been rising rapidly, and production has been deterred, at least relative to levels that could have been obtained. A continuation of current policy threatens continued price increases without incentives to increase supply from the most economic sources. This discussion and proposal is presented with an eye to increasing the overall benefits to the American economy and to the ultimate benefit to all American consumers. Any price impact of deregulation on low income Americans is mitigated by existing low income energy assistance programs that provide an average \$180 per family participating.

ISSUE

Should the public policy goal continue to be sought through partial or complete federal price controls, or should price and demand controls be lifted in order to permit market forces to allocate available gas supplies?

BACKGROUND

Natural gas commerce has been heavily regulated in the United States from its inception, with explicit wellhead price controls on all natural gas sold in the interstate market since 1954. The

low level of prices under controls caused increasing distortions in the late 1960s and early 1970s, a condition which rapidly worsened as oil prices increased after 1973. Increased prices allowed by the Federal Power Commission in 1976 offered some relief, but natural gas exploration continued weak, and gas production was increasingly diverted to the unregulated intrastate market. These conditions led to predictable shortages and consequent rationing of natural gas in the regulated interstate market during the winter heating seasons of 1976 and 1977.

In 1977 and 1978, Congress and the President attempted to deal with the distortions caused by the price control system then in effect, but only succeeded in creating a new set of problems. The Natural Gas Policy Act of 1978 (NGPA) is a system of partial price controls which has the following major features:

- o All gas in the country was brought into the new system, as price controls were extended to the unregulated intrastate market.
- o Some increase in prices was allowed for categories of "new" gas (drilled after 1977), and all prices were to be adjusted for inflation.
- o New gas was to be deregulated in January 1985, and certain categories of gas ("deep gas") were totally decontrolled in 1979.
- o In all, more than 20 categories of gas were created, depending on date of discovery, type of formation, size of producer, and location of reservoir.

In theory, prices for new gas were to rise smoothly until in 1985 new gas prices would approximate a decontrolled price, and decontrol could occur smoothly. Under this partial decontrol scheme, about 40-50 percent of the nation's gas would remain subject to price controls in 1985. The percentage of price controlled gas is expected to decline under NGPA to about 25 percent in 1990 as reserves of that gas are exhausted. The hope of a smooth transition to decontrol was upset by the price increases following the 1979 Iranian revolution. Between the enactment of the NGPA in late 1978 and late 1981, oil prices far exceeded prices permitted for comparable energy from natural gas. Additionally, higher oil prices greatly increased oil exploration relative to gas exploration (oil drilling up 40 percent annually, gas up 10 percent), and also encouraged conversions from oil to gas, even though price increases for gas did continue to create incentives for conservation.

Department of Energy analysis in late 1981 indicated that upon deregulation of natural gas, either immediate or phased, the average wellhead price of gas would rise significantly (about 70

percent), although that price would be no higher than the price after the currently planned partial immediate decontrol in early 1985. There would be substantial efficiency gains, as more gas would be produced and substituted for expensive oil, and as increased quantities of gas would be conserved.

Over the past year, however, a significant change in circumstances has taken place. Against expectations, oil prices declined substantially. The decline is dramatically illustrated as the price for government purchases of oil for the SPR in early 1983 will be approximately 30 percent less than the price anticipated in early 1981. All sources now agree that a market clearing price upon decontrol, immediate or phased, would be considerably lower than anticipated in 1981. This means that the pure efficiency advantages from a higher price will be lower than anticipated earlier, but so will the consumer cost.

Some argue that the delivered cost of gas could even decline to some extent under at least one decontrol option. Many consumers groups, state public utility commissions, and gas distribution utilities (who, anomalously perhaps, oppose decontrol) have claimed in congressional testimony and before the Federal Energy Regulatory Commission that substitute fuels have become cheaper than gas, causing industrial customers to leave the gas market. Although the statistical evidence for the contention is weak, accepting the claims as true suggests that a properly structured decontrol option would permit gas prices to decline so gas could again compete with the substitute fuels.

Changed circumstances which have alleviated fears of dramatic price increases in the event of decontrol are only one factor arguing in favor of it. There are others. The present statute spawns other inefficiencies than over-consumption and under-supply caused by artificially low prices. It mandates unequal access to certain categories of supply. Differentially priced gas means that gas will continue to be allocated inefficiently, while the various price categories induce the industry to produce a mix of gas that is more costly than necessary. Pipelines have different gas costs depending on how much cheap, price-controlled gas they have under contract. That leads to anomalies such as gas costing a dollar per thousand cubic feet less in western Pennsylvania than eastern Pennsylvania (according to claims of members of Pennsylvania's public service commission).

Long-term contracts, which are prevalent in this industry, lead to other complications. As gas sales have declined due to conservation, the recession, and fuel-switching, recent gas purchase contracts have forced some pipelines to take and deliver expensive gas while shutting in or delaying acceptance of some amount of cheaper supplies. This has created the seemingly

perverse effect of escalating prices in gas markets faced with a declining demand. The existence of controls has compounded this problem. By reducing the certainty of available supplies, controls have served to increase the level of take or pay commitments (described below) that were written into more recent gas purchase contracts.

Furthermore, many analysts fear the effect of "indefinite price escalator clauses," defined below. Upon scheduled partial decontrol under the NGPA, gas under such contracts could rise to 110-130 percent of the price of No. 2 heating oil, which is about twice the level of the presently estimated market-clearing price.

A major item of public discussion at this time is why, in the face of falling oil prices, gas prices continue to rise sharply. It should be noted that these increases are not unexpected. Overall, natural gas prices have been rising at about 20 percent a year in the residential market for the last six or seven years, and price increases have been fairly close to what was projected at the time the Natural Gas Policy Act was passed. It is true that in a free market prices will generally fall when supply rises and demand falls. This is what has been happening in the only free part of the natural gas market, the market for deep gas.

When prices have been controlled at an artificially low level, it is not surprising that they would continue to rise from that artificially depressed level to at least market clearing levels, even if the market clearing price is falling at the same time. The cause is two-fold. First, the NGPA provides for inexorable statutory price ceiling increases for categories of "newer" gas, while older and much cheaper supplies are being exhausted. Accordingly, the statutory decontrol schedule is allowing average gas costs to come up to market levels. Simultaneously, contract provisions which developed in a price-regulated regime permit prices to rise with NGPA-allowed increases, but do not permit them to fall in response to market pressure. As a consequence, the NGPA's price ceilings often act as price floors.

Even though the NGPA now provides for the decontrol of about half of all gas in 1985, there is no guarantee that this will actually take place. There are a number of congressional efforts now underway to freeze or roll back natural gas prices, and to delay decontrol, raising the predictable spectre of consequent shortages and rationing such as experienced in 1976-77. In addition, if decontrol is not already accomplished or deemed phased in (as oil decontrol was), the political pressures to "save the consumers" by renewed controls in the summer of 1984 may prove irresistible, to the detriment of consumers.

DISCUSSION

The Working Group unanimously agreed that a deregulation initiative could be prepared which would be better for the country than either a continuation of the present law, or increased controls. The group also unanimously agreed that if there were some reasonable prospect of success, the President should present a decontrol initiative to Congress.

I. Major Proposals

The types of initiatives suggested fall into three broad categories, although a number of subsidiary issues, some with sub-options, are presented later as well. The three major proposals are referred to here as immediate total decontrol, modified immediate decontrol, and phased decontrol.

- A. The immediate total decontrol option essentially takes the position that the current average wellhead price is relatively close to the price that would prevail under decontrol; that the individual aspects of the current system are so complex and confounded that a gradual unravelling will not be effective and that the benefits of decontrol are sufficiently compelling that they should be obtained as soon as possible. Under this option, all gas is decontrolled immediately or in a very short period, with provisions that simultaneously free purchasers and sellers from existing contract obligations at the wellhead on contract terms such as price escalators or required contract takes. This proposal argues that giving producers immediately the price freedom they have sought, especially on gas already produced and contracted for, will be much more politically saleable if balanced by freeing purchasers from obligations which they assumed, frequently in reliance on the existence of controls or conditions created by the system of controls.
- B. The modified immediate decontrol option would also decontrol all gas prices immediately, but would adopt one of the more moderate contract solutions discussed below. As in option A, immediate decontrol is preferred because of the anticipated political pressures arising in 1984 from phased decontrol and because of further possible efficiency losses arising from a known delay in full decontrol. Supporters of this view believe that average wellhead prices are currently near the market clearing level and that immediate decontrol limits the possibility of "overshooting" of gas prices that could

occur under phased decontrol. Supporters of this modified option, however, also believe that some contract "adjustment" is needed. It might, for example, place a moratorium on indefinite price escalators for a definite period of time to allow for renegotiation. In addition, a temporary limit on take-or-pay obligations might also be appropriate.

- C. The phased decontrol option basically seeks to assemble a consensus for a gas decontrol bill by a package of specific changes to the current structure. It seeks to phase out all price controls on natural gas by 1985, while making some modifications to the contract regime which grew up as a result of the various systems of price controls. Supporters of this view believe that the incremental approach can garner support that would be put off by the seeming abruptness and risk of the two alternatives discussed above.
- D. The Working Group evaluated a fourth proposal of only addressing the contracts problem. This idea was rejected because it ignores the inefficiencies that would be caused by continued price controls.

QUANTITATIVE ANALYSIS

The Department of Energy has continued its modeling work in attempting to forecast the effects of alternative natural gas systems, including immediate decontrol, current policy, and continuing price controls. As was done last year, the DOE modeling assumes that the 1985 fly-up of prices resulting from indefinite price escalators does not materialize under NGPA, immediate or phased decontrol. These options assume either that the marketplace will force quick renegotiation of unreasonable contract terms or that any decontrol scenario will be accompanied by a legislative contract solution. Refiner acquisition costs for imported oil are assumed to decline slightly in real terms through 1984 and go up at 1 percent annually thereafter.

Current DOE analysis for immediate decontrol shows only a very small price increase (10 percent at the wellhead, 5 percent for residential users) as compared to 100 percent and 50 percent respectively in last year's analysis. Efficiency benefits and wealth transfers are correspondingly much smaller. This radical difference in analysis is primarily due to lower oil prices, improved supply prospects, and significant reduction in demand. For the longer run, DOE analysis suggests that the market for gas will tighten as the economy improves, and therefore projects real average wellhead price increases of more than 10 percent per year for several years with or without decontrol (about 5 percent in residential prices). Some members of the group found this

analysis somewhat extreme, expecting instead somewhat larger price increases immediately under decontrol, but with little real price increase thereafter. DOE notes that their current analysis projects crude oil and residual oil prices 15-25 percent lower than those assumed last year for the period 1983-1985.

Because of the relatively small difference in price between current policy and full decontrol, phased decontrol tends to differ little from either of the other two options. Phased decontrol has almost the same effect whether one phases to a 60 percent or 70 percent crude oil target because it was assumed that the new maximum lawful prices would not act as floors, and that prices would be dictated by market conditions, not contracts. Under immediate decontrol, market-clearing levels in 1985 are approximately at 60 percent of crude; therefore, the two options appear the same.

DOE analysis continues to show substantial adverse effects from extended price controls versus allowing NGPA to run its course. Such controls would cost the American economy an extra \$21 billion (NPV in 1980 dollars), a loss of 6.7 trillion cubic feet of gas production and an increase of over 1.5 billion barrels in additional oil imports through 1995.

Impact on Low Income Families

Low income households have been receiving federal cash assistance for energy bills since FY80 at an annual rate of about \$1.8 billion, or an average of \$180 per participating household. While this program was enacted by Congress in 1979 to offset a portion of the increase in home heating oil costs resulting from the doubling of oil prices in 1979, this program applies to households using natural gas for heating as well. The real increase in residential natural gas prices in 1983 of approximately 5 percent expected under full decontrol (about \$30 per low income household) does not justify a new low income energy assistance program or an add-on to the existing program. Nor does the small increase justify not proceeding with decontrol.

III. ELEMENTS OF MAJOR PROPOSALS

The specific issues addressed under these options are: timing and scope of decontrol; demand restraints; problems of escalator clauses in contracts; problems of take-or-pay clauses in contracts; associated tax or expenditure proposals.

A. Timing and Scope of Decontrol

Under both the immediate total decontrol and modified immediate decontrol options, all natural gas would be decontrolled either immediately upon enactment, or on

some date certain within perhaps a year of enactment. One variation would allow decontrol upon renegotiation of contracts. At the end of a fixed period, a so-called market-out clause would be imposed by statute, which would allow buyers to abrogate contracts which had not been renegotiated.

The phased decontrol option would follow the recommendation made by the Cabinet Council last year, with the price of each category of gas allowed to escalate from its current level to a target level of 70 percent of the refiner acquisition cost of crude oil by January 1, 1985.

For this discussion, the 70 percent price level has been maintained, although some DOE analysis argues that the likely market clearing price is as low as 60 percent. This was done for two reasons. First, there is some significant skepticism that the current market is sufficiently soft that the 60 percent figure is accurate. Second, a price "under-shoot" could raise once again the spectre of a price "spike" in early 1985 and stimulate cries at that time for continued control. A similar "overshoot" would simply mean that the market clearing price would be reached prior to the decontrol date, and that price increases would then level off, if the gas market operates in a competitive fashion.

B. Demand Restraints

Under the theory behind the NGPA, natural gas use should be restricted to "high priority" uses, such as residential and commercial use, so other uses should be specifically discouraged (Fuel Use Act) or should pay very high prices (incremental pricing). As predicted by opponents at the time of passage, this has led to an artificial diminution in industrial use, which is now increasing oil demand, and raising the amount of fixed cost that the residential sector must bear as industrial load leaves the system. Under all options, the incremental pricing provisions of the NGPA and all provisions of the Fuel Use Act which impact natural gas prices would be repealed upon enactment.

C. Problems of Escalator Clauses in Contracts

The basic problem addressed here is that most contracts, both in the interstate and intrastate market, contain provisions specifying prices that can be charged at specified times in the future, or upon decontrol. The most popular type of these clauses are as follows:

- o "Definite price escalator" -- These include such figures as a 1 percent increase every five years, or a specified dollar price upon deregulation.
- o "Oil parity clauses" -- set a price by specific reference to other oil (or gas) product prices, such as the equivalent of 130 percent of the distillate price in New York Harbor, the average of all decontrolled gas, etc.
- o "Favored nations clauses" -- set the price for gas equal to some high gas or average gas price within a specified area, such as a county, state, or producing field.
- o "Area rate clauses" -- These were originally clauses which specified that the producer could receive the highest rate permitted in his area by the FPC. Some controversy has arisen as to how these would be interpreted upon decontrol, when there was no ceiling price set by any regulatory authority.
- o "Indefinite price escalators" generally applies to all escalator clauses other than "definite escalators."

The problem generally addressed in discussions of these clauses is that upon decontrol at least some contracts would escalate to "oil parity" prices and producers would receive these new higher prices. Then, "favored nations" clauses would be "triggered" throughout the areas in which the oil parity clauses operate. The evidence seems to be that there are sufficient oil parity clauses, and the areas specified in favored nations clauses are sufficiently widespread that a "cascading" effect would ensure that a very large proportion of all gas in the country would have at least the theoretical right to a price which would be substantially above what the market would support.

In one analysis, this situation could not be maintained for long, and private renegotiation of contracts would eliminate the problems by providing the same resolution as would have been reached in a market without these clauses. There is, consequently, some argument for making no reference to

this contract escalator problem. However, the fear of the effects of such clauses is sufficiently great that a bill which made no reference to these problems would be even more difficult than usual to pass.

In the immediate total decontrol proposal, this problem is solved by allowing the purchaser simply to opt out of any contract containing such clauses if it cannot be renegotiated. At the same time, because a pipeline in many cases has monopsony power over a producer that is connected only to that pipeline, a pipeline that opted out would be required to transport gas to a new purchaser, in return for a transportation charge specified by FERC.

The modified immediate decontrol and phased decontrol solutions, on the other hand, would essentially "decouple" or "insulate" indefinite price escalator clauses from other contracts or events happening prior to decontrol. No clause or contract or event entered into or occurring before the date of decontrol could be used to trigger any indefinite price escalator. Thus, if one producer were receiving \$10 per mcf under a contract entered into in 1978, this could not be used to escalate prices under a contract at the time of decontrol. On the other hand, if new contracts were entered into after decontrol at whatever price, then contracts could operate according to their terms. Supporters of this option argue that a decoupling initiative represents minimum interference with respect to contract integrity, yet at the same time attacks the primary source of a possible cascading price effect.

An alternative option would specifically limit prices under escalator clauses to a numerical price cap such as, e.g., 70 percent of the refiner acquisition cost of crude oil or the average price of new gas contracted for during any period after decontrol. The Working Group believed that the latter option would in effect be a new form of price control, requiring FERC action to formulate the new pricing levels. For this reason, the working Group rejected this proposal, although it would have two attractions: (i) it would provide absolute assurance that some set of circumstances could not drive escalator clause contracts above the general average level of contracts after decontrol; and (ii) it would also attack oil-parity contracts themselves.

Some in the Working Group believed that those who signed oil parity contracts knew very well what they were doing, and thus do not deserve the special relief provided by this option. Furthermore, a granting of relief in this case could contradict earlier Administration policy against such contract bailouts and would lead to renewed pressures for contract relief in other industries. Others believe that the relative equity of oil parity contracts is irrelevant because (i) not granting relief on oil parity contracts represents a glitch in the otherwise smooth functioning of the deregulation initiative; and (ii) it could be divisive to development of a consensus because of the predictably strong negative reaction of pipelines, distribution companies and consumers. Also, a cap based on a rolling average of prices does not give a federal agency broad discretion as to where prices should be set. Instead, it implies only a data collection and distribution function.

In addition to oil parity issues, other contentious issues seem sure to arise. If, for instance, an interventionist contracts option is chosen, there is a choice as to whether to include contracts for already deregulated Section 107 gas. Such interference will be popular politically but represents blatant recontrol of gas prices to the detriment of investors in these high-cost projects.

D. Problems of Take-or-Pay Clauses in Contracts

The production of natural gas is a highly capital intensive activity. To minimize capital costs, it often is not efficient for several pipelines to serve a single locality. Therefore, a potential producer will usually demand a long-term contract to protect himself from the potential future bargaining power of the contracting pipeline. On the other hand, before a pipeline may be constructed, the pipeline company must show its regulators and creditors that the proposed pipeline has sufficient assured supply. The pipeline, thus, also has an important interest in signing a long-term contract. Take-or-pay clauses are important integral components of these long-term contract arrangements. By requiring specified payments, regardless of the buyer's momentary needs, those clauses ensure that pipelines cannot arbitrarily walk away from a contract to buy gas.

Under price controls, purchasers are forbidden to compete for new supplies by offering a higher price. Therefore, purchasers under controls competed by

increasing their take-or-pay commitments to very high percentages (80-100 percent). In a time of lessened demand, as in the present, a pipeline may find that it has over-extended and obligated itself to take a lot of high priced gas, and is correspondingly forced to cut back some of its other potential supplies, even if they could sell at a lower price.

An important policy issue is whether the federal government should step in and abrogate these high percentage take-or-pay contracts. In so doing, however, the government would be rewarding those few pipelines that exercised rather bad business judgment to the detriment of those pipelines that refused to agree to extreme contract terms and consequently had to go without the additional gas supplies.

Under the immediate total decontrol option, the take-or-pay clauses could be included in a statutory market-out clause which would permit the purchaser to abrogate his contract.

Supporters of the modified immediate decontrol option generally believe that abrogation of take-or-pay clauses should be avoided. As discussed in the case of oil parity clauses, abrogation of take-or-pay clauses could contradict existing Administration policy against industry bailouts and could lead to a Pandora's box of outcries for similar relief.

Under the phased decontrol option there are two possible proposals: (i) a simple cap of limited duration, e.g., 75 percent for three years; (ii) a comprehensive control system requiring pipelines wishing to escape their take-or-pay obligations to do so commencing with their most expensive gas and gas produced by themselves or affiliates. The latter option would require an elaborate FERC enforcement apparatus with implications for time lags in enforcement.

The percentage to which take-or-pay obligations could be reduced could, of course, be varied. Congressman Brown (R-Ohio) has submitted a bill which would allow reduction as far as 50 percent. This would be a rather severe disappointment of the obligations and expectations of the producer at the time of contract.

One other consideration merits mention. Some gas is produced in association with oil production. Contracts for the sale of such "associated" gas often call for very high percentages of take because the alternative is

shutting in oil production when the purchaser refuses to take gas or maintaining oil production, but wasting the gas through venting or flaring. Accordingly, even a restrictive take-or-pay solution should deal separately with the peculiar problems of associated gas production.

A final consideration is applicable to the discussion of both indefinite price escalators and take-or-pay. If a cap is placed on each of these provisions for some period of time, a market-out could be provided upon termination of that period and applied only to contracts of specified types which have not been renegotiated. There is some evidence that such a provision would receive broad support. It would mitigate the problem of intransigence in renegotiation, while advantaging neither the pipelines nor producers unduly.

E. Duration of Legislated Contract Changes

The purpose of the various possible changes in the contracts is to provide a transitional mechanism to move from almost thirty years of price regulation (with its attendant impact on contract terms) to a freer market for natural gas sales. Thus the contract changes would be expected to have a two to three year duration during which time the parties to the contracts could renegotiate the offending terms. The effect of these terms would be suspended for the two or three year period. If the parties did not renegotiate the take-or-pay provision during such period, it would be reinstated. However, the offending indefinite price escalators, if not renegotiated, could (a) remain suspended and subject to the transition pricing mode, or (b) be subject to a market-out provision, or (c) be reinstated.

F. Associated Tax or Expenditure Proposals

Many members of Congress have stated that a natural gas decontrol proposal can be adopted only if there is some type of tax on the "windfall" arising therefrom, either as a means of helping consumers or punishing the producer. The Working Group unanimously agreed that any such tax would increase consumer costs and reduce gas exploration and production, and was, therefore, totally unjustified from a policy point of view. Under present economic conditions, the revenues theoretically generated would not be worth the increased consumer costs and decreased exploration activity.

G. Imported Gas

Five percent of U.S. gas is imported from Canada, Mexico, and Algeria, with Canada representing about 90% of this volume. Under the terms of an understanding reached between the U.S. and Canadian Governments in March 1980, there is a uniform border price (currently \$4.94 per million BTU) for all gas imported from Canada. A similar understanding accorded Mexican gas the same pricing treatment. While the U.S. views the uniform border price as a ceiling, Canada and Mexico view it as a floor. Therefore, although the U.S. does not now preclude importers from renegotiating lower prices with Canadian and Mexican suppliers, such changes would be subject to Canadian and Mexican Government approval.

Effects on existing contracts: Under full decontrol and a possible contracts "fix" scenario, there is a question whether new legislation would apply to existing contracts with foreign producers. There may be pressure from Congress to include these existing contracts in any new legislation. Because of the government-to-government understandings and the likely need for imported gas during the life of existing contracts. The State Department believes it would be preferable to use diplomatic means, rather than unilateral and extra-territorial legislative action, to bring about renegotiation of existing contracts.

Effects on new contracts: Under full decontrol, there would be no need for regulatory authorities to review the price aspects of proposed gas imports from Canada and Mexico (in addition, imports of Algerian LNG would probably no longer be necessary). Following notification to the Canadian and Mexican Governments that the U.S. would no longer consider previous understandings as valid for new contracts, the market would determine what price importers pay for future foreign supplies and gas imports would no longer receive special pricing treatment. As a general principle, legislation affecting other aspects of domestic contracts (take-or-pay, escalator clauses) would also be applied to new international contracts in a non-discriminatory fashion.

Effects on international energy security and trade: An Administration initiative on decontrol could increase U.S. gas production and reduce oil imports. The SIG-IEP has identified decontrol as a key domestic measure to enhance U.S. energy security. Full decontrol would also eliminate a source of trade friction with both the Europeans and Japanese, who have complained that U.S. price controls serve to subsidize U.S. petrochemical exports.

SUMMARY OF OPTIONSA. (Immediate Total Decontrol)

Immediate decontrol, purchasers can opt out of contracts.

Advantages

- o Provides greatest efficiency benefits by allowing all gas to reach a market-clearing price immediately.
- o Permits greatest flexibility in prices, both up and down.
- o Permits legislators to disclaim responsibility for any particular "target" price.
- o Provides greatest flexibility for new market arrangements.
- o Provides earliest dismantling of regulatory apparatus.
- o The most unsettling aspect of decontrol would be concluded before the highly charged 1984 election season.

Disadvantages

- o Violates legitimate contracts and expectations of large numbers of businesses.
- o Provides no protection against fears of unlimited price increases.
- o Could be politically difficult to sell.
- o Requires effective restructuring of natural gas industry under very short time deadline.
- o Could be argued to jeopardize security of supply necessary for service of long-term public utility obligations.
- o Creates renewed claims by other industries (e.g., timber) for contract "adjustments."

B. (Modified Immediate Decontrol)

Uses a more "moderate" contracts approach.

Advantages

- o Almost the same as in Option A.
- o Does not interfere as much with legitimate contracts entered into by private parties.
- o Minimizes the overshooting or undershooting of prices that could occur from phase decontrol.

Disadvantages

- o The modified contracts approach may be difficult to implement and contemplates government intervention.
- o Would also be politically difficult to sell.

C. (Phased Option): Phase decontrol through 1985, with moderate amendments to ease contractual problems.

Advantages

- o Makes incremental moves from current situation to general decontrol.
- o Works in policy framework with which Congress is familiar.
- o Provides a predictable framework for future developments in natural gas industry, both production and consumption.
- o Should cause relatively minor price impact beyond that which would occur anyway.

Disadvantages

- o More likely to become mired in congressional changes and horse trading.
- o Still creates some additional government intervention by modification of existing contracts in violation of expectations.
- o Sufficiently complex that true adjustment will not begin in the natural gas industry until after 1985.

D. (Continue NGPA)

Advantages

- o Avoids an immediate political fight on our initiative.
- o Current situation is perceived as not too bad, as price gap between oil and gas has diminished.
- o Avoids the possibility of Administration initiatives leading to an ultimate bill worse than the present situation, which the President would have to decide whether to veto.

Disadvantages

- o Hurts consumers by leading to increased prices and decreased supply over the long run.
- o Leaves initiative in hands of proponents of controls, who will continue to press for further restrictions on gas prices.
- o Prevents most effective and efficient production and use of natural gas, thus exacerbating energy problems.
- o Could hurt consumers by maintaining artificially high prices over the short to mid term.
- o Practically guarantees a fight over reimposition of extension of controls in the 1984 political season.
- o Will further discourage exploration and conservation efforts as natural gas situation remains unsettled.
- o Leaves energy and economic situation subject to the vicissitudes of the world oil market. In the event of a price increase, gas controls would become even more entrenched and damaging.