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Receipt And Coordination Of Natural Gas Reserve Data

B-178912

Federal Power Commission
Securities And Exchange Commission

**BY THE COMPTROLLER GENERAL
OF THE UNITED STATES**

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APRIL 30, 1974



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-178912

u The Honorable Henry B. Gonzalez
House of Representatives

Dear Mr. Gonzalez:

Your letter of June 15, 1973, requested the General Accounting Office to review the dealings of the Coastal States Gas Producing Company with the Securities and Exchange Commission (SEC) and the Federal Power Commission (FPC) with regard to the seemingly conflicting natural gas reserve claims made to these agencies by Coastal States. C, 1296
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As agreed with your office, our examination has been directed toward determining (1) what natural gas reserve information FPC and SEC receive, (2) whether FPC verifies that sufficient gas is available when interstate gas sales are approved, and (3) whether SEC and FPC coordinate their efforts so that disparities in the data they receive are disclosed. 256

During our review, we examined the agencies' policies and procedures dealing with the collection of natural gas reserve data, reviewed applicable agency records, and held discussions with agency officials. Our review was conducted at the Washington, D.C., headquarters offices of the FPC and the SEC.

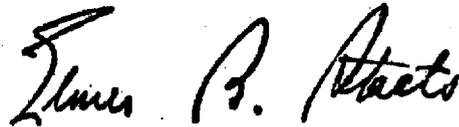
At the time our review began in July 1973 Coastal States Gas Producing Company and all but one of its several subsidiaries, South Texas Natural Gas Gathering Company, were engaged in intrastate operations. Since FPC is concerned with interstate operations, only South Texas was subject to FPC's jurisdiction. Nevertheless, based on our limited review of FPC's and SEC's policies and procedures, it appears to us that there exists an opportunity for SEC and FPC to improve coordination through an exchange of the natural gas reserve data each receives, and we have included recommendations to the Chairmen of SEC and FPC on this matter. A complete report on the results of our review is enclosed.

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Both agencies were offered an opportunity to comment on a draft of this report. Their comments were considered in preparing this report and are included in their entirety in Appendices I and II of the enclosure for your information.

CR The Chairman, Subcommittee on Communications and Power, House Committee on Interstate and Foreign Commerce, previously requested that we review FPC's operations with a view toward identifying areas where improvements might be made. In accordance with arrangements made with your office, we are providing the Chairman with copies of this report. Copies are also being sent to the Chairmen of the SEC and FPC. However, any additional release of this report will be made only if you agree, or if the contents of the report have been made public. *H 2309*

Sincerely yours,



Comptroller General
of the United States

Enclosure

REPORT ON
RECEIPT AND COORDINATION OF
NATURAL GAS RESERVE DATA
BY THE
FEDERAL POWER COMMISSION
AND
SECURITIES AND EXCHANGE COMMISSION

NATURAL GAS RESERVE INFORMATION RECEIVED

Securities and Exchange Commission

The Securities Act of 1933 (15 U.S.C. 77a) requires that registration statements, containing detailed financial and other information, be filed with SEC when securities are to be offered for public sale. The act requires that a prospectus, which must be part of the registration statement, be furnished to investors to enable them to evaluate the securities and make an informed investment decision. Also, the Securities and Exchange Act of 1934 (15 U.S.C. 78a) requires issuers of securities to file proxy statements and annual and other periodic reports with SEC so as to provide a public file of significant current information.

Companies engaged in the production or sale of natural gas are required to include an estimate of their remaining gas reserves when filing registration statements in accordance with the Securities Act of 1933. SEC officials told us that it is a common practice for companies filing such registration statements to provide data supporting the reported estimate of gas reserves.

The registration statements are examined by SEC's Division of Corporation Finance for compliance with adequate and accurate disclosure standards. The SEC staff must assure itself that the disclosure standards have been met before the sale of securities can begin. Within the Division of Corporation Finance, the Office of Oil and Gas provides

technical assistance to other sections of the Division. This assistance includes reviewing the reasonableness of the natural gas reserve data contained in registration statements filed by natural gas companies and any supplementary supporting data they provide. In most instances, the supporting data is supplied by the companies with the understanding that it will not be made public because of its significant commercial value. SEC's general practice is to return most of the supporting data to the companies.

In connection with registration statements and other filings submitted or to be submitted to SEC, oral briefings are often made by the gas companies to officials of the Office of Oil and Gas. We were advised by SEC officials that they prepare no records that show the specific matters discussed in the oral briefings. As a result, SEC may have little information on file about the specifics of the gas reserves of companies engaged in the production or sale of natural gas, even though it receives substantial gas reserve information in connection with the filings of gas companies.

Federal Power Commission

With respect to natural gas, FPC is responsible for regulating the interstate aspects of the natural gas industry with the objective of assuring an adequate supply of natural gas at reasonable prices to meet the Nation's energy needs. The FPC is vested with broad information gathering powers and obtains natural gas reserve data from interstate gas pipeline companies on a regular basis. The gas pipeline companies submit annual reports of their natural gas reserves to FPC. This data is available to the public.

FPC has also obtained gas reserve data from gas producers. It has been obtained in connection with individual cases or rulemaking proceedings. Because of the significant commercial value of the data, FPC obtained the information with the understanding that it would not be made public.

FPC may also obtain gas reserve data in connection with formal proceedings involving proposals for interstate sales of natural gas and proposals for gas pipeline construction, expansion, or abandonment.

DOES FPC VERIFY THAT SUFFICIENT
GAS IS AVAILABLE WHEN APPROVING
INTERSTATE GAS SALES?

Within the Bureau of Natural Gas, the Gas Supply and Production Section of the Systems Operations Division is responsible for determining the accuracy of gas reserve estimates presented in applications for certificates of convenience and necessity which authorize the sale of gas in the interstate market. The primary purpose of verifying the accuracy of gas reserve estimates is to provide reasonable assurance that a company proposing a sale of natural gas has the reserves necessary to support the sale. It is done by applying generally accepted gas estimating techniques to the data supporting the company's gas reserve estimates and comparing the results with the reserve estimates shown in the certificate application. Discrepancies are resolved with the companies or in a hearing.

Officials of the Gas Supply and Production Section informed us that they determine the accuracy of gas reserve estimates presented in applications for certification when:

- (1) the applicant proposes the construction of facilities involving significant amounts of money and gas reserves become critical to the necessity of the proposed construction.
- (2) a proposed sale of natural gas seems questionable based on the FPC staff's experience with the gas reserves of the companies involved in the proposed sale.
- (3) intervenors raise gas supply questions about an application.
- (4) a new market is added to an interstate pipeline.

The officials stated that the Gas Supply and Production Section does not review the gas reserve estimates presented in applications for certification when:

- (1) the applicant is a producer, although producer reserves may be reviewed in instances where the purchaser files an application for certification

because of a new market or construction of facilities as described above.

- (2) the application involves relatively small construction expenditures and/or minor sales volumes.
- (3) the application involves the sale of additional natural gas over a network of facilities already constructed and there are no additional construction costs included in the proposal or no new markets added.

We were also informed that gas reserve estimates that are not reviewed at the time the certificate is issued may be reviewed when the Gas Supply and Production Section reviews FPC's form 15, which is a report of total gas supply filed annually by pipeline companies. The form 15 contains reserve estimates and deliverability projections for each source of supply, e.g. reservoir, gas field, or gas plant; and map showing the location and delineating the boundaries of each reported gas reservoir. However, not all FPC form 15's are reviewed in detail each year. It could be 5 or 6 years before a detailed review is performed and there is no assurance that specific gas reserves supporting specific purchases from producers are given close scrutiny.

No estimate has been made by the FPC staff of how many of the approved sales had been reviewed in detail to determine that sufficient gas reserves were available to support the sales. Such an estimate could not be provided without an extensive staff analysis of the files. It is the opinion of the FPC staff that a large majority of reserves supporting gas sales have been reviewed because large gas sales involve new markets or significant new construction, which are areas under which a review is performed.

ARE THE AGENCIES
COORDINATING THEIR EFFORTS?

Our examination showed that very limited coordination exists between SEC and FPC with respect to gas reserve data. We noted that:

--FPC does not seek gas reserve information from SEC in carrying out its statutory responsibilities.

- Although SEC regularly submits gas company prospectuses to FPC for comment, it does not provide the underlying supporting gas reserve data to FPC for that agency's use in evaluating the prospectus.
- SEC and FPC officials were generally not knowledgeable as to the nature of the gas reserve data possessed by the other. Little or no information exchange takes place between the technical experts of each agency.

Requests Made to FPC by SEC

Most of the interagency requests involved SEC transmitting to FPC for review and comment prospectuses filed by gas companies intending to sell securities to the public. In making such requests, however, SEC does not supply FPC with any of the supplementary gas reserve data it received supporting the prospectus.

When our review began in July 1973, we found that both agencies handled such requests on an informal basis. Written instructions of SEC's Division of Corporation Finance require that whenever a registration statement is received from a company engaged in the production or sale of natural gas, a copy of the prospectus should be sent to FPC for comment. During our review, however, we noted four instances where gas company prospectuses were not sent to FPC as required, and an SEC official told us that he could find no specific reason why these statements were not sent.

We also found one instance--involving Coastal States Gas Producing Corporation--where the files indicate that SEC requested comments on a prospectus and, when no response was forthcoming, took no follow-up action to determine why. In this instance FPC officials advised us that they had no record of having received the prospectus. SEC officials indicated that they did not consider the absence of a response from FPC to be a serious matter. In this regard, SEC advised us that except where there may be a specific reason for doing so, it might not wait for comments from FPC beyond a given target date, nor would it find it necessary to follow up on prospectuses referred to the FPC.

Requests from SEC for comments were processed by FPC's Office of Accounting and Finance. To identify possible misstatements or deficiencies, that office compared the accounting and financial data in the prospectuses with data in the latest annual reports submitted to FPC. The Office of Accounting and Finance also asked FPC's Bureau of Natural Gas for any comments it might have on the reasonableness of the gas reserve data presented in the prospectus or registration statement; however, in June 1973, the practice was discontinued. The Office of Accounting and Finance official previously responsible for responding to SEC requests told us that the Chief of the Bureau of Natural Gas said his Bureau would no longer comment on gas reserves presented in prospectuses because of the problems and misunderstandings encountered by the Bureau with proprietary gas reserve data. The Acting Chief of the Bureau was unable to explain to us the specific reasoning behind the action taken by his predecessor, but we were advised that the practice of commenting on gas reserve data in prospectuses had been reinstated by the Bureau as of October 1973.

We were told by Bureau officials that they usually compared the gas reserve figures appearing in a prospectus or registration statement with gas reserve figures appearing in the company's Annual Report of Total Gas Supply. This report is required to be filed with FPC by June 1 of each year and covers the previous calendar year. In those instances where discrepancies were noted, the Bureau attempted to reconcile the differences. If the figures could not be reconciled, SEC was merely informed through the Office of Accounting and Finance of the discrepancies.

We noted instances where the Bureau went beyond commenting on gas reserves. In those instances, the Bureau commented that:

- a prospectus contained serious omissions of important information;
- a company was involved in an FPC proceeding affecting the gas reserves; and
- a company was a successful bidder for a 25 percent interest in certain offshore oil and gas leases.

Thus FPC may have significant information to offer to SEC in a particular case.

Transmission of Comments from FPC to SEC

Until October 1973, FPC's comments were usually transmitted orally by the Office of Accounting and Finance to the branch chief within SEC's Division of Corporation Finance whose branch was handling the registration statement. In October 1973, new procedures were instituted requiring a telephone notification of the results of a review plus a follow-up letter to SEC if deficiencies are noted by FPC.

As stated previously, the SEC's Office of Oil and Gas also comments on registration statements. Technical experts in that office advised us that they did not receive FPC's comments on prospectuses and that they had virtually no contact or information exchange with FPC. These individuals were unaware of the type of information that was available at FPC, including the existence of the Annual Report of Total Gas Supply.

Requests Made to SEC by FPC

At FPC, there are no formal procedures for obtaining gas reserve data from SEC. Nothing precludes members of the FPC staff from seeking information available at SEC; however, the only information that would be made available would be the information made available to the general public unless SEC approval is obtained to review the supplementary data received with registration statements or information obtained through special investigations on an ad hoc basis.

SEC officials told us that they knew of no instances where FPC officials requested proprietary gas reserve data from the Commission. They told us that they thought SEC would approve any such request if the request was reasonable and for a good cause. Conversely, FPC officials told us that FPC would not provide SEC with access to gas reserve data that it had promised not to make public.

THE COASTAL STATES CASE

South Texas Natural Gas Gathering Company was the only affiliate of Coastal States engaged in interstate transactions and thus subject to regulation by FPC.

On April 2, 1971, South Texas applied to FPC for approval to remove certain of its pipeline facilities for transporting gas to its largest customer, Transcontinental Gas Pipe Line Corporation. South Texas claimed that anticipated gas reserves had not materialized and that it could not supply the full amount of gas contracted for by Transcontinental.

On September 28, 1971, Coastal States filed a registration statement with SEC to sell first mortgage bonds. In its prospectus, Coastal States claimed that it and its subsidiaries had gas reserves of 10,090 billion cubic feet. The reserves of the subsidiaries, including South Texas, were not separately identified in the prospectus, but the lump sum reserve figure was supported by detailed supplementary data. [It was from this data that the FPC staff counsel determined that 1,653 billion cubic feet of gas reserves were dedicated by South Texas to Transcontinental in interstate commerce (see p. 9)]. In accordance with SEC instructions, the branch in SEC's Division of Corporation Finance that was reviewing the registration statement requested technical assistance from SEC's Office of Oil and Gas and according to SEC's records, the prospectus was sent to FPC for review and comment. The supporting data was not sent to FPC.

Officials in the SEC's Office of Oil and Gas told us that they concluded that the gas reserves presented in the prospectus were reasonable. SEC's request to FPC was dated October 5, 1971; however, SEC officials told us there was no response from FPC. FPC officials told us they had no record of receiving the request from SEC and did not know whether they had commented on the prospectus. Apparently SEC was not told that South Texas--a Coastal States subsidiary--had claimed in an April 1971 application to FPC that it could not supply the full amount of gas contracted for by its largest customer. The prospectus became effective on October 15, 1971.

On January 27, 1972, FPC issued an order requiring a hearing on South Texas' application to remove the facilities used to supply gas to Transcontinental and in February 1972, South Texas and Transcontinental performed a joint study of South Texas' gas reserves. The study, furnished to FPC in March 1972, showed South Texas gas reserves dedicated to Transcontinental of 416 billion cubic feet.

At about the same time--February 1972--FPC's staff counsel learned of the supplementary data filed with SEC supporting Coastal States' claimed gas reserves and subpoenaed the data from the company. From the data, FPC's staff counsel determined that 1,653 billion cubic feet of gas reserves were dedicated by South Texas to Transcontinental in interstate commerce--a difference of 1,237 billion cubic feet from the joint reserve study estimate. FPC's Bureau of Natural Gas told the staff counsel in April 1972, that the 416 billion cubic foot estimate used in the joint reserve study was correct. The discrepancies between the 416 billion cubic foot estimate and the data filed with SEC were made part of the record in the June 1972 hearing on South Texas' application.

FPC's staff counsel informed us that he reported the differing figures to SEC's Office of Oil and Gas in September 1972. The staff counsel stated that he had learned that officials of the Office of Oil and Gas were scheduled to meet with officials of Coastal States and their independent gas consultant and that he hoped some reconciliation might be worked out. The staff counsel also informed us that his request to attend the meeting with Coastal States was denied by SEC officials. SEC officials informed us that their policy is to permit persons other than SEC and company officials to attend such meetings if the company approves; however, the FPC official told us he wasn't given the option of seeking company approval to attend the meeting.

SEC officials stated that the joint study estimate (416 billion cubic feet) was not discussed at any length in their September 1972 meeting with Coastal States. Shortly after the meeting, SEC informed FPC that it believed that the estimate included in Coastal States' prospectus (10,090 billion cubic feet) was reasonable. An SEC official informed us that the 10,090 billion figure was SEC's major concern because it was the figure shown in the prospectus and the figure upon which prospective investors would evaluate the company.

In view of the fact that the 1,653 billion figure represented about 16 percent of Coastal States claimed reserves, we believe that a more detailed inquiry should have been made. We believe that further justification for a more detailed inquiry existed in that any discrepancy in the

South Texas figure would have directly affected the total gas reserves claimed by Coastal States, to the possible detriment of prospective investors.

On January 10, 1973, FPC approved a settlement agreement between South Texas and its customers. One of the effects of the settlement was to make additional gas available to Transcontinental, but at a higher price. The increased rate to be charged by South Texas was to offset the added costs South Texas would incur in obtaining additional gas. Also, in January 1973, Coastal States became a wholly owned subsidiary of a new corporation, Coastal States Gas Corporation.

On June 4 and 5, 1973, SEC officials met with representatives of Coastal States Gas Producing Company and its independent consultants to discuss the company's gas reserves. On June 5, 1973, SEC temporarily suspended trading in the securities of the new parent corporation, in part because of rumors concerning the accuracy of claimed gas reserves. Sometime after June 5, SEC officials attempted to reconcile the results of the joint reserve study (416 billion cubic feet) with the 1,653 billion cubic foot estimate computed by FPC from the supplementary data to Coastal States Gas Producing Company's October 1971 registration statement. By subtracting items believed to be omitted from the joint reserve study, SEC officials arrived at an estimate for South Texas gas reserves of 865 billion cubic feet. SEC officials told us, however, that they had no documentation supporting the figures given to SEC by FPC and could reach no firm conclusion as a result. In this regard, we found no indication that SEC ever tried to obtain the supporting documentation from either the companies or FPC and we were advised by FPC officials that SEC never informed FPC of the results of its attempted reconciliation.

On August 8, 1973, SEC temporarily suspended trading of Coastal States Gas Producing Company's first mortgage bonds, because of questions as to the Corporation's financial statements for fiscal years 1971 and 1972, and the accuracy of statements concerning available gas reserves.

Trading in all of the securities was resumed on September 26, 1973, after SEC and the companies reached a settlement whereby Coastal States agreed, among other things, not

to make untrue statements of material facts concerning transactions affecting deliverability and availability of natural gas. Also, Coastal States agreed to file full and more detailed data about their gas reserves and the deliverability of gas. In this regard, SEC officials emphasized to us that the reported gas reserves of Coastal States were never challenged by the SEC. Rather, SEC challenged the deliverability of the gas.

In a report to security holders dated September 12, 1973, Coastal States Gas Corporation stated that SEC had suspended trading because of rumors concerning the integrity of the reported gas reserves, even though SEC had for many years reviewed the company's gas reserves as a matter of policy. In the report, Coastal States Gas Corporation also stated that, as of May 1, 1973, it had reserves contracted to its Texas gas gathering operation of 9,379 billion cubic feet, of which 1,291 billion cubic feet were committed to the interstate market. A copy of this report was deposited with SEC. In August 1973, South Texas filed its 1972 Annual Report of Total Gas Supply with FPC which showed 556 billion cubic feet. Since SEC and FPC officials informed us that South Texas remains the only subsidiary in the Texas gathering operation of Coastal States Gas Corporation, it appears that the figures on file with SEC and FPC are still different.

On January 14, 1974, the FPC issued its final decision in the South Texas case. In its decision, FPC stated:

"The staff attempted to attack the 1972 joint study by showing the results of two independent studies made for South Texas, known as the Huddleston and Gruy reports. The Huddleston Report shows remaining recoverable reserves dedicated to Transco to be 1,652,563 MMcf as of June 30, 1971, while the Gruy report shows an amount of 723,889 MMcf as of September 30, 1971. The results of these studies were included in a prospectus filed by South Texas' parent, Coastal States Gas Producing Company, with the Securities and Exchange Commission. While it is clear that the Huddleston and Gruy results show larger amounts for reserves than the 415,942 MMcf found in the 1972 joint study, these reports were prepared for a different purpose and reflect unknown methods. The 1972 joint study was

prepared by the Reservoir Engineering Departments of both Transco and South Texas, its methods were discussed in the record; and there is nothing to detract from its results. We find no reason to believe that South Texas is depriving Transco of gas supplies by manipulation of the reserve figures." (Underscoring supplied.)

If SEC and FPC had better coordinated their efforts, perhaps more insight could have been gained into the basis for the different estimates.

CONCLUSIONS

We believe that FPC's Bureau of Natural Gas would be in a better position to understand the basis for differences that exist between the data in a prospectus and the data on file with FPC if the Bureau were provided the supplementary data available to SEC pertaining to a company's interstate operations. Since unexplained differences provide no assurance that either agency's data is accurate, we believe that SEC and FPC should jointly look into such matters.

In the instance involving Coastal States, where FPC had no record of receiving a prospectus, a follow-up by SEC would have disclosed this. FPC's new procedures, implemented in October 1973, should assist in this area because SEC is to (1) receive oral notification of the results of a review and (2) a follow-up written notification of adverse findings. We believe that SEC should initiate follow-up action if it receives no notification from FPC within a reasonable time since that would indicate a breakdown of the procedures.

We believe that the Coastal States case illustrates the potential benefits to be derived from close coordination, because, in our view, FPC had significant information to offer SEC.

AGENCY COMMENTS AND OUR EVALUATION

Comments on a draft of this report were received from SEC on January 30, 1974, (see app. I), and from FPC on February 1, 1974 and February 5, 1974, (see app. II).

A summarization of the agencies' comments as well as our analysis follows.

Securities and Exchange Commission

The Chairman of SEC stated that SEC agrees with the principle embodied in the suggestion that SEC and FPC should establish procedures and policies that would enable them to utilize the gas reserve data available to each other. However, he questioned whether reserve data available to one agency would be useful to the other because the data received by SEC and FPC is not directly comparable. He stated that he did not believe the report supported a conclusion that inadequate coordination existed between SEC and FPC, but expressed a willingness to discuss proposals for increased use of information with respect to gas reserves and proposals for more adequate energy-resource reporting with FPC, or with any other concerned agency of the U.S. Government.

The Chairman requested his staff to prepare a detailed response, which is also included in appendix I for your information. In the detailed response, SEC expressed the belief that their procedures to test the reasonableness of reserves are effective in obtaining appropriate disclosure of reserve information for the primary benefit of investors. SEC is not convinced that, after having made their examination, there is any material benefit to be derived by reference to or an attempted reconciliation of reserve figures presented in an administrative proceeding before the FPC, or by comparison to figures filed with the FPC. SEC believes that their procedures are adequate for obtaining appropriate disclosure of investor information in accordance with the Commission's statutory responsibilities.

Among other things, the comments also state that the report contains no factual support for the belief that the public interest would have been better served had the agencies worked together, and that, since the professional staff of SEC's Office of Oil and Gas satisfied itself with respect to the reasonableness of Coastal States' gas reserve estimates, there would have been nothing to be gained by having engineers and geologists from the FPC review the same data.

Federal Power Commission

The Chairman of the Federal Power Commission stated that FPC and SEC should use the public files of both agencies in coordinating natural gas reserves data and stated that FPC does this. He believed that the reconciliation of reserve figures would require statutory authority affording greater access to underlying data than is now provided in the acts administered by SEC and FPC.

FPC also submitted detailed comments in response to our draft report. In these comments FPC stated that our consideration of what FPC considers to be the basic issue of this review--whether FPC and SEC have a duty to reconcile varying gas reserve estimates filed with these two agencies--discloses a total lack of understanding of the nature of gas reserves estimates. They state that when estimates filed with the two agencies by the same company purport to represent approximately the same gas, FPC should assist SEC by advising it of discrepancies to the extent FPC can, consistent with its own priorities and responsibilities. FPC stated that the idea in the report that FPC should undertake to reconcile all gas prospectuses is not sensible.

Concerning the Coastal States situation, FPC stated that our draft report criticized FPC for not reconciling the figures filed with the FPC by South Texas with the figures filed with the SEC by Coastal States, and stated that FPC neither had the means nor the obligation to verify Coastal States' figures. Also the comments state that the SEC has never complained of inadequate assistance from FPC.

GAO evaluation

It appears that the comments of both agencies reflect a "we can do the job ourselves" attitude. In SEC's comments, for example, SEC states that in certain instances, comments by FPC would be of assistance, however, the responsibility for reviewing the filings is that of SEC and this responsibility cannot be shifted to the FPC. FPC, in its comment, stated that at no time has FPC sought the assistance of SEC in meeting FPC's responsibilities.

The subject of estimating gas reserves involves judgment and is not an exact science. We agree with FPC that

it is difficult. However, we believe that FPC's practice of merely advising SEC of a discrepancy without either agency looking into the basis for that discrepancy is not too much help to SEC and provides no assurance to FPC that its figure is reasonable. We would not expect a reconciliation to be an exact accounting for the differences between two estimates. However, we would expect the agencies to seek explanation for the differences between the estimates so that an informed judgment can be made as to the usefulness of the reserve data each has.

FPC is not correct in stating that it is the idea of the report that FPC should undertake to reconcile all gas companies' prospectuses filed with SEC with FPC gas reserves data. That idea is not ours. We were told by officials of FPC's Bureau of Natural Gas that they usually compared the gas reserve figures appearing in an SEC prospectus or registration statement with gas reserve figures appearing in the company's Annual Report of Total Gas Supply. In those instances where discrepancies are noted, the Bureau of Natural Gas attempted to reconcile the differences. If the figures could not be reconciled, SEC was merely informed of the discrepancies.

With respect to the Chairman of FPC's comment that reconciliation of reserves figures would require statutory authority affording greater access to underlying data than is now provided in the acts administered by these two agencies, we can only refer to information obtained from SEC. Most of the requests for information noted during our review were initiated by SEC, and much of the proprietary information to be exchanged would belong to SEC. SEC officials indicated that they would make such information available to FPC for good cause, and did not mention any legal restrictions that would impede such an exchange.

The section of the Natural Gas Act cited in FPC's detailed comments (15 U.S.C. 717g (b)) states the following:

"The Commission shall at all times have access to and the right to inspect and examine all accounts, records, and memoranda of natural-gas

companies; and it shall be the duty of such natural-gas companies to furnish to the Commission, within such reasonable time as the Commission may order, any information with respect thereto which the Commission may by order require, including copies of maps, contracts, reports of engineers, and other data, records, and papers, and to grant to all agents of the Commission free access to its property and its accounts, records, and memoranda when requested so to do. No member, officer, or employee of the Commission shall divulge any fact or information which may come to his knowledge during the course of examination of books, records, data, or accounts, except insofar as he may be directed by the Commission or by a court". (underscoring supplied)

Thus, it appears that the Commission already has the authority to authorize the exchange of proprietary information with SEC.

As it demonstrated in the report and in the comments of the two agencies, SEC and FPC arrived at independent decisions as to the courses of action they should take. In part, this was because the gas reserve estimates given the other agency were prepared on some unknown basis, while each agency completely understood the figures in its own possession. It still seems sensible to us, and in the public interest, to at least determine that the data possessed by one agency doesn't disclose deficiencies in the data possessed by the other. To us, this is only a logical extension of FPC's existing attempts at reconciliation of reserve figures.

We realize that SEC and FPC received different data for different purposes and that one agency may not need all the data received by another. We also realize that neither agency can delegate its responsibilities to the other. It appears to us, however, that SEC and FPC could reduce the burden of these responsibilities somewhat by sharing the information that is available to one another. When differences in reserve figures occur, it would seem that SEC and FPC should work together to seek explanation for that difference--for their mutual benefit and for the benefit of the public they represent.

As noted earlier, at the time our review was conducted, the SEC officials were unaware of the nature of the gas reserve data filed with the FPC. Nevertheless the SEC has taken an adamant position that there is nothing to be gained by providing the FPC with supplementary gas reserve data.

If, as the SEC contends, the gas reserve figures reported to the two agencies are so fundamentally different that a comparison of the data supporting a prospectus with that on file at the FPC cannot be expected to provide any meaningful information to either agency, then the FPC would seem compelled to reevaluate its procedure with the view to eliminating what might be termed an inherently unproductive procedure.

However, a follow-up at the Bureau of Natural Gas showed that the Bureau is proceeding as before--attempting to reconcile the reserve figures in a prospectus with those on file with FPC. We believe that this process could be substantially strengthened were the FPC provided the supplementary data SEC receives.

If this were tried and proved to be of little or no value, it could always be terminated. This, to us, seems a better alternative than rejecting the idea without trying it.

RECOMMENDATIONS

To assist FPC in its review of prospectuses, we recommend that the Chairman of SEC direct the Division of Corporation Finance to provide the FPC with the supplementary gas reserve data it receives pertaining to interstate operations when submitting prospectuses to FPC for review and comment.

We also recommend that the Chairmen of the FPC and SEC jointly evaluate the results achieved to serve as a basis for determining the need to continue or eliminate the practice.



SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

January 30, 1974

Mr. Robert A. Peterson
 Assistant Director
 General Government Division
 United States General Accounting Office
 Washington, D. C. 20548

Dear Mr. Peterson:

Thank you for your letter, dated December 21, 1973, enclosing copies of your proposed report to Congressman Gonzalez dealing with coordination between our agency and the Federal Power Commission. I am grateful for the opportunity to consider and comment upon the proposed report and for the time and attention made available for the numerous conferences and other conversations with our staff. We directed our staff to cooperate fully in your inquiry, and we continue to desire to cooperate with the General Accounting Office in all practicable ways.

I have requested our staff to prepare a detailed response, which is enclosed, and to which I would add only these general comments.

The principal thrust of your proposed report is that inadequate coordination between the FPC and the SEC may have resulted in some detrimental effect on the public interest, particularly in connection with certain matters involving Coastal States Gas Corporation and its subsidiary, South Texas Natural Gas Gathering Company. The report suggests that the FPC and the SEC should establish procedures and policies that would enable them to utilize the gas reserve data available to each other.

We agree with the principle embodied in this suggestion, but it raises the question whether the reserve data available to one agency would be useful to the other. The answer to this question is complicated by the fact that historically and currently the FPC and SEC ask for and receive gas reserve data on different bases and for different purposes. The result in any given situation is that the data received by the respective agencies is not directly comparable; for example, we understand that the FPC requires information concerning gas reserves dedicated to certificated purchasers to be reported on Form 15, "Annual Report of Gas Supply." This agency requires reserve information to be reported only if it is material to an investment decision. Furthermore, the method of determining estimates of gas reserves as required by the FPC differs in significant technical respects from the method required by us. Accordingly, comparison

Robert A. Peterson

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of the figures in an FPC report on Form 15 filed by an interstate gas transmission company reflecting dedicated certificated reserves with those filed by its parent in a Securities Act registration statement reflecting all the reserves in which the parent has an interest would result in little, if any, benefit to investors. Moreover, it does not appear that the estimates reported on Form 15 would assist our engineers in evaluating other estimates.

I am unable to concur in the report's conclusion that the public interest has been impaired by any action or inaction on the part of this agency. I believe that the review procedures of our staff, as outlined in its attached response, provide adequate machinery to accomplish the statutory purposes of this agency. Moreover, I believe the Commission has acted effectively in the public interest and in accordance with its responsibilities in the trading suspension and injunctive action involving Coastal States Gas Corporation.

As I have indicated, I do not believe the report supports a conclusion there exists inadequate coordination between the SEC and FPC. However, we are prepared to discuss with the FPC, and any other concerned agency of the U. S. government, proposals for increased use of information with respect to gas reserves or other energy sources and proposals for more adequate reporting with respect to energy resources.

Again, I wish to thank you for the opportunity to review and comment on your proposed report to Congressman Gonzalez. I hope my comments are useful.

Sincerely,



Ray Garrett, Jr.
Chairman

Enclosure

MEMORANDUM IN RESPONSE TO GAO DRAFT LETTER
DATED DECEMBER 21, 1973, PREPARED BY
DIVISION OF CORPORATION FINANCE

As a basis for comment on the assertions and conclusions contained in the GAO draft letter, we believe it would be helpful initially to present briefly certain factual information with respect to the topics under Parts I, II, and III below:

- I. SEC'S DISCLOSURE REQUIREMENTS AND PROCEDURES FOR REVIEW OF FILINGS BY COMPANIES ENGAGED IN THE NATURAL GAS INDUSTRY
- II. INFORMATION FURNISHED TO THE FPC RELATING TO GAS RESERVES
- III. COASTAL STATES GAS CORPORATION
 - A. Proceeding before the FPC Relating to South Texas and Transco.
 - B. South Texas Reserves in FPC Hearing and in Form 15 Filed with FPC.
 - C. Coastal States Reserves in Filings with the SEC
 - D. SEC Recommended Action with Respect to Coastal States Gas Corporation.
- IV. SPECIFIC COMMENTS ON GAO DRAFT LETTER

Throughout this memorandum, "Coastal States" refers to Coastal States Gas Corporation; "Transco" refers to Transcontinental Gas Pipe Line Corporation; and "South Texas" refers to South Texas Natural Gas Gathering Company.

I. SEC'S DISCLOSURE REQUIREMENTS AND PROCEDURES FOR REVIEW OF FILINGS BY COMPANIES ENGAGED IN THE NATURAL GAS INDUSTRY.

A. Requirements for Disclosure of Information Concerning Natural Gas Reserves

The disclosure requirements under the Securities Act of 1933, particularly Section 7 and Schedule A thereof, form the statutory basis for the Commission's disclosure requirements applicable to all registrants, including those engaged in the natural gas industry. The Securities Act does not expressly require that the Commission become a depository of information concerning the natural gas reserves in which these companies may have an interest. However, the Commission has adopted registration forms and guidelines pursuant to the broad authorization in the Securities Act to require information material to present or potential investors in companies offering their securities to the public, and certain of these registration forms and guidelines require disclosure of natural gas reserves by companies that have such reserves in a material amount (Form S-1, Item 10, Description of Property, Instruction 2; Form S-7, Item 5(a), Business; Form S-11, Item 19, Recoverable Gas in Tract; and Guides for Preparation and Filing of Registration Statements, Guide 28, Extractive Reserves.) 1/

1/ In addition, Form 10, the form for initial registration of securities, of publicly-held companies under the Securities Exchange Act of 1934, also requires disclosure relating to natural gas reserves in Item 3, Property, Instruction 2. Other registration forms under the Securities Act such as Form S-16, which is available for registration of securities to be offered in certain secondary transactions, and Form S-8, which is available for registration of securities to be offered pursuant to certain employee plans, do not require disclosure of natural gas reserves. The Commission's reporting forms under the Exchange Act (for example Form 10-K, the annual report form in general use) do not require disclosure of natural gas reserves, although registrants may voluntarily include such reserves. Registrants voluntarily also may include natural gas reserves in the reports they send to their security holders, although there is no specific requirement under the Exchange Act that they do so.

The Commission requires disclosure of extractive reserves, including natural gas reserves, in these registration forms in order to provide information material to investors in determining whether to buy, hold or sell securities.

Although the Commission has not published specific guidelines defining reserves, its staff generally follows widely accepted definitions of that term. For example, the Commission's amicus curiae brief in Sunray DX Oil Co. v. Helmerich & Payne, Inc. (C.A. 10, July 12, 1968) CCH Fed. Sec. L. Rep., '67-'69 Decisions para. 24,151.205 contained (p. 6) the following statements related to oil reserves which is also applicable to natural gas reserves:

"The Commission has always been very careful in its scrutiny of statements on oil reserves because their proper evaluation requires a type of knowledge seldom possessed by those outside of the petroleum industry. "Reserves" is the term used to describe oil which has not yet been produced, or lifted from the ground, but which, it is thought, can feasibly be produced. Because there is no way of measuring precisely the amount of oil in any given area or the amount of it which can be lifted, other than by actually producing it, any statement on reserves is necessarily only an estimate or a prediction of how much oil can be produced."

That brief includes two (1968) acceptable definitions of "proved" reserves. As indicated by the following discussion, the staff presently finds acceptable another definition of proved reserves which is generally followed by the industry.

The SEC staff, in administering federal disclosure requirements, generally follows the definition for "proved reserves" set forth in "Reserves of Crude Oil, Natural Gas Liquids, and Natural Gas in the United States and Canada and the United States Productive Capacity as of December 31, 1971," Volume 26, May 1972, published by the American Gas Association, the American Petroleum Institute and the Canadian Petroleum Association.

In general, the term "proved reserves" means the current estimated quantity of natural gas and natural gas liquids which analysis of geologic and engineering data demonstrate with reasonable certainty to be recoverable in the future from known oil and gas reservoirs under existing economic and operating conditions. Reservoirs are considered proved if they have a demonstrated ability to produce by either actual production or conclusive formation test. The area of a reservoir considered proved is that portion delineated by drilling and defined by gas-oil, gas-water contacts or limited by structural deformation or lenticularity of the reservoir. In the absence of fluid contacts, the lowest known structural occurrence of hydrocarbons controls the proved limits of the reservoir. The proved area of a reservoir may also include the adjoining portions not delineated by drilling but which can be evaluated as economically productive on the basis of geological and engineering data available at the time the estimate is made. Therefore, the reserves reported to the Commission include total proved reserves which may be in either the drilled or the undrilled portions of the field or reservoir.

The appropriate disclosure of information relating to reserves is subject to reconsideration based on experience with the informational needs of investors. For example, in the Sunray DX case, the issue was whether it was a violation of the antifraud provisions of the Commission's proxy rules not to disclose "possible" oil reserves in a merger proxy statement. The Court concluded that the proxy statement was not misleading. This position has been criticized by several knowledgeable authorities and their views are presently under consideration by the staff. Further, as indicated by discussion of the Coastal States case, the Commission has determined that in certain circumstances disclosure of reserves in the absence of information

concerning the deliverability of those reserves may be misleading. The staff is currently developing guidelines to reflect this general conclusion.

B. Review Procedure

The Division of Corporation Finance's review function is performed by Branches of Corporate Analysis and Examination. These branches review the filings by companies engaged in the natural gas industry as they would any other type of filing, but reserve information included in the filings generally is referred to the Division's Office of Oil and Gas for review by the professional staff of that Office as to the reasonableness of the reserve estimates.

In reviewing reserve estimates, the Office of Oil and Gas may request supporting data and explanation from the registrant and any consultant who may have reported on reserve estimates. Such data is supplied as supplemental information and not as part of the registration statement or any other public filing with the Commission. This data is produced voluntarily by the registrants in order to assist the staff in its review process. It is often voluminous and highly technical and may contain information of a proprietary nature which would be of commercial value to the competitors of the registrant. For all of the foregoing reasons, this material is not placed in the public files of the Commission. Very little of this material is retained by the staff after it has satisfied itself as to the reasonableness of the reserve data for which this information serves as a basis. The material is returned to the registrant, or, indeed, taken by representatives of the registrant after informal conferences with the staff. The Commission neither has the statutory responsibility nor the proper facilities for maintaining this voluminous supplementary data.

The determination of the reasonableness of the reserve estimate included in a prospectus is generally based upon a lease by lease review of information used by the registrant or the consultant in arriving at the

estimate. This review may entail the examination of lease and well pressure decline curves, pressure versus cumulative gas production curves, or other types of decline curves, production information or volumetric calculations, maps, electric logs and formulas.

The obligation to make full and fair disclosure responsive to the disclosure requirements adopted by the Commission under the Act is that of the registrant and not of the Commission's staff. Registrants failing to make full and fair disclosure are subject to civil liability and, if the failure is willful, to criminal penalties. The Commission's staff does review the disclosure in registration statements to provide some assurance of the adequacy of the information available to the public in order to determine whether to advance the effective date of a registration statement pursuant to Section 8 of the Act. These review procedures do not duplicate the work of the issuer or its consultant, and our permitting the registration statement to become effective does not constitute a guarantee or even an endorsement of the reasonableness of the stated estimates of proved reserves. Even these procedures may be curtailed in accordance with publicly announced staff review policies.

C. Transmittal of Prospectuses to the Federal Power Commission

In connection with reviewing filings by companies engaged in the natural gas industry, the Division of Corporation Finance generally transmits, by letter, copies of the prospectuses of companies subject to the jurisdiction of the Federal Power Commission to that Commission in order that it may review the prospectus and comment thereon. This procedure was

codified in an internal memorandum dated February 17, 1971, later superseded by an internal memorandum dated August 2, 1971. Those memoranda indicate that the transmittal letter to the FPC should provide a target date for comments and pinpoint any particular area in which the staff may have questions. Contrary to the GAO draft report, in no instance of which we are aware has the staff requested the FPC specifically to address itself to the question of the reasonableness of the reserve data in a registration statement. Since the Commission has its own professional staff to make such determinations, it has not found it necessary to make such requests or to transmit supplemental data to the FPC to assist the FPC in making such determinations.

This is not to say that comments from the FPC would not be of assistance to the staff in reviewing registration statements of companies engaged in the natural gas industry. For example, the registration statement may refer to the FPC and actions it may have taken or proceedings pending before it. In such instances, comments by the FPC as to the accuracy of such information would be of assistance. However, the responsibility for reviewing the filings is that of the SEC and this responsibility cannot be shifted to the FPC. The SEC, or its staff pursuant to delegated authority, must make the final determination as to the compliance with the disclosure requirements by the registrant. A part of this determination involves consideration of the time limit involved in public financing and the need to avoid delays whenever possible. In this connection the staff, except where there may be a specific reason for doing so, might not wait for comments from the FPC beyond a given target date, nor would it find it necessary to follow up on prospectuses referred to the FPC.

II. INFORMATION FURNISHED TO FPC RELATING TO GAS RESERVES

It is our understanding that the FPC receives gas reserve data from three principal sources.

First, the FPC may receive reserve data from gas producers in conjunction with individual cases or rule making proceedings subject to an understanding that such information, which may have significant commercial value, will not be made public. Although the FPC might not make the data available to the SEC staff to assist in its review of a pending registration statement, the SEC could request such material directly from the company.

Second, the FPC may obtain gas reserve data in connection with formal proceedings involving proposals for interstate sales of natural gas, gas pipeline construction, expansion or abandonment.

Third, gas pipeline companies file annual reports with the FPC, which are available for public inspection and contain gas reserve data. It is our understanding that such reports on FPC Form 15, "Annual Report of Gas Supply", are required to be filed only by certain companies engaged in interstate gas operations and that the information with respect to reserves is required to be furnished only with respect to "dedicated reserves." "Dedicated reserves" are defined as the volume of recoverable salable gas reserves which are committed to, controlled by, or possessed by the reporting pipeline company and used for acts and services for which both the seller and the company have received certificate authorization from the FPC.

Further, we understand that for purposes of reporting to the FPC on Form 15, "recoverable proved reserves" are defined as the estimated quantities of certificated natural gas which geological and engineering data demonstrates with reasonable certainty to be recoverable in the future from known natural oil and gas reservoirs under existing economic and operating conditions. (See Definition 23 to FPC Form 15).

In contrast to the FPC reporting requirements, the SEC disclosure requirement with respect to natural gas reserves, referred to herein, relates to total proved gas reserves owned or committed to a publicly-owned company. Such a company may own natural gas properties not dedicated and certificated by the FPC, or it may control a gas pipeline subsidiary required to report to the FPC but may not itself be subject to the reporting requirements of the FPC. For example, Coastal States reports the total proved reserves of itself and its subsidiaries, including South Texas, to the SEC, but not to the FPC, while South Texas Reports only its dedicated certificated reserves to the FPC.

III. COASTAL STATES GAS CORPORATION

A. Proceeding Before The FPC Relating To South Texas And Transco

As noted in Part II above the FPC frequently receives gas reserve data in formal proceedings including proposals relating to interstate sales of natural gas, gas pipelines, construction, expansion or abandonment. One such proceeding involved South Texas, a subsidiary of Coastal States, and Transco, a customer of South Texas. The proceeding was, to some extent concerned with the gas reserves of South Texas.

It is important to emphasize at this juncture, however, that the reserve estimates at issue were those only of South Texas, the reporting entity at FPC and not those of Coastal States, its parent, the reporting entity at the SEC. Moreover, it should be noted that the gas reserves of South Texas represent only a small portion of Coastal States, total reserves.

Background

The FPC issued an order on July 23, 1969 which authorized, among other things, the sale of increased volumes of natural gas to Transco at a set rate pursuant to a contract between the two parties as well as the construction and operation of facilities to transport that gas.

On April 2, 1971, South Texas filed a motion with FPC that asked that it be permitted to abandon certain facilities which were ordered installed pursuant to the July 23, 1969 order. To support such a request, South Texas asserted that the additional volumes of gas that it had anticipated would be available for delivery to Transco had not materialized and that the total reserves dedicated to Transco from a certain Field would not enable the delivery of the additional gas. In this, Transco agreed with South Texas.

The Hearing

On January 27, 1972, the FPC issued an order calling for a hearing on the issues of (1) abandonment, (2) rates and other charges collected by South Texas, and (3) matters concerning transportation or delivery of natural gas by South Texas.

South Texas presented a settlement agreement on October 6, 1972 that was not opposed by any party except the staff of FPC. By order dated January 10, 1973 the FPC approved the settlement.

On January 13, 1973, the Administrative Law Judge in the FPC proceeding issued his Initial Decision wherein it was found that South Texas was not in violation of the Natural Gas Act.

The Administrative Law Judge in noting that the Commission (FPC) settled the issue of abandonment in the parent case, determined, among other things, that while South Texas deliveries to Transco have drastically declined, South Texas had not made a partial abandonment of service as contended by the staff, in violation of Section 7(b) of the Natural Gas Act or any other sections of the Act.

The FPC's staff filed exceptions to this initial decision on February 16, 1973.

On January 14, 1974, the FPC issued its final decision in the case in which it found that the FPC's staff failed to show that South Texas had partially abandoned its sale to Transco. In its decision, Opinion No. 683, the FPC stated:

"The staff attempted to attack the 1972 joint study by [of South Texas and Transcontinental Pipeline Company of America] showing the results of two independent studies made for South Texas, known as the Huddleston and Gruy Reports. The Huddleston Report shows remaining recoverable reserves dedicated to Transco to be 1,652,563 MMcf as of June 30, 1971, While the Gruy Report shows an amount of 723,889 MMcf as of September 30, 1971. The results of these studies were included in a prospectus filed by South Texas' parent, Coastal States Gas Producing Company, with the Securities and Exchange Commission. While it is clear that the Huddleston and Gruy results show larger amounts for reserves than the 415,942 MMcf found in the 1972 joint study, these reports were prepared for a different purpose and reflect unknown methods. The 1972 joint study was prepared by the Reservoir Engineering Departments of both Transco and South Texas, its methods were discussed in the record; and there is nothing to detract from its results. We find no reason to believe that South Texas is depriving Transco of gas supplies by manipulation of the reserve figures."

B. South Texas Reserves in FPC Hearing and in Forms 15 Filed with FPC

We understand that in the proceeding before the FPC, exhibits were introduced which display three estimates for gas reserves dedicated to Transco through commitments by the owners of the properties to South Texas. These estimates were set forth on a comparative table captioned, "Remaining Recoverable Reserves Dedicated to Transco and South Texas", namely, an estimate prepared by the joint study of 415,942 million cubic feet; an estimate prepared by H. J. Gruy & Associates in the amount of 723,000 million cubic feet; and an estimate prepared by Huddleston in the amount of 1,652,563 million cubic feet. (See Exhibit 85 received in the record July 6, 1972, Docket CP67-349.) Exhibit No. 86 captioned, "Remaining Recoverable Reserves Dedicated to Transco by Contract", presents similar information with reserve estimates ranging between 333,151 million cubic feet and 1,636,323 million cubic feet.

The FPC staff has had in its possession the consultants' detailed reports prepared in support of the various gas reserve estimates. These back-up documents were identified in the proceedings as Exhibits 74 through 84 but were not received into the record. Also, in connection with the proceeding the FPC staff had subpoena power to require the testimony of persons who prepared the estimates to elicit such testimony as might be useful in resolving the apparent differences in the various estimates; however, none of these persons were called to testify for that purpose. Nor was testimony elicited from FPC's own technical experts concerning the exhibits. In that connection, it should be noted that the draft GAO letter states that

the staff of FPC's Bureau of Natural Gas informed counsel for the FPC staff that the joint study estimate appeared to be technically correct. Notwithstanding this, however, staff counsel urged in its brief that the Administrative Law Judge accept, and in essence, hold South Texas to the higher Huddleston figure.

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In the course of this proceeding, Matthew S. Muratta, an engineer in the employ of South Texas testified with respect to reserve estimates for the McAllen Ranch Field. (Record: Docket No. CP67-349, Vol. 14-17, 1441-1803). He testified that the original recoverable reserve estimates as reported in the company's Form 15 entitled "Annual Report of Natural Gas Supply" reports for the years 1963 through 1971 were:

<u>YEAR ENDING</u>	<u>ORIGINAL RECOVERABLE RESERVES</u>	
	<u>MMCF</u>	
	<u>14.65 psia</u>	<u>14.73 psia</u>
12-31-63	480,000	477,393
12-31-64	480,000	477,393
12-31-65	480,000	477,393
12-31-66	480,000	477,393
*12-31-66 (CP67-349)	1,638,420	1,629,522
12-31-67	1,622,815	1,614,001
12-31-68	1,545,407	1,537,014
12-31-69	1,067,104	1,061,309
12-31-70	862,151	857,469
12-31-71	491,834	489,163

*This estimate reflects the additional McAllen Ranch Field dedications included in Exhibit "H" and subsequent Forms 15.

C. Coastal States Gas Reserves In Filing With The SEC1933 Act

On October 15, 1971 a registration statement filed by Coastal States Gas Producing Company, No. 2-41931, became effective under the Securities Act of 1933. The prospectus set forth the gas reserves dedicated to gathering operations, in millions of cubic feet, at June 30 of each year as follows:

1969	9,467,929
1970	9,901,974
1971	10,090,695

Under date of December 7, 1971 another registration statement of the company, No. 2-42357, became effective containing the same reserve information.

1934 Act

For a number of years the Coastal States annual reports to security holders have set forth selected statistics for each of the prior ten years including gas reserves dedicated to gathering operations. The estimates of gas reserves are based upon reports by independent oil and gas consultants. The amount of gas reserves dedicated to gathering operations, in millions of cubic feet, as of June 30 of each year, are:

1969	10,667,929
1970	11,101,974
1971	11,290,695
1972	11,691,435

In each year 1,200,000 million cubic feet for probable reserves are included. Deduction of such amounts brings these estimates into agreement with those set forth in the company's registration statements. Copies of these reports were sent to each shareholder of the company, reported to number approximately 16,000 as of June 30, 1972, as well as to others in the financial community.

APPENDIX I

Copies of these reports are also deposited in the Coastal States public files at the SEC. Under date of November 28, 1972 the company issued a proxy statement which set forth gas reserves as of June 30, 1972. The number is the same as in the shareholders report except that it estimates the "probable" reserves. Coastal States has also filed with the SEC annual reports on Form 10-K for 1971 and 1972 which set forth information with respect to gas reserves.

In 1973 the company changed its fiscal year from June to December. No annual report to shareholders for December 1973 was issued. The company issued a "Special Report to Security Holders--Six Months Ended June 30, 1973" which sets forth the following:

The May 1, 1973 Huddleston report and supplements thereto show the breakdown of reserves by commitment category as of May 1, 1973 as follows:

GAS RESERVES IN BILLIONS OF CUBIC FEET

	Proved		Probable	Total
	Producing	Non-Producing		
Interstate Commitment	646	645	50	1,341
Specific Contract Commitments	105	5		110
Transportation	2,188	143		2,331
Isolated Systems	50	191		241
System Uncommitted	3,798	1,608	1,150	6,556
Totals	6,787	2,592	1,200	10,579

Reserves represent gas recoverable from a reservoir. The rate at which the gas can be removed from a proved producing property--the availability rate--is influenced by a number of factors, most of which are beyond the Company's control. These include conservation regulations of the Texas Railroad Commission and other regulatory agencies, the producers right to control prudent operation of his wells and leases, the mechanical operation of equipment, weather conditions, the ability of wells to deliver gas of pipeline quality and pressure, development of new producing technology, and the unpredictable decline in production from specific wells. At times, the Company is able to supplement availability by purchases of short-term supplies from others.

SEC REVIEW OF ESTIMATES

The SEC Office of Oil and Gas has reviewed the estimates of reserves mentioned above and the consultant's detailed information which support the estimates. Such reviews occurred prior to use of the estimates for 1969, 1970, 1971 and 1972. The review of the 1973 estimate was made after its use. The Office of Oil and Gas states that it has found no ground to recommend action to the Commission with respect to such estimates.

D. SEC Action with Respect to Coastal States Corporation

On June 5, 1973 the Commission announced the temporary suspension of trading in the securities of Coastal States for a ten-day period. The Commission indicated that it had initiated the suspension because of the circulation of rumors concerning the accuracy of Coastal States' stated gas reserves, deliverability of gas under existing conditions and for other reasons. The Commission, at successive ten-day intervals, issued additional temporary suspension orders.

On September 11, 1973 the Commission filed a complaint against Coastal States and others in the United States District Court, Houston, Texas. The complaint alleged, among other things, that in connection with public statements by representatives of Coastal States relating to the availability of reserves to meet long-term contractual commitments and the ability of Coastal States to increase its reserves during time of material shortages, defendants omitted to disclose that they had entered into transactions which effected the deliverability and availability of gas, the earnings and profitability of Coastal States and other matters. Contemporaneously with the filing of the complaint, the defendants, without admitting or denying the allegations in the complaint, consented to a permanent injunction from violating the anti-fraud periodic reporting provisions of the Federal securities laws. The court also ordered that the then existing board of directors of Coastal States be increased from 10 to 13 and 6 new independent members, satisfactory to the Commission, be designated by the court and elected by the board. In addition, the court ordered the establishment of a new independent executive committee and a new independent audit committee, with the executive committee authorized

to retain independent legal counsel at Coastal States' expense. The order further provided for a special review by Coastal States' independent auditors and a report to the Commission as to the results of that review and that Coastal States mail a special report to its security holders advising them of the foregoing actions and of information as to Coastal States' gas reserves and the availability thereof. Such a report was mailed on September 13, 1973, and the Commission lifted the suspension of trading effective September 26, 1973. In summary, for a period of approximately 4 months, the Commission, in the public interest, kept the securities of Coastal States suspended from trading while in the opinion of the Commission the information relating to Coastal States available to the public was inadequate. The Commission also took legal action to cause disclosure of adequate information concerning Coastal States to the public and to install new and responsible management for Coastal States.

IV. SPECIFIC COMMENTS ON GAO DRAFT LETTERA. Coordination Between the Agencies

The basic thrust of the GAO letter is that inadequate coordination exists between the SEC and the FPC with respect to natural gas reserve data received by the two agencies; that this lack of coordination may in some way be detrimental to the public interest; and that the two agencies should develop procedures to better utilize the information filed with each other. GAO attempts to illustrate and buttress these conclusions by reference to circumstances surrounding the two agencies' activities with respect to Coastal States Gas Corporation and its subsidiary, South Texas. In summarizing a section of the report captioned, "Lack of Effective Coordination" GAO concludes:

It appears to us that, given the difference in the regulatory roles of the two agencies, it could be to the advantage of a company to present different gas reserve pictures to the SEC and FPC. When a difference in the amount of gas reserves claimed is disclosed, it would seem that the public interest would be better served if the agencies resolved the differences.

In order to properly evaluate the report and its conclusions, it is necessary first to analyze its factual content. When subjected to close analysis, such factual content is limited to (1) the fact that differing gas reserve figures for South Texas appeared in various places including an FPC proceeding, in filings with the FPC, and in filings with the SEC,

or were brought to the attention of members of the staffs of either or both agencies and (2) that members of the staff of both agencies did or did not do certain things in the performance of their duties regarding Coastal States and South Texas. We believe that to jump from these simple factual recitations to the conclusion stated in the report is clearly unwarranted.

With respect to the assertion that it could be to the advantage of a company to present different gas reserve pictures to the SEC and FPC, we believe this point is adequately dealt with in the FPC opinion of January 14, 1974 where after the differing reserve figures of South Texas as noted, it is stated: "We find no reason to believe that South Texas is depriving Transco of gas supplies by manipulation of the reserve figures."

As to the need for resolution of differences the procedures utilized by the Commission to test the reasonableness of reserves are set forth in Part I hereof. We believe these procedures to be effective in obtaining appropriate disclosure of reserve information for the primary benefit of investors. As noted, these procedures involve lease-by-lease examination and reference to back-up geological data. We are not convinced that having made such examination that there is any material benefit to be derived by reference to or an attempted reconciliation of reserve figures presented in an administrative proceeding before the FPC or by comparison to figures filed with the FPC. Insofar as benefits may be derived from coordination with the FPC, we believe the provisions for this program outlined in Part I above are adequate for obtaining appropriate disclosure of investor information in accordance with the Commission's statutory responsibilities.

B. SEC Action Relating to Coastal States Gas Corporation

The GAO report contains a section captioned "A CASE STUDY OF THE NEED FOR INTER-AGENCY COOPERATION." Under this caption the GAO report discusses the proceeding before the FPC involving Coastal States' subsidiary, South Texas and the SEC's action in reviewing reports filed by Coastal States and in suspending trading in the securities of Coastal States and its subsidiaries and in filing an injunctive action against Coastal States and others. The GAO report makes a point that the SEC and the FPC received differing data on natural gas reserves of Coastal States and South Texas and asserts that the SEC and FPC "failed to coordinate or cooperate in their objective efforts to determine the true picture as to Coastal States' and South Texas' gas reserves." The report further concludes that the GAO is "unable to determine the effect that the lack of cooperation and coordination had in this particular situation." Nevertheless, the report indicates that the GAO is "convinced" "that the public interest would have been better served had the agencies worked together." However, the report contains no factual support for this expressed conviction.

1. SEC Action with Respect to Coastal States.

With respect to the filings made by Coastal States with this Commission specifically the gas reserve estimates included in those filings, the professional staff of the Office of Oil and Gas satisfied itself with respect to the reasonableness of such estimates. In our opinion there would have been nothing to be gained to have engineers and geologists from the FPC review the same data. The fact that the FPC received different reserve estimates, from a different entity (South Texas), prepared on different bases, by a different person, for a different regulatory purpose is irrelevant.

When it became apparent to the SEC that statements were being made with respect to the business and operation of Coastal States which in the opinion of the SEC were materially misleading the SEC took effective action to protect the public interest, including suspending the securities of Coastal States from trading for a period of approximately four months, obtaining a permanent injunction against Coastal States and certain of its officials, which prohibited future violations of the securities laws, and to install new management for Coastal States. It should be noted that during the course of this litigation the Commission at no time challenged the reasonableness of the reserve data filed with it. We believe that the Commission's action in Coastal States was in the public interest, and that nothing would have been gained by consulting with the FPC in connection with these actions.

2. Proceeding Before the FPC

At no time during the proceeding before the FPC did the FPC request the SEC to intervene or to assist the FPC in connection with that proceeding. The FPC staff had available to it all of the information with respect to the reserve data filed with the SEC which was available to the SEC. The FPC has a competent professional staff, and, unless specifically requested by the FPC, it would not have been appropriate to divert the attention of the SEC's limited staff to assist the FPC.

FEDERAL POWER COMMISSION
WASHINGTON, D. C. 20426

OFFICE OF THE CHAIRMAN

February 5, 1974

Mr. Robert A. Peterson
Assistant Director
General Government Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Peterson:

In reply to your letter of February 1, 1974, concerning this agency's response to your request for comment on the draft letter report to Congressman Gonzalez, please be advised that the letter signed by Mr. Forquer, our General Counsel, was submitted as a comprehensive commentary on your staff's draft letter intended to be useful in the preparation of your final letter report. I endorse Mr. Forquer's comprehensive comment.

The Federal Power Commission and the Securities and Exchange Commission should use the public files of both agencies in coordinating natural gas reserves data filed with these agencies. This has been the practice insofar as the Federal Power Commission is concerned. However, the reconciliation of reserves figures prepared for different purposes under different assumptions requires much more detailed examination and would require statutory authority affording greater access to underlying data than is now provided in the acts administered by these two agencies.

Mr. Maxson, our Executive Director, accurately advised your staff located at the Federal Power Commission that the delay in forwarding this agency's comment on the draft

Mr. Robert A. Peterson

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letter was caused by my insistence upon a complete commentary which would assist your agency in preparing its final report. During the course of your review and the FPC General Counsel's preparation of comment thereon, the South Texas case was pending before the Commission, and the Commission order was not issued until January 14, 1974. Accordingly, you can appreciate that I would not be in a position to comment on a case before the Commission and subject to possible rehearing. The General Counsel is in the best position to comment on such matters, as he has done in this case. I defer from comments on matters relating to litigated proceedings because the staff of this Commission has direct knowledge of what transpired. In my quasi-judicial capacity and because of the principle of separation of functions it would be inappropriate for me to re-examine the details of what may have transpired outside the record in litigated proceedings. In my capacity I act on appeals from initial decisions. The members of the Federal Power Commission do not try the cases.

Your letter states that the purpose of your request for comments on the proposed letter report is to provide the Congressman an opportunity to read the views of those having overall responsibility for the activities discussed in GAO report. I affirm Mr. Forquer's comments as my official position regarding your draft letter report furnished on December 21, 1973, as to the procedures relating to coordination between the Federal Power Commission and the Securities and Exchange Commission. Such coordination has been the policy of this Commission since I became Chairman. However, I must rely upon Mr. Forquer's detailed summary of the particular South Texas Natural Gas Gathering Company proceeding. You will note that the first review of South Texas reserves occurred in 1968 before I became Chairman.

As for your reference to the cooperation extended by the Federal Power Commission to the GAO staff, not only have I pledged the cooperation of my office but in all fairness you must recognize that there has been complete cooperation

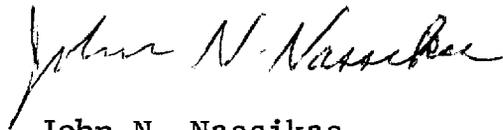
Mr. Robert A. Peterson

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with the GAO personnel whom you have stationed with this agency. During the period that they have occupied offices here many man-years of FPC staff time have been spent in efforts to assist your investigations. As for your dissatisfaction with the style of Mr. Forquer's letter, I suggest that it is quite apparently a considered evaluation of your staff's draft letter report intended only to overcome the inadequacy of that draft letter report. While Mr. Forquer's commentary may be lengthy, oversimplification of reserves analyses is misleading and this Mr. Forquer found to be the basic deficiency of the draft letter report.

Since I endorse Mr. Forquer's comprehensive comment, I respectfully request that it be appended to this letter as part of my report. Your letter indicates that you would be amenable to receiving comments limited to the main issue in the draft letter report, which you characterize as the coordination of gas reserves data between the Federal Power Commission and the Securities and Exchange Commission. Since the main issue is clouded by the several peripheral issues raised in the draft letter, you can readily understand my insistence that Mr. Forquer's comment be considered the official response to your request for comment.

Very truly yours,



John N. Nassikas
Chairman

Enclosure

Ltr of 2/1/74 from Leo Forquer, FPC
General Counsel, to Robert A. Peterson

GENERAL COUNSEL
FEDERAL POWER COMMISSION

FEB 1 1974

Mr. Robert A. Peterson
Assistant Director
General Government Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Peterson:

By letter of December 21, 1973, you have submitted to the Federal Power Commission for comment a Draft Letter Report to Congressman Henry B. Gonzalez reviewing "the dealings of the Coastal States Gas Producing Company with the Securities and Exchange Commission and the Federal Power Commission." The Federal Power Commission of course has no "dealings" with Coastal States or any other company. The FPC fulfills its regulatory responsibilities by requiring jurisdictional companies 1/ to file formal applications for required authority with respect to certificates, rates, and other matters and renders formal decisions on those applications on a public record.

The draft report wholly misconceives the functions and operation of the Federal Power Commission under the Natural Gas Act. For example, it is not until after the general discussion, findings, and conclusions of the draft report (at page 11 of the 17 pages of text) that the report acknowledges that the Coastal States Gas Producing Company and all but one of its several subsidiaries 2/ are engaged only in intrastate transactions and thereby are exempt from FPC jurisdiction. Yet this is basic to the entire review.

1/ In the draft report the terms "jurisdictional" and "non-jurisdictional" relate to whether the companies are subject to FPC jurisdiction as pipelines. This particular review does not concern producers as natural gas companies (defined in section 2(b) of the Natural Gas Act, 15 U.S.C. 717a(6)).

2/ The single jurisdictional pipeline subsidiary of Coastal States was South Texas Natural Gas Gathering Company. Coastal States recently acquired another jurisdictional pipeline, Colorado Interstates Gas Co.

The Federal Power Commission is an independent regulatory agency established by statute with delegated and therefore limited powers and responsibilities with respect to natural gas in interstate commerce. The report should state clearly at the outset that Coastal States is not subject to FPC jurisdiction because it does not sell gas in interstate commerce, that therefore it does not file gas reserves reports with the FPC, and that the FPC had no basis upon which it could have answered the question raised by Congressman Gonzalez in initiating this review, that is, whether Coastal States overstated its gas reserves in its filing with the SEC.

The basic issue which this GAO review attempts to examine is whether the FPC and the SEC have a duty to reconcile "seemingly conflicting claims" in the form of varying gas reserves estimates filed with these two agencies by gas companies. Forgetting for the moment the matter of FPC jurisdiction over these companies, the draft report's consideration of this question discloses a total lack of understanding of the nature of gas reserves estimates.

Attached hereto as enclosure 1 is a very brief description of the methodology of natural gas reserves estimation sufficient to suggest the great number and variety of interpretations and judgments involved. Different gas reserves estimates for different purposes, at different times in a reservoir's history, based upon different technical data, and applying different economic and other assumptions can, for valid reasons, produce widely varying results. Where estimates filed with the two agencies by the same company purport to represent approximately the same gas, the FPC should assist the SEC by advising it of discrepancies, to the extent the FPC can, consistent with its own priorities and responsibilities. However, the idea of the draft report that the FPC should undertake to reconcile all gas companies prospectuses filed with the SEC with FPC gas reserves data simply is not sensible. As in the case of Coastal States' reserves, the FPC may not have the basis for reconciling the figures filed with the SEC.

A third basic misunderstanding reflected in the draft report concerns the nature and scope of the reserves information which is in the possession of the FPC. At page 4 the draft report indicates that "the FPC is vested with broad information gathering powers" without noting any limitations on those powers. The report infers at least that any information needed by the FPC to verify SEC filings is either in its files or could easily be obtained through the use of those powers. The report fails to distinguish between this

agency's information gathering powers under the Natural Gas Act and the much broader powers afforded by the Federal Power Act, which of course cannot be brought to bear upon the type of problem which is the subject of this review. Further, the draft report evidences no appreciation of the problem of the proprietary nature of gas reserves information. Large sums of money are expended by natural gas companies in exploration, the acquisition of leases, and the development of fields. The proprietary character of reserves information therefore commands constitutional protection and presents important problems with respect to the disclosure of information collected by governmental agencies. Congress has at least twice recognized the problem, in the Natural Gas Act, at 15 U.S.C. 717g(b), and in the Freedom of Information Act at 5 U.S.C. 552 (b) (9). The report finds that "it makes little sense" for the SEC to request FPC assistance without turning over to it all of the confidential information it has received. Both agencies are criticized for not having policies which would make all of the information in the hands of each available to the other. Further, the report finds the FPC's management controls inadequate because they do not disclose to the SEC all pertinent information in the FPC's possession. All of these observations should be revised at least to acknowledge the problem, if not to suggest a solution. To provide a better understanding of the nature of this agency's gas reserves information, there is attached hereto as enclosure 2 a summary of FPC reserves data collection operations.

Finally, the draft report is completely misleading as to the actions of the Federal Power Commission in meeting its responsibilities in the particular matter reviewed in this draft report, which matter the draft report presents as "a case study of the need for increased interagency cooperation" when, in fact, the FPC did all it could to assist the SEC in this case.

In April 1971, the South Texas Natural Gas Gathering Company, which was then the single pipeline subsidiary of Coastal States subject to FPC jurisdiction, filed with the Federal Power Commission an application for authority to remove certain facilities for transporting natural gas to the Transcontinental Gas Pipe Line Corporation. The alleged grounds for the abandonment were that South Texas was unable to supply the gas required. It thereby became the responsibility of the FPC to determine the recoverable reserves of South Texas available for its contract with Transco.

Since 1967, the staff of the FPC Bureau of Natural Gas has reviewed South Texas' reserves on three different occasions. The first review, in 1968, was of reserves figures calculated using the volumetric method. In that estimate, a calculated recovery factor of approximately 92% was applied to the major fields. From the information available at the time, the 92% recovery factor appeared to the FPC staff to be justified. In this reserves estimate, it was assumed that all reservoirs and undrilled acreage would be developed based on calculations of well productivity. Considerable additional drilling was contemplated. In this estimate the reserves were calculated to be 1,614,000 MMcf.

After approximately three years of production, it was evident that well performance was not up to expectations. This prompted South Texas to reduce the recovery factor to approximately 70%, thus dropping their total recoverable reserves in 1970 from 1,537,000 MMcf to 1,060,000 MMcf. Subsequently, in another 1970 estimate, again due to poor well performance, the recovery factor was further reduced, causing the total recoverable reserves of South Texas to drop to 857,000 MMcf.

In August 1971, BNG staff reviewed all South Texas' reserves records at their offices in Corpus Christi, Texas, and concluded that this latest estimation of gas reserves was reasonable. At this point BNG staff discussed with South Texas the possibility of converting from volumetric reserve estimates to the pressure decline method. South Texas did not feel that they could utilize this method because at that point they still planned further development of their major fields, and the pressure decline method could not be applied to new drilling and recompletions.

In June 1971, South Texas filed its annual Total Gas Supply Report (FPC Form 15) showing that on December 31, 1970, it had reserves of 988 billion cubic feet. During the summer of 1971, the Federal Power Commission technical staff verified the 988 billion cubic feet figure as being substantially correct.

In September 1971 the Coastal States Gas Producing Company, of which South Texas is a subsidiary, filed with the SEC a registration statement supported by a confidential independent consultant's report (the Huddleston Report) showing reserves of that company, including all of its subsidiaries, to be 10,090 billion cubic feet. Although the SEC staff reports that it requested of the FPC staff its

view as to the reasonableness of that reserves estimate, it states that it did not send to the FPC a copy of the supporting independent consultant's report since that report was received in confidence by the SEC. As is noted in the draft report, the FPC has no record of the request and cannot otherwise verify that it ever received the request. In any event, FPC had no basis for evaluating the estimate, since the FPC had data on only the one jurisdictional subsidiary, South Texas.

In February 1972, South Texas and its customer, Transco, had performed a joint study of South Texas' gas reserves dedicated to Transco. That study reported that in February 1972 the recoverable reserves of South Texas totalled 490 billion cubic feet, and its reserves dedicated to Transco were 415 billion cubic feet. The FPC technical staff reconciled the 490 billion cubic feet figure as of February 1972 with the December 31, 1970, verified figure of 988 billion cubic feet. It found that the decline resulted principally from converting from one gas reserves estimating technique to another for a portion of the reserves and from eliminating certain independent producer reserves included in the 1970 Annual Report of Total Gas Supply but excluded from the February 1972 joint study.

The FPC hearing on South Texas' application began in March 1972 and continued into the summer months. In preparing for the hearing, the FPC staff counsel learned of two independent consultant's reports which included estimates of South Texas' gas reserves, the Huddleston Report and the Gruy Report, and subpoenaed both in the South Texas case. His analysis of the Huddleston Report indicated that Coastal States, for purposes of its registration statement filed with the SEC, was claiming that its subsidiary, South Texas, had total reserves of 1,653 billion cubic feet as of September 1971. The Gruy Report, commissioned by the same company and prepared at about the same time, attributed to South Texas total reserves of approximately 771 billion cubic feet. These figures, along with the December 31, 1970, Form 15 figure of 988 billion cubic feet, were entered in the record of the South Texas hearing, and the Huddleston and Gruy Reports were made an offer of proof in that proceeding. The joint study figure of 490 billion cubic feet was extensively examined on the record of the FPC hearing in the light of these varying estimates.

In September 1972 FPC staff counsel, in a further effort to reconcile the difference between the FPC data

and the South Texas reserves reported in the Coastal States filing with the SEC, requested of the SEC permission to participate in a meeting between the SEC Office of Oil and Gas and technical officials of Coastal States and their independent consultant. The request was denied.

On January 10, 1973, the FPC approved a settlement agreement in the South Texas case. Its own figures, the verified 1970 figures, and the reconcilable 1972 joint study figure, provided a sound basis for that action. In addition, FPC staff counsel fully advised the SEC staff of the discrepancies between its South Texas figures and SEC's Coastal States figures, and did all it could, in the FPC proceeding and through the SEC staff, to reconcile the differences. Following the technical meeting between the SEC Office of Oil and Gas and Coastal States' representatives, the SEC staff advised the FPC staff that the SEC had accepted as reasonable the total Coastal States figure of 10,090 billion cubic feet. Although the draft report acknowledges all of these actions of FPC staff in meeting its responsibilities and its effort to coordinate its information with the information presented to the SEC by Coastal States, the report criticizes the FPC for not reconciling the figures filed with the SEC by Coastal States with the figures filed with the FPC by South Texas.

Nowhere does the report make it clear that in all of these cases the SEC is seeking assistance from the FPC staff, not the other way around.

The SEC of course at all times has access to the public record in FPC cases. In the South Texas case, the record includes a complete development of that company's reserves estimates. The FPC regularly consults the SEC public files to examine the information filed with that agency by companies subject to FPC jurisdiction. However, at no time has the Federal Power Commission sought the assistance of the SEC in meeting the FPC's responsibilities. The Federal Power Commission conceives its responsibility, where reserves figures are in issue in an FPC proceeding, as a duty to provide the necessary verification through the hearing process or review or audit by the FPC, not some other agency. Reviews and audits, both in-house and in the field, are frequently a part of FPC proceedings and are in addition to the continuing comprehensive studies of the reserves of the large companies such as those conducted in 1973 of the reserves of the United Gas Pipe Line Company and the Transcontinental Gas Pipe Line Company mentioned in enclosure 2.

On the first page, the report indicates that a principal purpose of this GAO review is to determine "whether the FPC verifies that sufficient gas is available when interstate gas sales are approved." The reports' conclusion on this question is misleading. Especially in the light of the developing gas shortage, the Federal Power Commission for several years has found adequacy of supply to be a key issue in many of these cases. In every case approval of additional sales is granted only upon proof that the applicant can deliver the gas. The finding in the report that the FPC "would take steps to determine whether the company had adequate reserves" only where there is reason to question the reserves claimed is not correct. Wherever verification is necessary to provide the requisite proof, it is accomplished, and the report should be revised at page 5 to so find.

The Securities and Exchange Commission staff initiated the informal procedure which is the subject of the report some years ago. SEC staff submits registration statements from electric and gas companies to the FPC Office of Accounting and Finance without any specific request. That office compares the information therein with FPC corporate and financial data and refers gas reserve estimates, where they are involved, to the FPC Bureau of Natural Gas. Any comments from the FPC staff which may be generated by this process are given to the SEC informally.

In June 1973, a particular SEC reserves estimate was referred to the Bureau of Natural Gas for review with a request that comment be furnished within a very short time because the SEC staff had scheduled an early meeting with the company's representatives. At that time, BNG declined to comment because it was not given adequate time in which to make a useful review, and apparently, because of other priorities, was unable to resume its participation in this informal procedure until four months later. During that interval the SEC staff submitted for review two registration statements which involved gas reserves estimates of jurisdictional companies, the Michigan Wisconsin Pipeline Company and the Iowa-Illinois Gas & Electric Company. No effort was made to reconcile the figures in these two instances. At no time has the SEC complained of inadequate assistance from the Federal Power Commission.

The draft report is critical of the informality of the procedure initiated by the SEC staff and recommends formalization. I firmly endorse this recommendation and,

APPENDIX II

if there is to be coordination of FPC and SEC gas reserves data, I feel that appropriate authority therefor should be included in the statutory authority of both agencies, and that both agencies should be provided with the additional resources needed to do the job effectively. This, in my view, should be the central conclusion of the report, not criticism of the FPC for failing to verify information filed by Coastal States with the SEC, which the FPC had neither the means nor the obligation to verify.

Very truly yours,


Leo E. Forquer
General Counsel

Enclosure 1 - Brief description of gas reserves estimation.

Enclosure 2 - Summary of FPC gas reserves data collection process.

Enclosure 1 - Natural Gas Reserves
Estimation Techniques

Stated simply, two basic methods, the volumetric method and the pressure decline method, are in general use for estimating reserves. The volumetric method first requires that the bulk volume of a reservoir, the acreage multiplied by the average thickness, be computed in acre-feet. This in turn is multiplied by the cubic feet of gas per acre-foot to obtain the volume of gas in place. In using this method, reservoir volumes are obtained by planimetry structural and isopachous maps based on data from electrical logs, cores, and drill-stem and production tests. The net productive thickness, porosity, and interstitial water values are estimated from core-analysis data and from the interpretation of electrical, acoustical, density and other types of logs. These factors, when applied to the bulk volume of the reservoir, determine the net volume of pore space that contains gas. The determination of reservoir pressure and temperature by recording instruments and laboratory analysis of the gas to determine its compressibility are the remaining factors needed to estimate the volume of gas in place.

However, it must be understood from the outset that estimates such as those involved in this GAO review are not estimates of the volumes of gas in the ground. Rather these were estimates of recoverable reserves and estimates of recoverable reserves deliverable to a particular customer.

Since not all of the gas in place in the reservoir can be recovered, a recovery factor based on the judgment of the estimator is applied, based on a pre-determined abandonment pressure, which depends on a variety of economic and technical judgmental factors, including the price expected to be received for the gas, the expected productivity of the wells planned, size of the field, geological and other characteristics, and its location in relation to market and type of market.

All of the factors involved in estimating recoverable or deliverable natural gas, except pressure and temperature, require the application of judgment on the part of the individual estimator. Obviously, interpretations and judgments by different estimators may vary significantly depending upon the individual's skill and experience and his familiarity with the area under consideration. The two basic factors, acre-feet (reservoir volume) and the recovery

factor, are particularly influenced by these interpretations and judgments, and variations among different estimators will have a substantial effect on the resulting figures. The volumetric method is used early in the life of all reservoirs, and in some cases is the only method of estimation used.

The other method, the pressure decline method usually comes into use later in the productive life of the reservoir, after there is sufficient production history to provide a measurable decline trend in the reservoir pressure. The method is based upon the simple gas laws governing escape and expansion of gas from a reservoir of constant volume. As the gas is removed, reservoir pressure decreases, and there is a definite ratio between the drop in pressure and the volume of gas removed. When a trend has been established, it can be projected, using other information gained from the drilling and production history, to estimate the reserves in place and the volume of reserves recoverable to any expected abandonment pressure. An essential requirement for the application of this method is reliable evidence that formation water encroachment or water drive is slow enough so that reservoir pressure is not artificially maintained.

Whatever the method, a great many and a wide variety of professional judgments are involved, and different gas reserves estimates at different times in a reservoir's history, for different purposes, utilizing different assumptions, with different inclusions and exclusions, may come to widely varying conclusions, for valid and legitimate reasons. Reconciliation therefore is a complex and difficult process, at best, which requires a thorough understanding of all of the interpretations and judgments applied. Frequently, without all of the underlying information, reconciliation may be impossible, even though both estimates are responsible and valid.

Enclosure 2 - FPC Data Collection Operations
Relating to Natural Gas Reserves

The Federal Power Commission engages in extensive data collection operations which are only casually mentioned at the bottom of page 4 and the top of page 5 of the draft report, even though the subject-matter of the report is reserves estimates. Any consideration of the reliability of gas reserves estimates should at least describe adequately the information collected by the Federal Power Commission.

The FPC requires all producers selling gas in interstate commerce, except small producers with exemption certificates, to file copies of each contract with an interstate buyer. Such contracts contain complete data on price, daily delivery volumes, description of dedicated acreage committed to buyer, and other provisions covering such matters as gas pressure, quality, delivery points, metering, gas processing for removal of liquids, periodic price escalations, possible interruptions in service and penalties for not meeting certain contract terms. The contracts are designated as FPC gas rate schedules and their submission is a requirement for obtaining an FPC producer sales certificate. Amendments must also be filed. These contracts contain the basic information on which producer sales of natural gas are regulated by the FPC.

The only other information which the FPC requires from its jurisdictional producers on a continuing basis are annual reports which summarize total interstate sales volumes and revenues (FPC Forms 301-A, 301-B and 314-B).

In the FPC's area rate proceedings, cost and investment data were obtained directly from participating producers by questionnaire, and this information was then subject to cross examination by the FPC staff and others under formal FPC hearing procedures. Other published data on producer costs also were made part of the evidentiary record in these proceedings. The latest questionnaire relating to cost, production, and investment data is the subject of Docket No. R-478, a current proceeding pending before the Commission.

Since 1963 Form No. 15 has been filed annually by interstate pipeline companies which own or control 50 billion cubic feet or more of natural gas reserves. Reserve estimates and deliverability projections are reported for each source of supply, e.g. reservoir, gas field or gas plant. Maps showing the location and delineating the boundaries

of each reported gas reservoir are also filed.

On March 6, 1973, the Commission issued Order No. 476 which improved the reporting procedures by ADP methods and required the reporting of detailed basic reservoir reserve and production data such as porosity, connate water, reservoir pressure, and gas well deliverability test results not previously reported. With these improvements the Commission staff is better able to monitor the interstate gas supply situation on a continuous basis.

In conjunction with the Form 15 program the staff continually, critically evaluates the techniques of reserves and deliverability analyses used by the interstate pipeline companies, particularly during in-depth studies of pipeline company supply status. The key feature of these in-depth studies is the staff audit of supporting information underlying company reserve estimates and deliverability projections. The studies are conducted both as a on-going program and in response to specific regulatory needs in certificate proceedings before the Commission.

Prior to 1973, the staff completed in-depth studies at the FPC of reserves and deliverability of Natural Gas Pipeline Company of America, Michigan Wisconsin Pipe Line Company, and Northern Natural Gas Company. In 1973 these procedures were improved by requiring field investigations of the companies as a supplement to in-house evaluation of data supplied by the companies.

Two in-depth studies of reserves and deliverability were completed in 1973 for United Gas Pipe Line Company and Transcontinental Gas Pipe Line Company and in-house reports analyzing the methods, data and procedures have been prepared with recommendations by staff for improvement in reporting and data. Follow-up investigations are planned.

Six to eight in-depth studies are planned for 1974. The staff is in the process of setting up field trips to go to the offices of El Paso Natural Gas Company, Trunkline Gas Company, and Panhandle Eastern Pipe Line Company. In the near future trips will be made to Texas Eastern Transmission Corporation and Arkansas Louisiana Gas Company.

In addition to these Form 15 in-depth studies, investigations are made of gas supply and deliverability of companies applying for certificates of public convenience and necessity under Section 7(c) of the Natural Gas Act and also in other proceedings. Generally, these studies are made on data filed with the Commission but if any problems with the data filing on supply and deliverability are detected, an investigative field trip is made to acquire the needed data. For instance,

in United Gas Pipe Line Company, Docket No. CP73-117, et al., (pending before an Administrative Law Judge) a staff team made a complete gas reserve and deliverability audit of Sea Robin Pipeline Company, United Gas Pipe Line Company's pipeline supplier, to determine the gas supply that United Gas Pipe Line Company could reasonably expect to receive.

On February 2, 1973, the Commission issued Order No. 471 prescribing the addition of a new form entitled, "Annual Report for Importers and Exporters of Natural Gas" (FPC Form No. 14). Form No. 14 provides data on imports and exports of natural gas, including LNG. In addition to providing monthly, peak day, and annual data on the volume and dollars paid or received for imports and exports, the form conveniently shows the importer or exporter, point of entry or exit, foreign buyer or seller, transporter, mode of transportation, weighted average annual price, and weighted average annual Btu content. The form is filed annually by March 31.

By Order No. 489 issued August 24, 1973, the Commission issued FPC Form No. 16, a Gas Supply and Requirements Form required to be filed by all natural gas pipeline companies that make sales of natural gas for resale in interstate commerce. It is required to be filed twice yearly (April 30 and September 30) and shows the company's actual monthly gas supplies, firm and interruptible requirements and curtailments for the year prior to the reporting date and comparable projections for the year following the reporting date. It also shows the same data for peak day of the year prior to the reporting date and projected for the year following the reporting date. This information is particularly useful in revealing the companies' actual and anticipated curtailment situation and gives a direct comparison, month by month, between the most recent actual data and projected data for the year immediately following the reported year.

FPC Form No. 17 is a Report of Natural Gas Pipeline Curtailments filed monthly by those pipeline companies that have curtailed firm deliveries to their customers during the month previous. It lists the names of the customers that were curtailed during the reported month, the volumes curtailed, the duration of curtailment, the rate schedule under which the curtailment was made, whether the customer is a jurisdictional or non-jurisdictional customer, (indicating firm or interruptible for the non-jurisdictional customers) and the base from which the volume curtailed was determined (contract demand, entitlement, maximum day, etc.). This form provides the Commission with timely curtailment information and keeps it abreast of the shortage situation.

All of these forms are available to the public. FPC staff reports analyzing and summarizing the information reported in the forms also are made publicly available.

As one important facet of the FPC National Gas Survey the staff conducted an independent study and analysis of the nation's proven natural gas reserves as of December 31, 1970. The National Gas Reserves Study (NGRS) was an unprecedented undertaking and represented the first independent appraisal and evaluation of nationwide natural gas reserves ever conducted by a government agency. The results of the study were published in May 1973 in the report entitled, National Gas Reserves Study, A Staff Report, which was subsequently revised in September 1973 to reflect minor changes. The major steps which were taken in the conduct of the NGRS were the following:

1. Developed a list of all productive gas fields in the United States as of December 31, 1970.
2. Obtained the list of gas fields utilized by the American Gas Association in their reserve estimates and the reserves attributed to these fields.
3. Compared the independently developed list of gas fields with the A.G.A. list to identify omissions from the A.G.A. list.
4. Drew up a statistically valid sample of fields which would have in-depth, independent, reservoir-by-reservoir analyses made of their gas reserves.
5. Dispatched reserve evaluation teams composed of professionally qualified Federal employees to make the independent estimates of reserves for the fields selected.
6. Estimated the total national proven reserves of non-associated gas on the basis of the sample utilized and the reserve estimates developed.

The services of the Oil Information Center (OIC) of the University of Oklahoma Research Institute were retained by the Commission to develop a comprehensive list of U.S. gas fields as of year-end 1970. OIC generated this list by relying on data from their Petroleum Data System, from state geological surveys or the state body responsible for oil and gas conservation, and from the International Oil Scouts Annual

Review. In total, the OIC identified 6,503 non-associated and associated gas fields.

To provide security for individual A.G.A. field reserve estimates, Arthur Young and Company was selected by the FPC to act as independent accounting agent classified the fields by reserve size, performed random selection of fields for reserve estimation, consolidated the findings of the reserve teams and reported total estimates of U.S. reserves to the National Gas Survey.

When OIC compared its independently developed list of fields with the field list utilized by A.G.A. and provided to OIC by Arthur Young, it appeared that 145 fields had not been included on the A.G.A. list. Subsequent investigation by the FPC staff revealed, however, that 83 of these were either not traceable in official state records, had been depleted, or plugged and abandoned prior to December 31, 1970, and thus could not be characterized as "A.G.A. omitted fields". The remaining 62 fields were considered to have been omitted and were thus automatically scheduled for audit by a reserve evaluation team.

The A.G.A. list of 6,358 gas fields was stratified into seven classes on the basis of field size by the independent accounting agent at the instruction of the Statistical Validation Team. The Validation Team was composed of experts from government and academia chosen because of their experience in the application of statistical principles to a variety of practical problems, especially in various disciplines of the mineral sciences. After stratification by reserve size, a sampling procedure which is widely used in situations similar to the NGRS was implemented. The sample was composed of all 108 fields on the population list with reserves reported to be greater than 400 billion cubic feet and 50 fields selected from the remainder of the population whose reserves were reported as equal to or less than 400 billion cubic feet. It is interesting to note that while the 108 largest fields comprised only 1.7 percent of the total they constituted 47 percent of the total national reserves as estimated by the staff.

The reserve evaluation teams which analyzed each field in the sample were composed of geologists, engineers and other professional personnel of the FPC and cooperating government agencies. Other agencies who contributed to the reserve estimation aspects of the program included the U.S. Geological Survey, which prepared estimates for sample fields located on the outer continental shelf, the Office of Naval Petroleum and Oil Shale Reserves of the U.S. Navy, the Office of Management and Budget and the Bureau of the Census.

The reserve teams went to company offices where they analyzed all relevant basic raw data. Total estimates for multi-reservoir fields were compiled from estimates developed on a reservoir-by-reservoir basis. The raw data consisted of various types of electrical, radio-active and acoustical wire-line logs; core analyses; fluid analyses; open hole, production, back pressure, draw down and build-up, and other types of well tests; temperature measurements; gas analyses; structural and isopachous maps; and pressure and production histories. These are the common basic tools from which reserve estimates are derived. The NGRS teams also appraised the adequacy, accuracy and validity of these raw data, then utilized the information to arrive at their own figures for reserves.

The scope of the NGRS was limited to an estimation of the magnitude of the proved reserves and did not include an analysis of deliverability. Similarly, no evaluation of the total gas resource base nor forecasts of gas to be discovered in the future were made. Gas volumes which cannot be produced economically now but which might only become available through the application of new technology were not included. The definition of proved reserves utilized by the NGRS was identical to that of the American Gas Association.

The field reserves teams based their estimates on production and pressure figures when sufficient historical data were available. In some cases in which an FPC team based its estimate on the production data up to December 31, 1970, the AGA estimate seemingly was either still based on volumetric calculations or production curves which had not been updated. This is the probable cause for many of the differences observed particularly in the Texas Gulf Coast fields and is a strong justification for the continuous monitoring of reserves.

As a result of this study, the proven natural gas reserves in the United States were estimated by the Staff of the Federal Power Commission to be 258.6 trillion cubic feet as of December 31, 1970.

Planning for an update of the NGRS is currently underway with a target reserve inventory date of December 31, 1973, the latest calendar year. The updated NGRS will be improved in that a larger sample of the universe of fields will be utilized and estimates of reserves on an area or state bases will be made if feasible.

Two years ago, following a contracted feasibility study, the Federal Power Commission undertook the development of an ambitious "Regulatory Information System" which now has progressed to the point where we are about to enter into a large

contract which includes initial operation of the system. The system will use the most advanced computer technology to improve greatly our collection and use of current natural gas reserves information and a broad spectrum of other energy data. The public use forms portion of this program began with the automation of four forms, and full operation insofar as the information on these forms is concerned is now scheduled for mid-1975.

GENERAL COUNSEL
FEDERAL POWER COMMISSION

March 1, 1974

Mr. Robert A. Peterson
Assistant Director
General Government Division
United States General Accounting Office
Washington, D. C. 20548

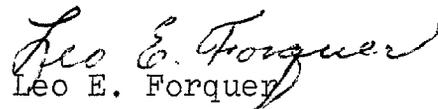
Dear Mr. Peterson:

We have been contacted by Mr. James H. Burrow, Supervisory Auditor from your office about some of the language in our letter to you of February 1, 1974.

Please refer to the fourth sentence of the first paragraph on page seven of our letter. This sentence should be changed to read "In every case approval of substantial additional pipeline sales is granted only upon proof that the applicant can deliver the gas. Certain minor sales may be approved under a blanket budget application without review and a pipeline purchase from a producer which does not involve construction costs or new markets may also not be reviewed at the time of certification. These sales or purchases may, however, be reviewed during pipeline company in-depth studies or during reviews of FPC Form 15, Annual Report of Gas Supply." The fifth sentence would continue after the above.

We hope that the additional explanatory material will resolve the questions that have arisen.

Very truly yours,


Leo E. Forquay
General Counsel